OVERSIGHT OF DISTRICT OF COLUMBIA CASH STATUS, OPERATING DEFICIT, AND PRIVATE FINANCIAL MARKET ACCESS

HEARING

BEFORE THE

SUBCOMMITTEE ON THE DISTRICT OF COLUMBIA

OF THE

COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT

HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

SECOND SESSION

JULY 19, 1996

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OVERSIGHT OF DISTRICT OF COLUMBIA CASH STATUS, OPERATING DEFICIT, AND PRIVATE FINANCIAL MARKET ACCESS

FRIDAY, JULY 19, 1996

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON THE DISTRICT OF COLUMBIA,
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:06 a.m., in room 2154, Rayburn House Office Building, Hon. Thomas M. Davis (chairman of the subcommittee) presiding.

Present: Representatives Davis and Norton.

Staff present: Ron Hamm, staff director; Howard Denis, counsel; Ellen Brown, clerk; and Cedric Hendricks, minority professional staff member.

Mr. DAVIS. Welcome to this oversight hearing on the District of Columbia's cash status, operating deficit and private financial market access. I want to thank the ranking member of this subcommittees Ms. Eleanor Holmes-Norton for working with me so closely on pursuing these issues on a bipartisan basis. I am grateful, as well, to our distinguished witnesses who will testify to this subcommittee: Anthony Williams, chief financial officer of the District; Dr. Andrew Brimmer, the chairman of the District of Columbia financial responsibility assistance authority; Dr. Gregory Holloway, Director of Governmentwide Audits, Accounting and Information Management Division of the GAO; and Mr. William Hayden, senior managing director for Bear, Stearns & Co.

[The prepared statement of Hon. Thomas M. Davis follows:]

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Congress of the United States

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OPENING STATEMENT

TOM DAVIS, CHAIRMAN
DISTRICT OF COLUMBIA SUBCOMMITTEE

JULY 19, 1996

Before we created the Control Board last year the credit rating for the District of Columbia had sunk to junk bond status.

The District had no access to the private credit and bond markets.

They had no money to pay creditors and vendors

The General Accounting Office confirmed under oath to this Subcommittee that the District was "insolvent."

We responded by passing landmark legislation. The legislation was bi-partisan and significant. It passed without a dissenting vote

Now, this year, we are beginning to see some progress, although we can not be blind to the fact that we still have a long way to go.

Now, the District, with the help of the Control Board, has given Congress more credible numbers to work with

The District, in the person of Tony Williams, the CFO, has a rational system for paying all creditors and vendors in an orderly fashion.

And now we are seeing the first signs that the District may be regaining access to the private credit market, at least in some cases and with certain conditions..

With the help of the General Accounting Office this Subcommittee reviewed, at a hearing on March 17, 1995, the experiences of several large U.S. cities where control boards were established. In each of the cities we studied the event or circumstances that most often led to the establishment of a control board was the loss of access to the municipal bond market. The same was true for the Nation's Capital.

I was therefore very encouraged to learn of the possibility that the District may now be in a position to achieve a short term borrowing of $220 million from private lenders. The purpose of this hearing is to gather information on this development and to explore its significance. We of course have serious questions as to any terms and conditions. The occurance of this borrowing in lieu of a further Treasury borrowing prompted me to call this hearing at this time. I believe that while this event is hopeful and important, it may be misunderstood by the public and some officials. This is a Tax Revenue Anticipation Note - known as a TRANS - and is not a long-term borrowing. This event does not address the District's long-term cash needs nor its accumulated operating deficit. We will explore the importance of those items and the potential for dealing with them.

The District is clearly faced with an ongoing financial crisis centered around cash shortages, budget deficits, and a moribund capital account. These crises may be causing further delay in implementing necessary and mandated budget and financial reforms. There has even been a suggestion that the growing accumulated operating deficit and flat revenues may deplete the District's short-term Treasury window in 1998, causing another insolvency.

Clearly, as the GAO testified to the Appropriations Committee last month, the accumulated operating deficit and continuing cash shortages must be dealt with before substantial improvement can be realized in resolving the District's fiscal crisis. I look forward to hearing from our witnesses on these and other related points as the Subcommittee continues to deal in a serious way with the District's financial situation. Hopefully, to paraphrase Winston Churchill, while this is not the beginning of the end in resolving the crisis, we may be, at long last, ready to get to the end of the beginning.

Mr. DAVIS. I will now yield to Ms. Norton, the ranking member of the subcommittee for any statements she may have.

Ms. NORTON. Thank you, Mr. Chairman.

The decision of Chairman Tom Davis to hold this hearing is an important initiative because of all of the related financial issues about which we will receive testimony this morning. More important, however, this hearing marks the first time that there has been an in depth airing of why borrowing to clear the District's accumulated deficit is or is not appropriate. There are always good reasons to oppose deficit financing of current obligations. The question remains under what circumstances, if any, such deficit financing may be appropriate.

Congress has not been unalterably opposed to financing current obligations with borrowed funds. Congress allowed the District to do a long-term borrowing to eliminate the accumulated deficit in 1991. By now, everyone knows the new deficit that has resulted was not a question of poor management alone. At the same time, everyone concedes that the District did not begin to reduce expenses soon enough to control spending despite the warning signs. However, objective analysts also admit that under the best of circumstances huge increases in Medicaid and other State expenses carried by the city and the flight of middle-income taxpayers has put the District in a uniquely difficult situation. A borrowing now has little to do with the District government.

Unlike the 1991 long-term borrowing, proceeds from any new borrowing will be controlled by the Authority and the chief financial officer. Moreover, the proceeds will not go to the District government, as before, but to the hidden victims of the District's insolvency, particularly vendors and others whom the District owes money.

Current death baring statistics tell a story of DC residents who are increasingly impatient with the city's financial crisis and the pace of recovery. We lost more of our people from 1990 to 1995 than we lost during the entire 1980's. Their continuing abandonment of the city must be arrested or taxpayer flight alone will doom every single effort under way to repair the city's finances and government.

The city and the Authority have been working night and day to quicken the pace before the crisis overwhelms them. If Congress wants them to dig out of the hole instead of digging the hole, this body must do more than cut the budget every year after deep consensus cuts have already been achieved.

The serious problems this city faces—congressionally accumulated pension liability, a Federal payment of steeply declining real dollar value and out-of-control State costs, such as Medicaid, can be addressed only by this body. Next year, we cannot afford another fiscal year like this one where, in part because of harshly gratuitous and counterproductive cuts and a delay in the receipt of Federal payment, conditions worsen rather than improve.

In some ways, the District has made very commendable progress with no help whatsoever from the Congress of the United States. I applaud the District and the Authority for securing a $220 million loan from Lehman Brothers despite the District's credit rating remaining below investment grade. This loan offers objective proof

of significant progress and the beginning of renewed confidence in the city. As a result of this loan, the District should be able to meet its financial obligations through the end of the current fiscal year.

While this loan does not represent full access to the market, it certainly shows progress in that direction. Surely this progress qualifies the District for its first help from Congress in almost 5 years, especially when that help consists only of the authority to borrow in order to eliminate an accumulated deficit that all admit cannot be eliminated in any other way.

How long is the city to be expected to live in a crisis mode with cash shortages, vendor bills and capital fund depletion? If the city goes down, and becomes a permanent basket case, history will record that it began in the 104th Congress where delay in borrowing as a one-sided strategy to slash government killed the city. It will be on our watch and on our conscience.

The 104th Congress is almost over, but there is still time. A long-term borrowing for the District would help rescue this session of Congress from a harsh and bitter epitaph.

I welcome today's witnesses and commend them on their work and look forward to their testimony.

Mr. DAVIS. Thank you very much, Ms. Norton.

What I would like to do now is hear from the first panel of four. I think it will be much faster to do that. I would like to welcome and introduce the panel which will include Chief Financial Officer Anthony Williams, Control Board Chairman Dr. Andrew Brimmer, the GAO Division Director Gregory Holloway and Mr. William Hayden at Bear, Stearns.

It is the policy of this committee that all witnesses be sworn before they testify, if you would rise and raise your right hands.

[Witnesses sworn.]

Mr. DAVIS. Please be seated. The subcommittee will review any witness statements you care to submit. We ask that any oral testimony be no longer than 10 minutes. I will start with Mr. Williams. Thank you for being here today and thanks for the job you are doing.

