PUBLIC HEARING

ON

BILL 20-506, "D.C. FISCAL YEAR DESIGNATION AMENDMENT ACT OF 2013"

Before the
Committee of the Whole
Council of the District of Columbia

The Honorable Phil Mendelson, Chairman

November 7, 2013, 9:30 a.m.
John A. Wilson Building, Council Chambers

Testimony of
Dr. Yesim Yilmaz
Director of Fiscal and Legislative Analysis
Office of Revenue Analysis
Office of the Chief Financial Officer
Government of the District of Columbia

Natwar M. Gandhi
Chief Financial Officer
District of Columbia Government

Good morning, Chairman Mendelson and members of the Committee of the Whole. I am Yesim Yilmaz, Director of Fiscal and Legislative Analysis, in the Office of Revenue Analysis. I am pleased to present testimony on Bill 20-506, the "District of Columbia Fiscal Year Designation Amendment Act of 2013."

This bill shifts the District's fiscal year from one that aligns with the federal fiscal calendar to a more typical state fiscal calendar. Currently, the District's fiscal year runs from October 1st to September 30th. The bill changes the District's fiscal year to begin on July 1st and end on June 30 each year. Such a change in the fiscal year has some appeal: First, the fiscal year would align closely with the school's academic year, replacing the advance payment to D.C. Public Schools and charter schools with a regular payment (although the timing and amount of this payment would be exactly the same). Second, assuming the fiscal year change will go hand-in-hand with budget autonomy, the lag between the time budget is proposed and implemented will be shortened.

On its surface, redefining a fiscal year to cover a different 12-month period should not have a long lasting fiscal impact since the change itself does not alter revenue or expenditures. However, the shortened fiscal year during the transition could run significant operating budget deficits. In my testimony, I will briefly summarize

what these transitions issues might be, and how the city could plan for such a change.

Expenditure Flows

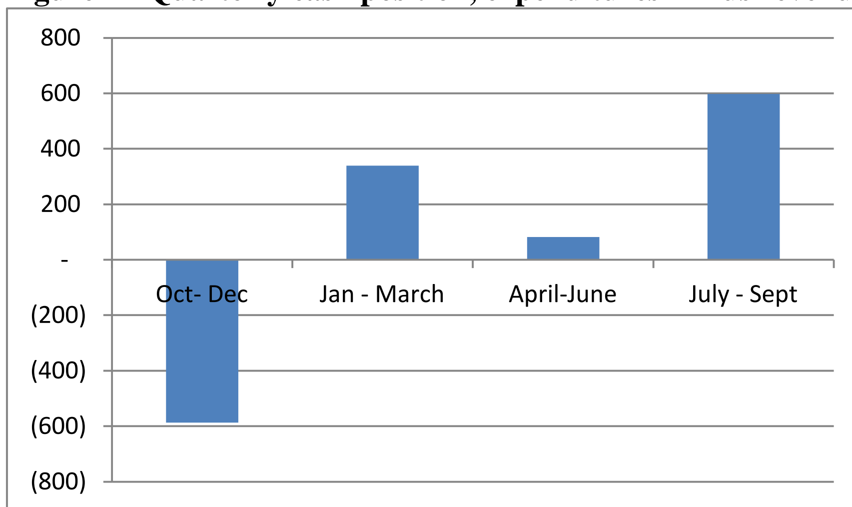
To implement the new cycle, a shortened fiscal year—lasting from October 1 to June 30—would precede the new full fiscal year. The expenses for the shortened fiscal year would roughly equal to three quarters of a full fiscal year except for three instances. First, the nine-month budget would still include the full budget for schools since all four payments to schools would happen before June 30, the end of the transition year. Second, we would have to shift our annual contribution to the OPEB Trust to June 30, since we need to make that payment by the end of the fiscal year. OPEB payment generally varies between $75 million and $100 million. Third, we would have to repay all the Tax Revenue Anticipation Notes (TRANs) borrowing (which is about $500 million) by the end of the shortened fiscal year.

Revenue Flows

While expenditures would be reduced, save for the three items noted above, revenue flows will be reduced even more in the shortened fiscal year. If the shortened fiscal year ends on June 30th, the District would not be able to use the second installment of real property taxes paid in September to cover the costs of this fiscal year. This is not a small amount—twenty percent of the revenues for the

fiscal year are booked in September. To illustrate the magnitude of this problem, we present below a measure of our quarterly cash position (the difference between expenditures out the door in that quarter and the revenues coming in). As you can see from the chart, we build a large cash shortfall in the first quarter of the fiscal year (approximately $600 million), which we manage through TRANs borrowing. We pay off the TRANs borrowing at the end of the fiscal year where we now have a large cash surplus (of similar magnitude).

Figure 1 - Quarterly cash position, expenditures minus revenues



If the fiscal year were to end in June, in the transition year, because we would not have the benefit of the September real property tax receipts, we would have to substantially reduce our TRANS borrowing, thus potentially creating serious cash flow problems at other times during the shortened fiscal year. These suggest that during the transition year, the District must find a way of financing an imbalance that could be in the range of $500 to $750 million. Given that such deficit would be

the product of a fiscal year change, perhaps steps could be taken to appropriately address this problem and provide the necessary explanation to stakeholders.

The District could use a combination of options through the transition. The city can use its cash reserves but this cannot be done in a way that would stress the reserve balances. Therefore, the city may want to delay the transition until it builds a strong cash reserve. The District can also use other bridge financing options. Two potential options to offset the impact of the cash shortage would be to consider a Commercial Paper program that allows us to borrow for short term periods such as 90 to 180 days or taking out a Bank Facility; the District could work with our banking partners and establish a liquidity line that would allow us to borrow directly from the banks. These options could be potential alternatives to our cash management issues however more due diligence would be done to determine the most cost effective method to bridge the imbalance.

Legal Issues

We are consulting with the Office of the Attorney General and OCFO legal staff to determine our recommendations as to what outstanding legal concerns should be resolved before implementing the proposed fiscal year change. At a minimum, we should note that changing the repayment date of TRANs borrowing would require an amendment to the Home Rule Act. Home Rule Act requires that all TRANs

borrowing is repaid in the year it is issued. This would also require explanations to rating agencies and investors to get them comfortable with the changes, as well as explanations to other stakeholders.

Prior to full implementation of a fiscal year change, a comprehensive review of existing bond covenants would be needed. The Office of the Chief Financial Officer (OCFO) is aware of at least one bondholder agreement in 2012 that does not allow for a change in fiscal year. This, and potentially other covenants, may need to be renegotiated prior to a fiscal year change.

Similarly, District agencies would also need to examine existing contracts, payments and processes, and make adjustments as necessary, to ensure a smooth flow of services amid the fiscal year shift. It is possible that some contracts may need to be renegotiated to accommodate the change.

Accounting Issues

The shorter fiscal year during the transition will make it difficult to prepare financial statements that are comparable to previous years. This is generally in contrast to what is required by generally accepted accounting principles. The same problem of providing comparable information will also affect the statistical data and the management discussion and analysis sections of the CAFR.

Finally, managers and staff throughout the District will likely experience a temporary increase in their workload to manage this change successfully, but this work can be absorbed within current agency budgets.

This concludes my testimony. The OCFO team present here is happy to respond to any questions you might have.