PUBLIC OVERSIGHT HEARING

ON THE

DISTRICT OF COLUMBIA'S CAPITAL IMPROVEMENTS PROGRAM

Before the

Committee of the Whole
Council of the District of Columbia

The Honorable Linda W. Cropp, Chairman

January 26, 2006, 10:00 a.m.
Council Chamber

Testimony of
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Good morning, Chairman Cropp and members of the Committee of the Whole. My name is Bert Molina, and I am the Deputy Chief Financial Officer for the Office of Budget and Planning (OBP). I am pleased to appear before you today to present testimony on the status of the District of Columbia's Capital Improvements Program (CIP). In my testimony, I will provide an update on the Capital Improvements Program, discuss the deficit in the General Capital Improvements Fund and our progress in managing it, briefly note the cash flow issues that the deficit has caused, and outline our vision for the future.

Current Status of the Capital Improvements Program

Capital expenditures in FY 2005 were lower than in FY 2004. District agencies spent about $380 million during FY 2005 on projects funded by General Obligation (G.O.) bonds. This figure might change slightly, as the FY 2005 Comprehensive Annual Financial Report (CAFR) has not yet been released. This is about $50 million less than the approximately $430 million of FY 2004 expenditures on similar projects. The reduced expenditure rate is partly a reflection of our efforts to reduce the deficit in the District's capital fund, which I will describe in greater detail below.

The District continues to benefit from improvements to its bond rating. In conjunction with our most recent bond offering, Standard & Poor's upgraded the District's general obligation bonds to A+ from A, while Moody's Investors Service revised the rating outlook on their A2 rating to positive from stable.

Borrowing constraints continue to affect the District's capital program, despite the recent success the District has experienced with our improved bond rating. We still have high debt ratios relative to other jurisdictions of comparable size. Our debt per capita, at approximately $7,197, is one of highest in the country and is more than twice the average of other major cities. In addition, the District will borrow large amounts for construction on some or all of the following projects in the coming months:

- A new baseball stadium,
- A new mental health hospital and the National Capital Medical Center,
- A convention center hotel,
- Two new government Gateway office buildings, and
- Refurbished or new bridges over the Anacostia River.

While some of these projects might be financed with specialized borrowing, such as Certificates of Participation or securitizations of specific revenue streams, they would all add to the District's overall debt level.

Based on these facts, the bond rating agencies consider the District's debt burden to be high, and they factor this into their rating decisions on the District's bonds. To help address these issues, the Chief Financial Officer has recommended a borrowing limit of approximately $300 million per year for G.O. bonds related to new capital expenditures going forward.

The District has just gone to market to borrow $345 million via G.O. bonds in FY 2006, and in the FY 2006 capital budget formulation process, the Mayor and Council agreed to add $199 million of pay-as-you-go (PAYGO) financing transfers from the General Fund to support capital projects. This combination of G.O.

bonds and PAYGO will allow for $544 million of capital expenditures in FY 2006, about a 30 percent increase over FY 2005 expenditures. However, because of past deficits and budget decisions, great care is needed to manage capital spending in FY 2006 and going forward.

Managing the Deficit in the General Capital Improvements Fund

As I have testified on several occasions, the District's General Capital Improvements Fund (the "capital fund") has been in deficit for several years. The FY 2004 deficit stood at $250 million, and the portion of this deficit attributable to G.O. bonds alone was approximately $346 million. That is, District spending on G.O. bond-backed capital projects, cumulatively through FY 2004, had exceeded bond proceeds deposited into the fund by a net $346 million. This deficit is a cause for concern in its own right, and we are taking several steps to manage and reduce it. The deficit has also created cash flow problems for the General Fund, which I will discuss below.

As we focused on managing the deficit during FY 2005, the first step was to ensure it did not increase as a result of FY 2005 operations. That is, the District should not spend more on capital projects than the revenues the capital fund receives. Preliminary results indicate that the deficit did not worsen in FY 2005 and, in fact, will be slightly less than in FY 2004. These figures might change before the CAFR is released, but the data at this point indicate that the deficit in G.O. bond-financed projects will decrease by $16 million, and the overall fund deficit will decrease by $4 million, as a result of FY 2005 activity. Table 1 shows these results at a high level, and Attachment A provides additional detail on components of the fund.