STATEMENTS OF ANTHONY A. WILLIAMS, CHIEF FINANCIAL OFFICER, DISTRICT OF COLUMBIA GOVERNMENT; ANDREW F. BRIMMER, CHAIRMAN, DISTRICT OF COLUMBIA FINANCIAL RESPONSIBILITY AND MANAGEMENT ASSISTANCE AUTHORITY; WILLIAM H. HAYDEN, SENIOR MANAGING DIRECTOR, BEAR, STEARNS & CO. INC.; AND GREGORY M. HOLLOWAY, DIRECTOR, GOVERNMENTWIDE AUDITS, ACCOUNTING AND INFORMATION MANAGEMENT DIVISION, GENERAL ACCOUNTING OFFICE

Mr. WILLIAMS. Thank you, Mr. Chairman. I appreciate that.

Mr. Chairman, it is appropriate to be here today to discuss the District's cash-flow situation, access to credit markets, operating deficit and long-term financing needs because today as I speak with you the District is completing its first public market debt borrowing since the creation of the DC Financial Management Assistance Authority and the establishment of the Office of Chief Financial Officer. This financing was a resounding success and represents a

first step toward fully regaining the credit market's confidence in the District and returning to investment grade.

Yesterday, around 11 a.m., the District entered the capital market with a $220 million issuance of short-term notes. The moneys from the borrowing are being used to fund District expenses until its tax revenues are available later this fall. These notes were priced with a coupon of 5.5 percent and a yield to maturity of 4.5 percent. Including the cost of issuance, this financing represented a true interest cost of 5.42 percent—below our corresponding U.S. Treasury borrowing rate. The notes were not rated by any of the national rating agencies and were sold to institutional investors and were underwritten by the investment firm of Lehman Brothers.

Today's public sale of the District notes does not mean that the District has the full confidence of Wall Street that it had prior to its severe fiscal crisis. It does not mean that the District no longer needs the support of U.S. Treasury borrowings. The District will need to access the U.S. Treasury in early fiscal year 1997 as its cash needs will exceed fiscal year 1997 projected expenditures.

However, today's public notes sale must be seen as a first step toward the goal of the District achieving investment grade ratings on its debt. This is a long-term objective and took years for other major cities in financial crisis to achieve. By accessing the public markets, the District is adding the discipline of the public markets to ensure that the short-term goals and obligations are satisfied. The District will continue to seek market access and discipline in achieving our long-term goals.

Mr. Chairman, there are a number of questions that you have asked, and I wish to answer them briefly in this testimony. The first is, what is the impact on the District and its ability to implement needed reforms of the accumulated operating deficit?

The District's accumulative operating deficit is being financed by utilizing current year's revenues to finance previous year's expenditures. The resulting cash-flow shortages are financed by borrowings from either the U.S. Treasury and/or the public markets. Specifically, the District borrows from the U.S. Treasury in the current year and repays the loan in the next fiscal year with its Federal payment. The only practical way to break this cycle is to permanently finance the deficit with long-term bonds. Without a long-term borrowing, the District must continue the cycle of borrowing from next year's revenue.

I have testified before to this committee regarding the accumulated deficit and its negative effect on the District's operations. The District cannot properly function as an efficient government if it is forced to carry this burdensome deficit. Long-term budgeting is made more difficult, short-term borrowing costs are increased, and cash-flow pressures will continue to be severe unless the District is able to refinance this deficit. If this situation is not addressed and resolved, the District's vendors are at risk of not receiving timely payment. Ultimately, the District is at risk of not receiving efficient services from its vendors unless the deficit is eliminated.

By proposing a long-term deficit financing, the District and the Authority are seeking approval to borrow for deficits, but this is, in practice, what is currently being done through the District's U.S.

Treasury cash-flow borrowings. What the District and the Authority are requesting is a more efficient method of paying for these deficits. Long-term borrowing provides the most efficient deficit financing method. It will allow us to better budget interest cost, plan for the timing of capital improvements, and more quickly reestablish investment grade ratings. Importantly, if the District is unable to finance its accumulated deficit and unable to access capital funds from sources other than U.S. Treasury borrowings, the District will run out of cash in fiscal year 1998.

In what way is the District's cash situation impacted by the announced borrowing from Lehman Brothers and what does that transaction represent or not represent about the District's ability to access the private financial markets for the long term?

Generally, the Lehman Brothers proposal did not impact the District's cash situation as the District would have proceeded with the U.S. Treasury borrowing if the public market sale had not been available. That being said, there may be some deferral of vendor payments at the end of the fiscal year to make sure that there are sufficient cash reserves available after the repayment of the notes due September 30, 1996. Our cash-flows now project a need to defer $20 million of Medicaid payroll—$10 million in local funds—and $14 million in general payables. These projected deferrals are estimated to be less in total than the District has deferred in prior years.

With a below-investment-grade bond rating, the committee has asked, can the District complete a long-term borrowing with reasonable conditions at this time? In the foreseeable future?

In terms of access to the public markets, the Lehman Brothers proposal is an indication of the market's perception of the District of Columbia's improving financial condition. I would add, our improving financial condition acting—managing our financial affairs under the auspices of the Authority because it has been clear to me in talking to investors over the last week that the Authority does indeed have special standing in the minds of investors. We have talked about the autonomy and independence obviously operating within the executive branch, but the autonomy and independence of the CFO in managing the city's cash, the investors have looked beyond this to the Authority for that overall bulwark in terms of confidence and reliability; and I want to emphasize that.

Having said that, in terms of the public markets this proposal does represent a market's perception of our improving financial condition.

Over the past 2 months, the District and the Authority have been receiving various types of unsolicited proposals for long-term borrowing. The District, with the support of the Authority, is beginning to generate investor confidence that it has the controls and processes in place to ensure that its debts are repaid in a timely manner. There is no question that the District now has market access, the question is at what rate, at what terms, with what structure, and with what further constraints the District would have to live under in order to access the market. These are the questions that the District, our financial advisors and the Authority will be working to answer over the next few months. What must happen

in order for the District to regain an investment-grade rating and be able to attract reasonable conditions for long-term borrowing?

The underlying structure of the District's credit has changed in the past year. Advances from the Treasury are now capped by the amount of the Federal payment and the U.S. Treasury has a first lien on the Federal payment prior to bondholders. Furthermore, the Federal payment is now deposited with the Authority which has sole discretion of how the payment is pledged and/or used. While these changes have had the effect of making the District's credit based upon its own resources, this has occurred at a time when the District's financial crisis is most severe.

Notwithstanding the above, the District has received indications of interest from underwriters and investors to purchase a "structured" financing of the District and/or the Authority. The District hopes to work with the Authority over the next few months to develop a formal solicitation of ideas on how the District's financing needs can best be met. We believe that in light of the successful sale of the $220 million financing and investor indications that the District and the Authority can attract financing at reasonable rates and terms.

Finally, Mr. Chairman, I want to defer to our other panelists, especially Dr. Brimmer. There is the question of, can the Control Board attain an investment-grade rating? We should let the Control Board speak for itself, but again, it is clear to me that the Control Board enjoys a special confidence among investors in terms of the management of the city's financial and fiscal affairs.

In terms generally of an investment-grade rating, I think the question of an investment-grade rating for the city is this: That is the District and/or the Authority can generate debt on investment-grade basis. The question becomes, in generating a credit structure and coverage that enjoys investment grade are we damaging the rest of our credit for existing investors because we have great pressures right now on local revenues in terms of debt service?

With that, Mr. Chairman, I would be happy to enter my remarks formally on the record and answer any questions you may have after the other panelists.

Mr. DAVIS. Without objection it will be entered in the record.

[The prepared statement of Mr. Williams follows:]

Testimony of Anthony A. Williams
Committee on Government Reform and Oversight
July 19, 1996

It is appropriate to be here to discuss the District's cash flow situation, access to credit markets, operating deficit and long-term financing needs. Because today, as I speak here with you, the District's is completing its first public market debt borrowing since the creation of the DC Financial Management Assistance Authority and the establishment of the Office of the Chief Financial Officer. This financing was a resounding success and represents a first step towards fully regaining the credit market's confidence in the District and returning to investment grade.

