STANDARD & POOR'S
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Summary:

District of Columbia; Appropriations; General Obligation

Primary Credit Analyst:
Hilary A Sutton, New York (1) 212-438-7093; hilary.sutton@standardandpoors.com

Secondary Contact:
Timothy W Barrett, New York (1) 212-438-6327; timothy.barrett@standardandpoors.com

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Credit Profile		
US$390.62 mil GO bnds ser 2014A due 06/01/2039		
Long Term Rating	AA/Stable	New
US$137.77 mil GO rfdg bnds ser 2014B due 06/01/2033		
Long Term Rating	AA/Stable	New
District of Columbia GO		
Long Term Rating	AA/Stable	Upgraded
District of Colu COPs		
Unenhanced Rating	AA-(SPUR)/Stable	Upgraded

Rationale

Standard & Poor's Ratings Services raised its long-term rating and underlying rating (SPUR) on the District of Columbia's general obligation (GO) bonds to 'AA' from 'AA-' due to a record of general fund surpluses that have strengthened flexibility. We also believe, following the planned sale of the 2014D GO bonds, the district will have reduced its contingent liability risk. At the same time, Standard & Poor's raised its long-term rating and SPUR to 'AA-' from 'A+' on the district's certificates of participation (COPs) and assigned its 'AA' long-term rating to its series 2014C and D GO bonds. The outlook is stable.

The GO rating is based on the district's full faith and credit pledge. We understand 2014C bond proceeds will finance capital expenditures, while the 2014D proceeds will refund all of the district's outstanding multimodal GO refunding bonds series 2008A and D.

The GO rating reflects our assessment of the following factors for the district, specifically its:

- Very strong economy that serves as the nation's capital as well as a regional employment center anchored by the federal government, military contractors, services, and tourism;
- Strong budgetary flexibility;
- Strong budgetary performance;
- Very strong liquidity providing very strong cash levels to cover both debt service and expenditures;
- Strong management conditions, although there is a dependence on the federal government for approval of the district's budgets as well as its appropriation authorization each year;
- Weak debt and contingent liability position despite by well-funded pension and other postemployment benefit (OPEB) plans; and
- Strong institutional framework.

Very strong economy

The district's economy is very strong, with participation in the broad and diverse Washington-Arlington-Alexandria, D.C.-Md.-Va. metropolitan statistical area (MSA). The district itself serves as a regional employment center anchored by the federal government, military contractors, services, and tourism. Unemployment across the district has fallen since 2010 – averaging 8.3% in 2013 – despite contractions in the public sector. The district's projected per capita effective buying income as a percent of the U.S. is 156.7%.

The district's total taxable value declined in fiscal years 2010 and 2011 but increased 5.2% for 2012 and 3.6% for 2013 to $151.7 billion. The corresponding market value for 2013 was $236.4 billion, which is $371,035 per capita. An estimated 31%-35% of the district's real property assessment base is tax exempt due to the large government and nonprofit presence in the district.

Strong budgetary flexibility

We believe the district's budgetary flexibility is strong. The district has improved its available balance as a result of consecutive general fund operating surpluses in fiscal years 2011, 2012, and 2013, with plans for another addition to available reserves for fiscal 2014. The surpluses were achieved despite the planned use of fund balance in each of the approved budgets. The district finished fiscal 2013 with a $984.2 million available fund balance (committed, assigned, and contingency reserve combined), equal to 15.1% of expenditures.

The proposed 2015 general fund budget totals $7.7 billion--reflecting a 4.8% increase from the fiscal 2014 revised budget--and incorporates revenue reductions from proposed tax cuts. It uses $148.6 million of general fund balance compared with the 2014 approved budget which used $146.9 million. The district's multiyear plan shows no use of fund balance in the out years (fiscal years 2016-2018).

The district's ability to expend its own funds requires a federal appropriation, but it was granted a one-year reprieve for fiscal 2015 with the passage of the consolidated appropriation act. That legislation (approved Jan. 17, 2014) gives the district spending authority should Congress fail to approve the district's budget before the beginning of the fiscal year. This follows a period of more than two weeks at the start of fiscal 2014 when the district was unable to spend its own funds due to the federal budget impasse. Instead, the district drew on its contingency reserve fund to pay operating costs. We understand that the district fully replenished the amounts drawn from the contingency reserve during this period.

Congress established the contingency reserve fund through the Home Rule Act and it must be funded at 4% of operating expenditures. Management reports the reserve can be used to cover revenue shortfalls that meet certain standards as well as nonrecurring or unforeseen needs. If drawn on, the district is expected to replenish the reserve to full funding over a two-year period, though we understand there are no penalties for failing to do so. We therefore believe this reserve enhances flexibility and have included it in our available balance calculation.

Strong budgetary performance

The district's budgetary performance, in our view, has been strong, with a surplus of 3.6% for the general fund in fiscal 2013 and a 1.8% surplus for total governmental funds (after adjusting for the spending of bond proceeds). Audited fiscal 2013 general fund revenues exceeded expenditures and transfers by $242.4 million due, in part, to growth in individual income tax and real property tax revenue growth. Management's projection for 2014 is another surplus despite appropriating fund balance in the budget.