Table 1: Capital Fund Surplus/(Deficit)
FY 2004 and FY 2005, Preliminary and Unaudited Data

(Dollars in millions; details may not total due to rounding)

	Components of Fund		Total for Fund
	G.O. Bonds	Other Fund Components	
(1) FY 2004 Year-End Position	(346.0)	95.8	(250.2)
FY 2005:			
(2) Bond Proceeds	395.9		395.9
(3) Other Sources		186.0	186.0
(4) Expenditures	(379.5)	(198.5)	(578.1)
(5) Surplus/(Deficit) equals (2) + (3) + (4)	16.4	(12.6)	3.8
(6) FY 2005 Year-End Position, equals (1) + (5)	(329.6)	83.2	(246.4)

Note: "Other Fund Components" include federal funds, master equipment lease proceeds, Certificates of Participation, Rights-of-Way fees, and several other sources of financing. See Attachment A for details.

The second step in managing the deficit is to put processes in place to ensure that each year going forward, the District again does not overspend its resources. A major cause of the deficit was the practice of awarding more budget allotments in the capital budget process than the District was able to finance. Cumulatively over four years – FY 2000 through FY 2003 – there was a $1 billion gap between (a) the capital budget allotments District agencies received to spend and (b) the G.O. borrowing the District performed to finance capital spending. These excess allotments are an ongoing concern, because in FY 2006, the capital budget allotments available for agencies to spend exceed new FY 2006 financing by more than $700 million. We have been working closely with the City Administrator to develop spending plans for FY 2006 that will ensure that District agencies, as a whole, do not spend more than the $544 million of FY 2006 financing.

After ensuring that the deficit does not increase on a year-by-year basis, the third step is to formulate a deficit reduction plan that applies available resources directly toward deficit reduction. For example, the Mayor and the Council agreed during FY 2006 budget formulation to use $53.8 million of FY 2004 fund balance, from the General Fund, for PAYGO capital to reduce the deficit in the capital fund. One component of the deficit reduction plan is additional transfers from the fund balance to the capital fund, when available. The second component of the plan is borrowing in excess of planned capital spending each year, and applying the excess amounts toward capital deficit reduction.

The deficit reduction plan will require careful implementation. The appropriate level of fund balance to devote to this purpose should consider the amount of fund balance available, other one-time expenditures that could reasonably be financed with fund balance, and the annual debt service costs that would be saved by using the fund balance instead of borrowing. With respect to the appropriate level of borrowing in a deficit reduction plan, as the Chief Financial Officer explained in his November 22, 2005, letter to the Council, the District must manage its debt carefully in light of current debt levels and several major projects that will be financed soon. The CFO will recommend a plan to the District's elected leaders that incorporates both fund balance use and additional borrowing, with final plan parameters to be determined through the budget process.

Cash Flow Issues Created by the Capital Fund Deficit

The deficit in the capital fund has caused cash flow problems for the District's General Fund. When the District makes a capital expenditure, the funds are first paid out of the General Fund (pooled cash). We then look to bond funds held in escrow, for each individual capital project, to reimburse the General Fund. When capital expenditures take place on projects that have no available funds in escrow, the General Fund cannot be reimbursed. In accounting terms, the capital fund "owes" the general fund for the expenditure, and this is the essence of the capital fund's deficit.

At some point, if the General Fund keeps advancing these expenditures for capital but is never reimbursed, the General Fund itself will start to run low on cash. This could threaten its ability to pay the District's other bills. One consequence might be an increased need to do short-term borrowing at the start of each fiscal year. While we are not at a crisis point yet, this potential makes it even more important to manage the deficit in the capital fund.