Yesterday, around 11:00 A.M., the District entered the capital market with a $220 million issuance of short-term notes. The moneys from the borrowing are being used to fund District expenses until its tax revenues are available later this fall. These notes were priced at a coupon of 5.50% and a yield to maturity of 4.50%. Including the cost of issuance, this financing resulted in a true interest cost of 5.42% – below our corresponding U.S. Treasury borrowing rate. The notes were not rated by any of the national rating agencies and were sold to institutional investors and underwritten by the investment firm of Lehman Brothers.

Today's public sale of District tax anticipation notes does not mean that the District has the full confidence of Wall Street that it had prior to its severe fiscal crisis. It does not mean that the District no longer needs the support of U.S. Treasury borrowings – the District will need to access the US Treasury in early FY 1997 as its cash needs will exceed FY 1997 projected expenditures.

However, today public note sale must be seen a first step towards the goal of the District achieving investment grade ratings on its debt. This is a long-term objective and took years other major cities in financial crisis years to achieve. By accessing the public markets, the District is adding the discipline of the public markets to ensure that short-term financial goals and obligations are satisfied. The District will continue to seek the capital market assistance and discipline in achieving our long-term gaols.

1. *What is the impact on the District and its ability to implement needed reforms of the accumulated operating deficit?*

   The District's accumulative operating deficit is being financed by utilizing current year's revenues to finance previous year's expenditures. The resulting cash flow shortages are financed by borrowings from either the U.S. Treasury and/ or the public markets. Specifically, the District borrows from the U.S. Treasury in the current year and repays the loan in the next fiscal year with its Federal Payment. The only practical way to break this cycle is to permanently finance the deficit with long-term bonds. Without a long-term borrowing the District must continue the cycle of borrowing from next year's revenue.

   I have testified before to this Committee regarding the accumulated deficit and its negative effect on the District's operations. The District can not properly function as an efficient government if it forced to carry this burdensome deficit. Long-term budgeting is made more difficult, short-term borrowing costs are increased, and cash-flow pressures will continue to be severe unless the District is able to refinance this deficit. If this situation is not addressed and resolved, the District's vendors are at risk of not receiving timely payment. Ultimately, the District is at risk of not receiving efficient services from its vendor unless the deficit is eliminated.

By proposing a long-term deficit financing, the District and the Authority are seeking approval to borrow for deficits, but this is in practice what is currently being done through the District's US Treasury cash flow borrowings. What the District and the Authority are requesting is a more efficient method of paying for these deficits. Long-term borrowing provides the most efficient deficit financing method. It will allow us to better budget interest cost, plan for the timing of capital improvements, and more quickly reestablish investment grade ratings. Importantly, if the District is unable to finance its accumulated deficit and unable to access capital funds from sources other the than US Treasury borrowings, the District will run out of cash in FY 1998.

Additionally, the District's access to US Treasury borrowings must be maintained. Without Treasury borrowings, the District does not have the access to current year funds to continue to operate.

2. *In what way is the District's cash situation impacted by the announced borrowing from Lehman Brothers and what does that transaction represent or not represent about the District's ability to access the private financial markets for long-term?*

Generally, the Lehman Brothers proposal did not impact the District's cash situation as the District would have proceeded with a US Treasury borrowing if the public market sale had not been available. That being said, there may be some deferral of vendor payments at the end of the fiscal year to make sure that there are sufficient cash reserves available after the repayment of the Notes due, September 30, 1996. Our cash flows now project a need to defer $20 million of Medicaid payroll ($10 million in local funds), and $14 million in general payables. These projected deferrals are estimated to be less in total than the District has deferred in prior years.

3. *With a below investment grade bond rating can the District complete a long-term borrowing at reasonable conditions at this time? In the foreseeable future?*

In terms of access to the public markets, the Lehman Brothers proposal is an indication of the market's perception of the District of Columbia's improving financial condition. Over the past two months, the District and the Authority have been receiving various types of unsolicited proposals for long-term borrowing. The District, with the support by the Authority, is beginning to generate investor confidence that it has the controls and processes in place to insure that its debts are repaid in a timely manner. There is no question that the District now has market access, the question is at what rate, at what terms, with what structure, and with what further constraints the District would have to live under in order to access the market. These are the questions that the District, our financial advisors and the Authority will be working to answer over the next few months.

4. *What must happen in order for the District to regain an investment grade rating and be able to attract reasonable conditions for long-term borrowing?*

The underlying structure of the District's credit has changed in the past year. Advances from the Treasury are now capped by the amount of the Federal payment and the U.S. Treasury has a first lien on the Federal payment prior to bond holders. Furthermore, the Federal Payment is now deposited with the Authority which has sole discretion of how the payment is pledged and or used. While these changes have had the affect of making the District's credit based upon its own resources, this has occurred at a time when the District financial crisis is most severe.

Notwithstanding the above, the District has received indications of interest from underwriters and investors to purchase a "structured" financing of the District and/or the Authority. The District hopes to work with the Authority over the next few months to develop a formal solicitation of ideas on how the District's financing needs can best be met. We believe that in light of the successful sale of the $220 million financing and investor indications that the District and the Authority can attract financing at reasonable rates and terms.

The District is and must continue to take a long-term perspective at improving its credit and achieving an investment grade ratings. The District (or the Authority) can achieve an investment grade rating, but the question is now at what cost. What kind of revenues need to be tied up. In addition, the District must have support of the Federal Government to resolve its long-term structural imbalance. With revenues being stagnate and obligations continuing to increase the District must have some relief. Additional revenues need to be made available to the District or the Authority without further eroding the District's tax base. Further, significant obligation and cost shifting from the District to the Federal government must occur in terms Medicaid reimbursement, pensions obligation, prisons costs, etc. or the District can not continue to be long-term viable entity.

. *Can the control board attain an investment grade rating? Under what conditions?*

Both the Control Board and the District can borrow funds at an investment grade basis – the question is – at what cost to the District.

To achieve an investment grade rating, the District could either take a specific revenue and pledge to bondholders or alternatively the District could to grant a revenue to the Authority and the Authority could pledge it to bondholders. However, the critical issues here is, assuming new revenues are not forthcoming, this what would happen to the District's existing general obligation bonds. In fact, one of the rating agencies, Standard & Poor's Corporation, has indicated that taking existing revenue and pledging it to bonds (either the District or the Control Board) would result in stress on the District's general credit.

Therefore, the optimal strategy for the District would be to receive additional revenues, that could be used to support or supplant revenues used for an investment grade financing debt service. Alternatively, the District and the Control Board and the must work with the District's existing resources and negotiate with the credit markets to achieve affordable borrowing without impairing the security of the District's current bondholders.

5. *Another suggestion for generating cash other than a direct borrowing would be able to restructure or refinance outstanding obligations. How much of the District's outstanding debt could be restructured? At what annual savings and at what long-term additional costs? Is there a reasonable mechanism to increase the amount of outstanding obligations which could be restructured?*

There are two basic reasons why local governments restructure its debt. First, local governments refinance for present value debt service savings by replacing high interest debt with lowering interest debt. Second, local governments have refinanced near-term debt with longer term debt by extending the maturity in order to either reduce operating budget pressures or to smooth out debt to create additional capacity. The District has in the past used both of these restructuring techniques.

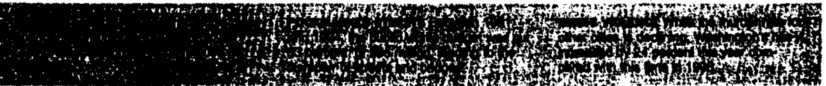
In terms of refundings for savings, over the last several years, as interest rates declined the District has refinanced in excess of $1.2 billion of high coupon bonds with lower coupon securities and have

achieved substantial present value debt service savings. While we continue to pursue additional financing opportunities, given market conditions and the District's lower rating which translates into relatively higher borrowing costs, debt service savings from refinancing will be very difficult to achieve.

In terms of restructuring for operating cash flow relief and/or generating additional debt capacity, the District has extended the maturities of certain of its outstanding bonds. This type of financing generally entails present value debt service savings costs and as such have been pursued in combination with new money and/or deficit financing.

Trying to Fix Capital Where 'Everything Is Broken'

A young man riding his bicycle down a street in the Southwest section of Washington, just blocks from the Capitol.