Automatic federal spending cuts related to sequestration began in fiscal 2013 and are scheduled to go through 2021. While sequestration is likely to weaken federal funding for the district in the form of grants and other payments, officials report the larger issue is reductions in federal employment and the effects on sales and income tax receipts. Additional revenue pressure is likely due to the district's creation of a tax revision commission two years ago that proposed modifications to the tax code. As a result, unless disapproved by Congress, the district will create a new lower income tax bracket and lower the business franchise tax rate effective January 2015. Taken together, the district expects the tax cuts to lower revenue by roughly $45 million. The commission proposed several additional modifications to the tax code likely to be phased in over time contingent on high levels of recurring revenue growth that would effectively create a ceiling on revenue growth. In our opinion, these additional modifications do not affect our view of future performance.

In addition, the district is continuing to provide subsidies to its financially beleaguered United Medical Center (UMC), a component unit of the district. Management has indicated that between July 2010 and the close of fiscal 2013, the district provided $24.7 million in operational support to the hospital. We understand that the district's subsidy for 2014 is likely to be lower, at $2.7 million due to expenditure cuts at the hospital as well as improved collections and patient volume. The larger issue, in our view, is the hospital's capital needs and reliance on the district to subsidize related expenditures. Management reports the hospital could require capital subsidies totaling $120 million between fiscal years 2016–2019. We understand district management is evaluating a potential transfer of the hospital to another health care provider. To the extent that UMC requires ongoing subsidies from the district or creates additional liabilities for it, this could weaken the district's budgetary performance.

Very strong liquidity

Supporting the district's finances is what we consider very strong liquidity, with total government available cash at 12.2% of total governmental fund expenditures and at 191.4% of debt service. We believe the district has exceptional access to external liquidity as it has issued bonds frequently in the past 15 years, including GO, COPs, and tax-increment and income tax-secured debt.

In June 2014, the district entered a direct purchase transaction with Banc of America Preferred Funding Corp. – its series 2014B multimodal GO refunding bonds – to take out its direct purchase agreement with Wells Fargo. The terms of the agreement with Banc of America include events of default that if triggered, result in the payment of a default rate but not an acceleration of principal. The district's other direct purchase agreement with Citibank – its multimodal GO refunding bonds series 2008A and D – is being taken out with the proceeds of the series 2014D GO bonds being rated by Standard & Poor's. Following the planned refunding, we believe the district will have reduced exposure to nonremote contingent liabilities to an extent that they do not affect our liquidity assessment.

Strong management

We view the district's management conditions as strong, with strong financial practices and policies, but believe recent political gridlock at the federal level, coupled with the district's reliance on federal appropriations, has impaired the district's ability to manage its own finances.

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Weak debt and contingent liability profile

In our opinion, the district's debt and contingent liabilities profile is weak, with governmental fund debt service at 6.4% of total governmental fund expenditures and net direct debt at 86.7% of total governmental fund revenue. The district has approximately $9.3 billion in total tax-supported debt outstanding, roughly 48% of which is income-tax revenue bonds and 31% GO bonds. The composition of the portfolio is largely fixed rate (88% of the total), though we do believe the variable-rate portfolio creates exposure to terms that could meaningfully increase debt service costs. The district's capital improvement plan identifies $839 million of additional GO or income tax debt planned in fiscal 2016 and $569 million in 2017, though this proposed additional debt does not affect our assessment.

We believe the district's pension and postemployment health benefit plans are well-funded and present limited long-term liabilities for the district. The district has two single-employer defined-benefit pension plans for police/fire and teachers and has fully funded the annual required contribution in each of the past three fiscal years. Based on its Oct. 1, 2013 actuarial study, each of the plans was more than 90% funded. In addition, the district sponsors a defined-contribution pension plan for permanent full-time employees hired after September 1987. For fiscal 2013, the district contributed $48 million toward this plan. Finally, the district offers postemployment health benefits to eligible employees. As of Sept. 30, 2012, the plan was 75.4% funded. Pension and OPEB costs in fiscal 2013 represented a modest 2.1% of total governmental fund expenditures.

Strong Institutional Framework

We consider the Institutional Framework score for the District Of Columbia strong.

Outlook

The stable outlook reflects the district's strong budgetary flexibility and strong management conditions. We expect the district to maintain strong budgetary performance and very strong liquidity during the two-year outlook period despite indications of slowing revenue growth and ongoing capital needs. Given its strong management conditions, we believe the district will continue to adjust its spending as needed to account for its evolving budgetary constraints.

Although we believe downward rating movement is currently limited, should the district's budgetary performance weaken such that our flexibility assessment is changed, we could lower the rating. On the other hand, should the district's budgetary flexibility and performance improve with clear plans to maintain such performance, we could raise the rating.

Related Criteria And Research

Related Criteria

- USPF Criteria: Local Government GO Ratings Methodology And Assumptions, Sept. 12, 2013
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Institutional Framework Overview: District Of Columbia Local Government

Ratings Detail (As Of September 29, 2014)		
District of Columbia multimodal GO rfdg bnds var rate dem oblig		
Long Term Rating	AA/Stable	Upgraded
District of Columbia multimodal GO rfdg bnds var rate dem oblig ser 2008D due 06/01/2034		
Long Term Rating	AA/Stable	Upgraded
District of Columbia COPs		
Long Term Rating	AA-/Stable	Upgraded
District of Columbia GO		
Unenhanced Rating	AA(SPUR)/Stable	Upgraded
District of Colu certs of part ser 2003		
Unenhanced Rating	AA-(SPUR)/Stable	Upgraded

Many issues are enhanced by bond insurance.

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