One way to limit cash flow difficulties is to reallocate bond proceeds to capital projects that are making expenditures. Some bond proceeds are held in escrow for projects that have not yet spent, or might not spend going forward, even as other projects are spending with no bond proceeds attached to them. If we reallocated from those not spending to those that are spending, we can more rapidly reimburse the General Fund. We plan to propose a bond reallocation for this purpose, but only after a careful analysis to ensure that the projects that we reallocate funds away from will not need those funds, because they are complete or will be completed soon.

Plans for the Future

As you know, Chairman Cropp, one of our greatest challenges in the capital program is bringing into alignment our future demands and our projected resources at a time when the capital fund is in deficit. The demands of several of our largest capital consumers, namely the Washington Metropolitan Area Transit Authority

(WMATA) and D.C. Public Schools (DCPS), have contributed to the imbalance between projected expenditures and borrowing capacity. For example, the District is required to contribute approximately $50 million to WMATA in FY 2006, as part of the investment in the system known as "Metro Matters." In addition, the current capital plan shows the District contributing $100 million per year in G.O. bond resources for DCPS (not including any additional financing proposals being considered). Given our determination, with input from our financial advisors, that the District's capacity is only approximately $300 million per year for new G.O. bond projects, we face a major conflict between resource demand and resource availability.

The Master Facility and Program Integration planning process continues to address this issue. This process ensures a comprehensive assessment of District facilities and should result in an integration plan that will not only improve service delivery at the neighborhood level, but will also propose an allocation of scarce capital dollars according to our highest priorities. As part of this process, the Technical Review Team continues to review capital budget requests and spending plans for technical merit, feasibility, and opportunities for co-location of new facilities.

In addition, OBP has strengthened central budget office oversight and internal control functions with regard to the capital program. As we stated last year, we want to ensure that the District's capital budget formulation and execution always stand up to our rigorous budgeting and accounting principles and standards.

Our current capital needs exceed our available resources to finance and to pay debt service on the financing of such needs, as the Chief Financial Officer has often noted in his discussion of the city's structural imbalance. Managing the District's capital program to deliver necessary capital improvements in so many of the city's areas of need, while working within the borrowing constraints we face and gradually reducing the accumulated deficit, is a major challenge for the Mayor, the Council, and the CFO. As always, the Office of Budget and Planning is committed to working collaboratively with you, Madam Chairman, this committee and the Council, stakeholders, and agencies to improve the effective and efficient operations of the capital program.

Madam Chairman, thank you for the opportunity to testify today. I will be happy to respond to any questions that you may have.

Attachment A

Detail on Capital Fund Surplus/(Deficit), FY 2005 Activity, Preliminary and Unaudited

(Dollars in thousands, details may not sum totals due to rounding)

	General Obligation Bonds	PAYGO	Federal Capital	Local Streets Fund	Private Grant	Miscel-laneous Adjust-ments	Certifi-cates of Partici-pation	Master Equip-ment Lease	Qualified Zone Academy Bonds	**Total, General Capital Improvements Fund**
Beginning Balance										**(250,152)**
Revenues and Other Sources:										
Bond Proceeds	395,913									**395,913**
PAYGO Transfers		20,550								**20,550**
Federal Grants			91,339							**91,339**
Federal Payments			21,215							**21,215**
Investment Earnings						291				**291**
Equipment Financing								15,036		**15,036**
R.O.W. fees				37,737						**37,737**
Other					150	(353)				**(203)**
Subtotal, Revenues and Other Sources	*395,913*	*20,550*	*112,554*	*37,737*	*150*	*(61)*	*0*	*15,036*	*0*	**581,879**
Expenditures and Other Uses:										
Capital Outlay	379,543	1,012	97,534	50,041			28,906	20,585	467	**578,088**
Subtotal, Expenditures and Other Uses	*379,543*	*1,012*	*97,534*	*50,041*	*0*	*0*	*28,906*	*20,585*	*467*	***578,088***
Surplus/(Deficit)	**16,370**	**19,538**	**15,020**	**(12,304)**	**150**	**(61)**	**(28,906)**	**(5,549)**	**(467)**	**3,790**
Ending Balance										**(246,362)**