By STEVEN A. HOLMES and MICHAEL JANOFSKY

WASHINGTON, July 24 — On any given day here in the capital of the richest nation in the world, nearly a third of the 16 water-pumping firetrucks are kept out of service to save money. Police officers dip into their own pockets to buy tires and put gasoline in squad cars. City clinics periodically stop testing for the AIDS virus because they cannot afford supplies. Local officials are dumping extra chlorine in drinking water to battle elevated levels of bacteria caused by eroding pipes.

The Washington of glittering monuments, world-class museums and graceful, leafy

MONUMENT TO DECAY

First of three articles.

neighborhoods continues to captivate tourists, hordes of them. But in ways big and small, the Washington of cold municipal reality is falling apart.

Two decades into Washington's experiment in limited self-rule the city is virtually insolvent. Its bond rating is junk status. Its population, 796,000 just 20 years ago, has fallen to 554,000 — the lowest since the beginning of the New Deal in the 1930's. While New York and other cities have registered lower crime rates, here crime is on the rise, and arrests are down. City contractors wait months to be paid. Public school employees are facing up to 12 days of furloughs in the coming academic year to help trim the school system's $7.1 million deficit.

And the people elected to run the city, especially Mayor Marion S. Barry Jr., lost the trust of Congress, which has the constitutional power to oversee the national capital. Last year, Congress shifted much of the local power to a board of financial overseers, known locally as the financial control board, appointed by the President.

"Everything is broken," said Anthony A.

Continued on Page B6, Column 1

Yeltsin Is Los... In Plan to L... Oil Investm...

Communists Frus... Overseas Compan...

By MICHAEL R. GORD...

MOSCOW, July 24 — In a st... rebuff to President Boris N. Y... the Communist-dominated ... ment has rejected legislation ... ed to encourage billions of dol... foreign investment in the oil a... industry.

The legislation, which woul... vide a legal framework for s... oil production, has been a top p... of Western oil companies ea... develop new fields. It has also... strongly supported by the Y... Government, which is eager t... erate badly needed revenue.

The Communists' success in ... ing the legislation shows the... have the determination and po... hamper market reforms d... their lopsided defeat by Mr. Y... in the presidential election on J...

The Communists are "extr... ideologically charged," said A... Y. Mikhailov, chairman of the... liamentary Committee on N... Resources, who supported the... lation. "They think that it is... when the state owns everythin...

But the failure to pass the law... reflects Mr. Yeltsin's slow st... getting his new policy team in p... as well as what are seen as h... handed efforts by Washington t... American oil companies, Russi... ficials said.

Parliament voted down the le... tion late Friday, setting off a rou... recriminations, and this week... tain Administration officials... their parliamentary allies vow... renew the fight.

Along with the decision by th... ternational Monetary Fund to ... hold its monthly loan disburse... because of Russia's tax-coll...

A FOOD INFECTION

Competing Priorities Slow the Recovery of Bodies

11-637 - 21

MONUMENT TO DECAY: The Search for Solutions

with 85 percent of the vote. She vowed to clean out City Hall, not with a broom but with a shovel.

Lost Opportunities

A Bad Situation Gets Even Worse

Before he left office in 1990 after his arrest and conviction, Mr. Barry brought together a diverse group of business, civic, academic and union leaders to study the problems of the city and recommend solutions. The $2 million project resulted in an extensive report that warned city leaders to cut spending and increase revenues, or face dire consequences.

While the Kelly administration adopted many of the recommendations, many others were unfulfilled.

"This was a big opportunity missed," said Alice M. Rivlin, the vice chairwoman of the Federal Reserve, who headed the group. "When Sharon Pratt Kelly came in, she had the window of opportunity and the enormous good will of Congress. There was momentum for D.C. to face up to its problems, reduce the city payroll, restructure the government and come up with long-term solutions."

"Once that opportunity was missed," Ms. Rivlin added, "things went from bad to worse."

Mrs. Kelly declined to be interviewed for this article. But Robert Mallett, her former city administrator, said: "I think many who found her a disappointment may have felt better about her had she had stronger political skills. But nobody could say she didn't tackle every major problem faced by the city."

When Mrs. Kelly took office after her election in 1990, Washington was $331 million in debt, the legacy of falling revenues in a bad economy. But unlike Mr. Barry, Mrs. Kelly was embraced by Congress and the financial markets. Wall Street firms raised $336 million for the city. Congress increased [illegible]

Stephen Crowley/The New York Times

Making Do: For many of Washington's residents, shortages are a way of life. A boy in a marching band in Anacostia, one of the city's poorest sections, used a wheeled swivel chair to carry his drum because his school could not afford the proper equipment.

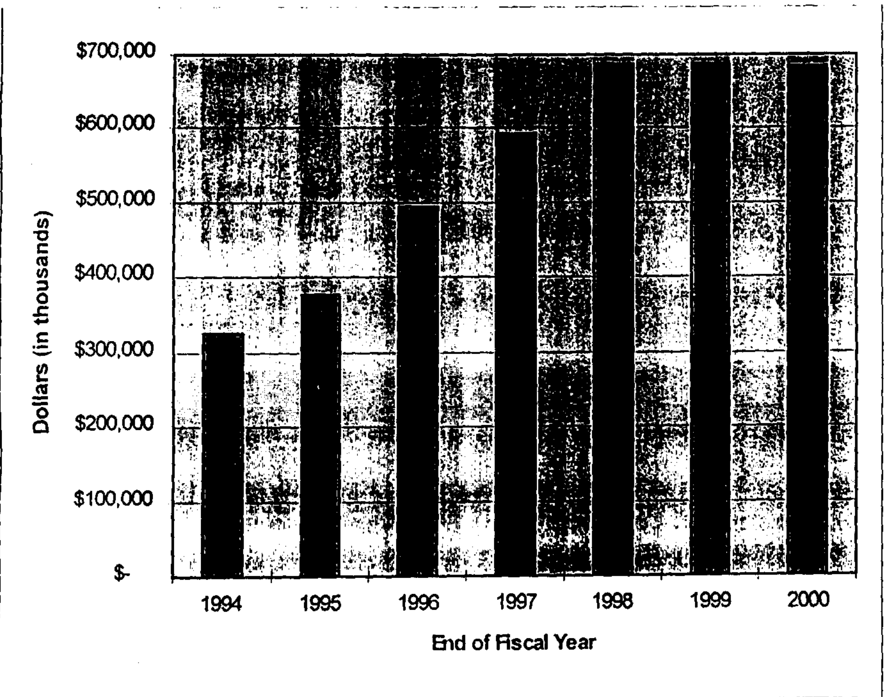
voting Congressional delegate.

On paper, the Kelly administration looked [illegible]

report. In one year, a "fifth quarter" of tax revenue was added to balance the books.

paying higher fees and property tax assessments, there were not enough layoffs. "They [illegible]

District of Columbia Cummulative Deficit Fiscal Years 1994 through 2000



Fiscal Year	Amount
1994	$ 324,406
1995	$ 378,533
1996	$ 494,644
1997	$ 593,640
1998	$ 687,517
1999	$ 685,775
2000	$ 684,649

Mr. DAVIS. Dr. Brimmer.

Mr. BRIMMER. Thank you very much, Mr. Chairman. I am delighted that I was asked to appear today and testify on behalf of the Authority.

First, let me say, Mr. Chairman, that I have a prepared statement which I would ask be put in the record; and I will make some oral comments basically summarizing several of the main points in that written statement.

As you attested, I am pleased to discuss several financial issues particularly the District's prospects for regaining reasonable access to the private financial markets and the status of the accumulated deficit. I think it is important to consider these issues in the context of the consensus 1997 financial plan and budget sent to the Congress last month.

As you know, the Mayor, the Council and the Authority, after much discussion and collaboration, did submit a consensus budget. We determined that the proposal that resulted from that discussion is in conformance with the act, will promote financial stability of the District government, and will further the interests of the people of the District. Everyone should recognize the progress—reflected in this budget—that the District has made in improving the conditions under which the budgets are formulated and implemented. I can also report that the situation that existed in the past with respect to the preparation and submission of budgets was not altogether sound.

As I mentioned earlier, working with the Mayor and the Council and the chief financial officer, we did put forward that budget and we have asked the House and the Senate to accept the recommendation. They do provide the background for an assessment of the District's overall financial situation and its prospects for access to the capital markets.

In my statement, Mr. Chairman, I describe a number of indicators of the progress we have made, in sum, that all add up to a conclusion for me that there has been a demonstration to investors that the city has improved its financial management. It demonstrates also that, through the Authority, there has been provided a means of assuring to investors that the city will be able and is committed to meeting its responsibilities with respect to the repayment of debt which has just been borrowed.

It is these types of activities that give us hope for the District's future. Positive results related to financial and management issues are having a healthy impact on the city, on how it is viewed. The Authority believes that these deservable and very welcome changes in the District's operations are responsible for the recent reaction from the private markets.

Mr. Williams has already described the short-term borrowing that has just been concluded; and it is being closed today, by the way. I, just sitting at this table, signed a document which is part of that closing, testifying to the Financial Control Board's commitments.

Now, however, we should keep in mind what this particular transaction does and what it does not do. First, this is a borrowing to cover short-term cash needs. It is not a borrowing to provide any additional funds to help finance expenditures beyond the budget.

Now, this borrowing was necessary because there is traditionally a gap between the city's collection of property tax revenues in the spring and the collection of revenues in the fall. Therefore, that gap has to be funded.

In the past, the Treasury has been the source of borrowing. Last year that was the case. The year before the city has been able to borrow—that is, in fiscal 1995, the city was able to borrow from the capital to cover that same short-term deficit. It borrowed something like $250 million. This year, up to now, the city has borrowed from the Treasury seven times to finance short-term needs. This latest borrowing is the latest example of that borrowing.

Now, as I have said, since the revenues are expected to be received prior to the repayment of the revenues from taxes and are expected to be received prior to the repayment date and that is estimating amounts, no additional revenue will be needed to repay the loan. As stated earlier, the short-term borrowing was anticipated and included the 1996 financial plan and budget approved by the Authority.

I have to mention that in addition to determination that the proposed borrowing structure might be considered reasonable market access under our act, the District requested the Authority's approval of the transaction, as well as the Authority's participation as a provider of additional security for the transaction through the execution of a letter agreement with the Mayor and the chief financial officer. As I said, just a few minutes ago, I signed that letter at this table.

To go further with this borrowing, the Authority considered many issues, including the Authority's role in the transaction as a provider of additional security. Specifically, the letter of agreement provides a guarantee that portions of the Federal payment would be used to repay investors should the District not otherwise meet its obligations for repayment.

Second, whether the transaction is consistent with the financial plan and budget.

Third, whether the terms of the act passed by the Council of the District of Columbia were acceptable to the Authority.

With respect to acting as a guarantor of repayment, the Authority, by request of the District, by means of that letter of agreement covenant, will deposit in the note escrow account any deficiency of any principal and interest on the note from the 1997 Federal payment held by the Authority upon receipt from the Treasury. According to the escrow agreement, the District is required to fund an escrow account beginning with the receipt of certain proceeds from the real property tax receipts. Those are all in place and we will take responsibility, as I say, to assure that they are repaid.

We will also take responsibility for working with the chief financial officer to assure that the funds, as they come in, are channeled into the escrow account so there will not be, at the end of the period, a huge deficit. So as the taxes come in, a schedule has been worked out whereby funds will be contributed in place of the escrow account. The chief financial officer would take responsibility for seeing that that is done.

Now, we also found that the borrowing is consistent with the current financial plan and budget. We came to that conclusion based

on our review of the transactions and its implications, as well as from discussions with the chief financial officer.

Finally, the Authority approved the Council's Note Act, which was the legislative branch's acceptance of the proposed borrowing, with the stipulation that nothing in the act blocked the Authority or the Chief Financial Officer from exercising their respective roles under the act. We thought that was important because, depending on how you look at the legislation, there were some possible interpretations which would have imposed limitations on the chief financial officer. We wanted to make sure that wasn't the case.

Let me turn now to the question of long-term borrowing. First, again we must keep in mind that in addition to short-term borrowing, the fiscal 1997 budget financial plan does address the need for borrowing to finance the effect of accumulated deficits and borrowing for capital investment. As we stated in our May 8 report, the Authority concurs with the need for borrowing, both for the deficit, as well as for capital needs.

With regard to the timing of a long-term financing, the financial plan and budget includes a recommendation for a long-term deficit borrowing in fiscal year 1997. A post-fiscal year 1996 financing would allow time for achieving anticipated results and assessing progress toward financial and management improvement goals. Also, this timetable would be supported by some continued borrowing on a short-term basis from the Treasury or other sources as needed. We further, therefore, recommended that the District explore options for long-term financing in fiscal year 1997. In passing, we should note that both New York and Philadelphia did borrow long term to finance their accumulated deficit.

Our law does contemplate long-term financing for the District. While capital borrowings have already been authorized by the law, any long-term deficit borrowings will require congressional approval. We are exploring our options to accomplish this goal and great flexibility will be needed to determine the appropriate structure of any such undertaking. That is why, in our reports on the fiscal year 1997 financial plan and budget, the Authority recommended that Congress should authorize the District to borrow long term up to a maximum amount for fiscal year 1997; and the Authority should be given power to decide the following: when the District can borrow, the specific amount of the borrowing, the terms and conditions of the borrowing, the collateral to be placed for security, and the specific uses of the proceeds from the borrowing.

The above changes are needed whether the District borrows, on its own account, from the Treasury or in the private capital market; or whether the Authority borrows in the private market on behalf the District.

Mr. Chairman, I have in the rest of my statement some additional comments about market access, and I also have some comments on various reforms which we think are necessary to strengthen the ability of the city to enter the long-term market in

the future. I will leave those for my written statement in the record, Mr. Chairman, and I would be delighted to respond to your questions.

Mr. DAVIS. Thank you. Without objection, the rest of your statement will be put in the record.

[The prepared statement of Mr. Brimmer follows:]

Mr. Chairman and Members of the Subcommittee:

My name is Andrew F. Brimmer, and I am Chairman of the District of Columbia Financial Responsibility and Management Assistance Authority (Authority). On behalf of the Authority, thank you for the opportunity to appear before the Subcommittee today.

Introduction

Mr. Chairman, as you requested, I am pleased to discuss several financial issues, particularly the District's prospects for regaining reasonable access to the private financial markets and the status of the accumulated deficit. I think it is important to consider these issues in the context of the consensus FY 1997 Financial Plan and Budget sent to the Congress last month. As you know, the Mayor, the Council of the District of Columbia, and the Authority have reached a consensus on the Fiscal Year 1997 Financial Plan and Budget. The Authority determined that, in accordance with Public Law 104-8, this budget and financial plan (1) is in conformance with the Act; (2) will promote the financial stability of the District government; and (3) will further the interests of the people of the District of Columbia. This consensus budget has been possible because of cooperation and a free exchange of information and views.

Everyone should recognize the progress -- reflected in this budget -- that the District has made in improving the conditions by which budgets are formulated and implemented. In the past, it has been the unreliable nature of financial information, a series of questionable budget assumptions and forecasts, and a penchant for budgetary gimmicks used to hide the fiscal truth, that contributed to the District's financial crisis.

I can report that this situation no longer exists. The Authority, after working with Mr. Anthony Williams, the independent Chief Financial Officer of the District of Columbia, and the Executive and Legislative branches of the District Government, has concluded that the fiscal 1997 budget meets the tests of reasonableness and reliability -- to the extent that the City's antiquated financial systems permit. All of us -- the Mayor, the Council, the CFO and the Authority -- support this budget.

I wish also to emphasize that this budget is not simply a paper document. A realistic budget document is being accompanied by concrete action. Numerous reforms outlined in the budget are already beginning to occur. For example, a cornerstone of the budget is the reduction in the number of District workers from more than 40,000 at the beginning of this fiscal year to 30,000 in fiscal year 2000. In fact, progress toward this objective already has been substantial, and we fully expect the District to meet the interim target of 33,850 FTEs by the end of this fiscal year. Other critical reforms also are moving forward, including significant changes in Medicaid management, improving

service delivery by converting the District's health care system to a Public Benefit Corporation, and major steps to reform procurement, particularly at the trouble-plagued Department of Human Services.

Short-term borrowing

Mr. Chairman, it is these types of activities that give us hope for the District's future. Positive results related to financial and management issues are having a healthy impact on the City -- and how it is viewed. The Authority believes that these discernible, and very welcome, changes in the District's operations are responsible for the recent reaction from the private markets.

As you know, on July 15, 1996, the Authority approved a short-term borrowing for the District to obtain $220 million from the private markets to meet its short-term cash needs. That amount of the borrowing was provided for in the FY 1996 budget. However, at the time, we thought the funds would have to come from the U.S. Treasury. Therefore, we were pleased that -- with the Authority providing assurance of timely repayment -- private investors were willing to lend to the City.

Mr. Chairman, I think it is important to state not only what this borrowing is -- but also what it is not. It is not intended to address long-term capital concerns or the accumulated deficit. It is a short-term seasonal borrowing to assist the City with a cash shortage occurring entirely within this fiscal year. The proceeds of this borrowing would be used to cover the District's normal shortfalls that occur midway between receipt of the spring property taxes and receipt of the fall property taxes. Because the borrowing is seasonal in nature, the repayment of the loan is dependent on the timing and the amount of the receipt of revenues. Since these revenues are expected to be received prior to the repayment date and at the estimated amounts, no additional revenue will be needed to repay the loan. As stated earlier, this short term borrowing was anticipated and included in the 1996 financial plan and budget approved by the Authority.

After making an initial determination that the proposed borrowing structure might be considered reasonable market access under District of Columbia Financial Responsibility and Management Assistance Authority act of 1995, Public Law 104-8, (the Act), the District requested the Authority's approval of the transaction as well as the Authority's participation as the provider of additional security for the transaction through the execution of a letter agreement with the Mayor and the Chief Financial Officer.

To go forward with this borrowing, the Authority considered several issues, including: 1) the Authority's role in the transaction as a provider of additional security. Specifically, the letter of agreement provides a guarantee that portions of the Federal Payment would be used to repay investors should the District not otherwise meet is obligations for repayment, and; 2) whether the

transaction is consistent with the financial plan and budget, and; 3) whether the terms of the Note Act passed by the Council of the District of Columbia were acceptable to the Authority.

With respect to acting as a guarantor of repayment, the Authority, by request of the District, by means of a letter agreement covenant, will deposit in the note escrow account any deficiency of any principal and interest on the notes from the 1997 Federal Payment held by the Authority upon receipt from the Treasury. According to the escrow agreement, the District is required to fund an escrow account beginning with the receipt of certain proceeds from the real property tax receipts. Proceeds available to fund the escrow include property taxes not already dedicated to the long term general obligation bonds, sales taxes and other fees.

The Authority also found the borrowing consistent with the current financial plan and budget. The Authority came to that conclusion based on its review of the transaction and its implications, as well as discussions with the Chief Financial Officer. Finally, the Authority approved the Council's Note Act, which was the Legislative Branch's acceptance of the proposed borrowing -- with the stipulation that nothing in the Act blocked the Authority or the Chief Financial Officer from exercising their respective roles under P.L. 104-8.

Long Term Borrowing

In addition to short-term borrowing, the fiscal year 1997 budget and financial plan addresses the need for borrowing to finance the effect of accumulated deficits, and borrowing for capital investment. As we stated in our May 8 report, the Authority concurs with the need for borrowing, both for the deficit, as well as for capital needs.

With regard to the timing of a long term financing, the financial plan and budget includes a recommendation for a long-term deficit borrowing in fiscal year 1997. A post fiscal year 1996 financing would allow time for achieving anticipated results and assessing progress toward financial and management improvement goals. Also, this timetable could be supported by some continued borrowing on a short-term basis from the Treasury or other sources. The Authority, therefore, recommended that the District explore options for a long term financing in fiscal year 1997. In passing, we should note that both New York and Philadelphia did borrow long term to finance their accumulated deficits.

P.L. 104-8 contemplates long term financing for the District. While capital borrowings have already been authorized by P.L. 104-8, any long-term deficit borrowings will require congressional approval. We are exploring all options to accomplish this goal and great flexibility will be needed to determine the most appropriate structure for any such undertaking. That is why, in our reports on the fiscal year 1997 financial plan and budget, the Authority recommended that

(1) Congress should authorize the District to borrow long term up to a maximum amount during fiscal year 1997; and (2) The Authority should be given power to decide the following: (a) when the District can borrow, (b) the specific amount of the borrowing, (c) the terms and conditions of the borrowing, (d) the collateral to be pledged for security, and (e) the specific uses of the proceeds from the borrowing.

The above changes are needed whether (1) the District borrows – on its own account – from the US Treasury or in the private capital market, or (2) whether the Authority borrows in the private capital market on behalf of the District.

Mr. Chairman, the District's market access for short-term seasonal borrowings is an important step back to the discipline of private markets, but it is only a first step. It would be misleading to assume that this means that the District or the Authority automatically has market access to fund the accumulated deficit. The District, the Authority and the Congress must continue to seek solutions to the structural issues affecting the District's long range viability, including the unfunded pension liability (which may reflect directly on the reluctance of investors to support the District) and county and state functions now performed by the District government that continue to undermine its viability.

Other Reforms

The Authority is committed to encouraging reforms that will result in major restructuring of District programs, significant enhancements in program delivery, a faster fiscal recovery, and a more stable future for our City. As part of its mandate to provide direction for solving the District's most enduring problems, the Authority has recently identified several specific areas to which it expects to devote considerable time and effort. Among these are:

- Pension Reform: Numerous studies have outlined the problems which exist with respect to the pension programs for police, firefighters, teachers and judges, and several solutions have been proposed to address them. In summary, pension liabilities owed to current employees and retirees exceed the District's pension fund assets by approximately $5 billion. Various options have been suggested to cover the unfunded liability and to address the significant growth in the District's annual payment. The Council recently considered legislation to create less costly pension plans for police, firefighters, and teachers hired after October 1, 1996. We applauded that move. Consequently, we were disappointed when the Council failed to adopt the reforms in the final reading of the bill on Wednesday, July 17. The next day, the Chair of the Council indicated that he would reconsider the measure, and that is scheduled to occur today. I hope that the bill will pass – since even this modest pension reform is sorely needed. Last month, the

Appleseed Foundation issued a report that outlined a thoughtful approach for resolving this issue. The Authority is reviewing their recommendations, along with several other options. We expect to set forth our own plan for Pension Reform within the next 60 days.

- Restructuring: The Authority is studying a number of reforms which would restructure the way the District carries out its activities. For example, the Authority is working with the Department of Human Services to review all entitlement and other program operations to reduce costs and improve District services. Key goals of this assessment will be to reduce District-provided benefits to levels no more generous than those provided by surrounding jurisdictions and to redirect resources to programs that achieve the highest results. For instance, as a result of a recent contractor's study, the District is reducing AFDC benefits to levels comparable to neighboring jurisdictions for a savings of $8 million in fiscal year 1997, or eight per cent below the $100 million the program otherwise would have cost. The Authority will assess other programs in the near future to ensure that District residents are receiving services in line with those provided to citizens in neighboring jurisdictions. An identification of such programs will be made within the next 60 days.

  Procurement Reform: Another critical restructuring reform is in the area of procurement. Two recent studies and numerous City Auditor and Inspector General reports have chronicled poor procurement practices. The Authority, as a part of its review of contracts, has observed numerous contracting problems. To date, the Authority has reviewed more than 2,000 contract actions. Based on these reviews, we have found that: (1) contracts are frequently sole-source that cover short time-frames; and (2) multiple contracts for similar services have been executed. Both practices can add considerable costs. The problems are particularly acute at the Department of Human Services, which annually contracts for over $1 billion in goods and services. Management failures at this department have seriously hampered the provision of services to the City's most disadvantaged residents. Working with officials in the City Administrator's Office and the Department of Human Services, a team has been formed to address DHS procurement weaknesses. This team believes that savings of ten to fifteen percent are not unreasonable. Yet, since DHS is just one agency in which such problems have been found, the Authority is committed to finding City-wide solutions in procurement that will provide more effective services at less cost. The Authority's recommendations for administrative and legislative changes will be finalized in the next 90 days.

- City-State Functions: The Authority is studying critical functions the City is performing that typically are carried out by states. A framework for structuring city/state responsibilities is integral to the District's future. One area of

immediate concern is the crisis in the Department of Corrections, especially as regards its prison facilities at Lorton, Virginia. In the rest of the country, such state prisons are operated by states, and not by cities. One key option is the complete privatization of the facility. The Authority continues to work closely with the District and the Federal Government to find a comprehensive solution to this troublesome situation. The District is also carrying out other State activities. A study of city-state functions and their equitable distribution is currently underway.

- Revenue Reforms: Long-term revenue needs of the District must also be addressed. Such issues range from a more realistic foundation on which to base the Federal Payment to the District to approaches needed to ensure an equitable source of revenue to cover the cost of services provided to non-residents. A solution to these and similar problems is of the utmost importance to the District's future. A study of these areas by the Authority is currently underway.

The Authority also is addressing a number of additional management issues -- including:

- Performance Management Reforms: The Authority is working with the District in a variety of ways to develop results and objectives-oriented management reforms that will enhance program delivery and reward effective management. These reforms include working with the District and the International City/County Management Association to develop performance measures and benchmarks based on information from 42 cities; surveying District citizens to provide a performance measurement baseline of local government services; and development of a pilot performance management project at the Department of Public Works that will increase accountability and performance in this critical core service agency.

- Financial and Management Information: Various studies and our experience have shown that the basic financial and other information needed to manage the District is not available. The District has begun projects to address this shortfall, including a needs assessment and requirements determination for a new financial management system, as well as the automation of all phases of personnel information and payroll processes. The Authority will continue working with the District to ensure these projects are implemented as quickly as possible.

- Assessment of Public Schools Management: Various studies of the District of Columbia Public Schools (DCPS) have noted that DCPS spending approaches $7,500 per pupil, one of the highest levels in the country. Yet, the money and the personnel, who presently number more than 11,000 Full-time equivalents -- do not appear to be allocated in ways that maximize

student achievement. Basic supplies (like textbooks and paper) are frequently lacking; many schools start the year with unfilled teaching positions, and leaky roofs and malfunctioning boilers are realities of everyday life for DCPS students. Discretionary funds for school principals and their local school restructuring teams are meager. Weak financial, personnel, and management systems make it very difficult to track the flow of dollars and the deployment of personnel at DCPS. The Authority expects to initiate a major review of the ways in which resources are used within DCPS and to identify means where by such resources can be redirected to upgrade the school system to retain and restore the city's middle-class tax base.

These are just a few of the areas that the Authority is working on to improve management of City programs and the delivery of services for District residents. The Authority is confident that the financial and management improvements we have outlined here today will restore confidence in the City, and will result in a better quality of life for everyone in the District of Columbia.

Mr. Chairman, this concludes my prepared statement. I will be happy to answer any questions that you or your colleagues have. Thank you.

Mr. DAVIS. We now ask Mr. Holloway.

Mr. HOLLOWAY. Thank you, Mr. Chairman. It is good to be here this morning—good to see both yourself and Congresswoman Norton. One of the advantages of being the third or fourth panelist on a four-person panel, it gives you the ability just to say ditto rather than restate what others have said before.

Mr. DAVIS. Your full statement is in the record as well.

Mr. HOLLOWAY. I would ask that my full statement be put in the record, and I agree with both Tony and Dr. Brimmer on the need for long-term borrowing.

I want to make a couple of observations, and it reminds me of a story I heard told once about a 7-year-old kid who wanted $100 and began to think about how to get it, and it struck him he ought to send a letter to God and ask for $100. So he sat down and crafted this letter and said, "Dear God, please send me $100," and he put it in the mailbox and sent it to the post office.

The Postal Service looked at it, but really didn't know what to do with the letter, couldn't think of, who could we send this letter to so somebody could respond back to the kid? So somebody decided to send it to the President.

They sent the letter to the President. The President opened it. He was just so impressed with the kid's industrious nature to try to raise the money he wanted. He thought this is nice, let me give him $5 and send it back to him. So he stuck $5 in the envelope, sent it back to the little kid.

Then the little kid got the letter back and he was thrilled he got a letter back from God, figuring the money was in there. He rushed to open the letter up. He noticed it had been sent back to him via Washington, DC. As he opened it up and saw the $5, he thought, I need to write a letter back to God. He sits down and crafts a letter back to God and says "Dear God, thank you for the $5 you sent me—no, thank you for the $100 you sent me, but like always happens, those people up in Washington deducted $95 before they sent me the $5."

I say that to say this——

Mr. DAVIS. Good thing he didn't send a letter to the Control Board.

Mr. HOLLOWAY. I think—there are a couple of important things that come upon me as I think about the District's plight. One of them is the need to separate perception from fact, and I think, as Congresswoman Norton said in her statement, there are a couple of real critical issues facing the District that have to be part of the overall situation and the need to deal with that somehow and the financial implications of it to the District. And I say that on two fronts; I say it on the front that says the District needs to do its part to revisit what is a reasonable set of services to offer and people who are eligible for these services recognizing its current plight, but also the need for the Congress to look at the financial implications of the current Medicaid payment that the District is required to make and whether or not it is reasonable in the context of the current environment the District has, and say that only in the sense of the issue of State versus city-type functions.

Second, the pension—and I don't want to belabor the point—certainly, that is a very significant cost and will become more significant if something isn't done to address the unfunded portion of it.

As to borrowing, the good thing about credit and borrowing, it is not rocket science, it is real simple, and what it really comes down to is the borrower's ability to repay, the proven history that they will exercise, the discipline to repay, and that they have adequate collateral to support it.

When you start talking about the ability to access markets and get reasonable rates, I think all of that is founded in showing the capacity and willingness to pay and being able to adequately collateralize whatever it is you are asking for, which leads me to, I guess, the final point that I would make, is the need, as we said in our testimony before the Subcommittee on Appropriations, to address those structural issues and to have a budget that clearly would demonstrate the capacity to absorb that borrowing as well as the current operations so as to facilitate not running continuous deficits. As you do that, you need to recognize that, to whatever extent you take on further debt service, you are impairing the availability of your current receipts for operational opportunities.

And I guess the final point that I would add to that is the need that all aspects of the District's finances be looked at and it just not be a budget-cutting exercise but also that you consider opportunities to streamline the budget to make it a cost-effective government.

But you also need to look at other issues that would either enhance the financial picture by lowering the cost. And I use the Medicaid and pension cost as two examples that possibly could, or even the Federal payment for that matter, if you want to look at different things people have proposed. But all of those things need to be on the table to try to come up with what is a reasonable budget and plan to finance what the District should do going forward.

And I think all of those elements have to be part of the solution you come out with. I certainly would agree, and I would ditto Dr. Brimmer as well as the CFO, Tony Williams, for the need for borrowing. I think you have a structure in place that assures the discipline, which is the Control Board and CFO, in their independence to control how the moneys are spent. I think that will go a long way to regaining market access and other things that have been talked about here, and rather than prolong my statement, I would rather give way the time for Q and A and just close by saying ditto, ditto, and thank you very much.

[The prepared statement of Mr. Holloway follows:]

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss the results of our review of the District of Columbia's financial condition. On July 9, 1996, I appeared before the House Appropriations Subcommittee on the District of Columbia. At this hearing, I testified[1] on the District's financial condition and the District of Columbia Financial Responsibility and Management Assistance Authority's (Authority) efforts to resolve the financial and management problems facing the District. In addition, I testified on the actions taken by the control boards of New York City and Philadelphia.

As you requested, first, I will discuss financial and budget trends in the District's revenue flows and expense patterns, comparing and contrasting the District's historical experience through fiscal year 1995 with its enacted and proposed budgets for fiscal years 1996 and 1997, respectively. To identify the pertinent trends and patterns in the District's revenues and expenses, we performed some analysis for fiscal years 1980 through 1992 of the District's Comprehensive Annual Financial Reports (CAFR) and performed extensive comparative analysis for fiscal years 1993 through 1995. In addition, we performed analysis of the District's enacted fiscal year 1996 budget and proposed fiscal year 1997 budget and financial plan as approved by the Authority.

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[1]District Government: Information on Its Fiscal Condition and the Authority's First Year of Operations, GAO/T-AIMD-96-126, July 9, 1996.

Where unusual trends were identified, such as when amounts changed in a way different than expected based on our knowledge of the District's operations, we met with District officials to determine the reasons for these differences. Where we deemed it necessary, we reviewed the detailed underlying supporting information and documentation to verify that the explanation provided was supported. We also reviewed reported fiscal year 1996 expenses incurred through March 31, 1996, to ensure that the trends identified in our analysis through the fiscal year ended 1995 were still appropriate. Finally, we reviewed congressional, GAO, Authority, Office of the Mayor, City Council, and consultants reports and testimonies to more fully understand the nature and history of the District's various sources of revenues and expenses.

Second, I will discuss the District's current cash position. We focused specifically on the District's cash position at the end of fiscal year 1995, as adjusted through March 31, 1996. To determine that the District's cash position as of the date of this testimony had not substantively changed from what we found in our review, we discussed the results of our analysis with the District's Chief Financial Officer. In addition, we reviewed what actions New York City (starting in June 1975) and Philadelphia (starting in June 1991) and their respective control boards took to respond to their respective cash shortages. We performed an analysis of both cities' cash and overall financial condition for the periods noted, which were the first year the respective control boards were in place, and we interviewed several key members of each city's control board and current and former government officials to understand how and why they took the actions they did.

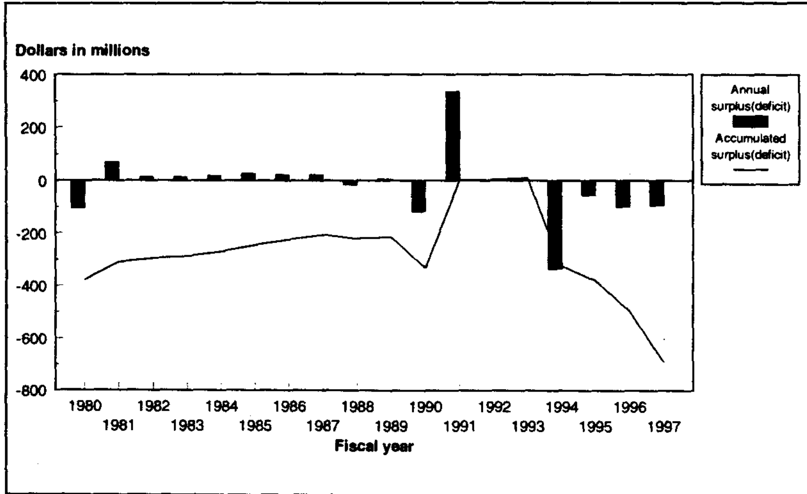
FINANCIAL AND BUDGET TRENDS AND ANALYSIS

The District of Columbia Self-Government and Governmental Reorganization Act (Home Rule Act), Public Law 93-198, approved on December 23, 1973, initiated the process by which limited autonomy was conferred on District residents, with the approval of the Home Rule charter by referendum election on May 7, 1974. In addition to the limited autonomy conferred on the District to govern local affairs, certain financial responsibilities were transferred from the federal government to the District. The most significant of these were an unaudited accumulated deficit and an unfunded pension liability relating to previously established pension plans.

Fiscal year 1979 was the first fiscal year, post-home rule, that an audited balance sheet was prepared on the District. During this audit, it was determined that the accumulated deficit was $274 million; however, in a period subsequent to fiscal year 1980, this amount was changed to $284 million–an additional deficit of $10 million. Fiscal year 1980 was the first fiscal year that a full financial statement audit was performed on the District. For fiscal year 1980, the District reported a deficit of $104 million that increased the accumulated deficit to $378 million. From fiscal years 1981 through 1990, the District incurred surpluses and deficits that resulted in an audited net surplus of $46 million and an accumulated deficit of $332 million at the end of fiscal year 1990. This deficit was fully funded in fiscal year 1991 with deficit reduction bonds, and the District had a small surplus for fiscal year 1992.

It was not until fiscal year 1993 that the District began to experience consistent annual deficits. While fiscal year 1993 had a reported surplus of $8 million, it included 15 months of property tax revenues due to a change in tax year that resulted in an additional $173 million in property tax revenue reported for that period. Thus, fiscal year 1993, adjusted downward for the extra 3 months of revenues, would have reported a deficit of $165 million. Therefore, our analysis focused on fiscal years 1993 through 1995–the period when the District's current financial difficulties began to emerge. In addition, we have included the congressionally enacted fiscal year 1996 budget and the fiscal year 1997 proposed budget that was approved by the Authority in our analysis. Figure 1 shows the reported actual budget surpluses/deficits for fiscal years 1980 through those projected for fiscal year 1997.

Figure 1: The District's General Fund Annual and Accumulated Surplus/(Deficit) for Fiscal Years 1980 Through 1997



Note 1: 1980 was the first year that a full set of audited financial statements was prepared.

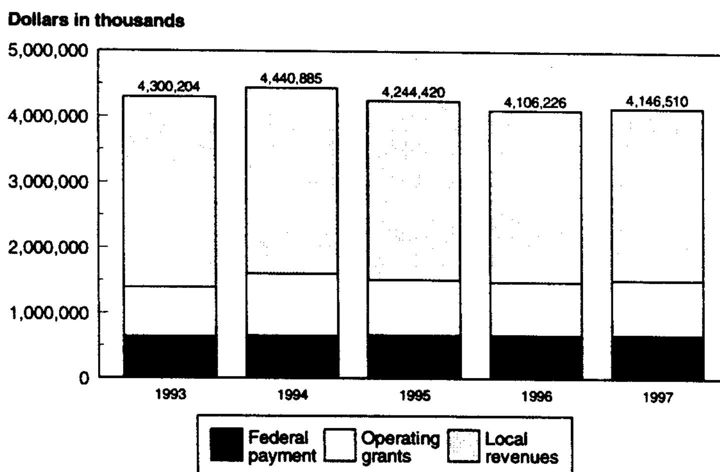
Note 2: Amounts for 1996 and 1997 are projected.

Source: Prior CAFRs and Fiscal Year 1997 Budget and Financial Plan.

General Fund Revenues

The District's revenue structure is made up of three types of revenue streams–locally generated revenues, operating grants, and the federal payment–as shown in figures 2 and 3.

Figure 2: The District's General Fund Revenues in Nominal Dollars for Fiscal Years 1993-1997



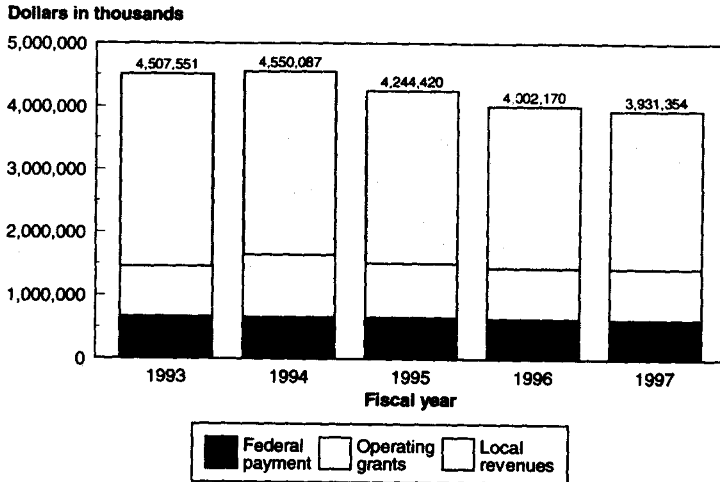
Note 1: Amounts for fiscal years 1996-1997 are projected.

Note 2: Local revenues do not include transfers from Lottery & Games.

Note 3: Nominal refers to revenues valued in actual dollars.

Source: Fiscal years 1993-1995 CAFRs and Fiscal Year 1997 Budget and Financial Plan.

Figure 3: The District's General Fund Revenues in Inflation-Adjusted Dollars for Fiscal Years 1993-1997



Note 1: Amounts are shown in fiscal year 1995 dollars. Amounts for 1996-1997 are projected.

Note 2: Indices used are from the Department of Commerce and the Bureau of Economic Analysis.

Local revenues consist primarily of levies that the District imposes, such as real property, income and business, and sales and use taxes. Operating grants consist mainly of reimbursements and grants from the federal government for the costs of social service

programs, such as the federal share of Medicaid. Generally, the federal payment may be viewed as compensating the District for any unreimbursed services that the District may provide the federal government as well as revenue losses that may be attributable to (1) the large percentage of federally owned tax exempt property in the District, (2) the federally imposed limitations on the height of buildings in the District, and (3) the federally imposed limitation on the District's authority to tax the income of nonresidents.

Local Revenues

In fiscal years 1993 through 1995, local revenues declined by $175 million--from about $2.9 billion in fiscal year 1993 to about $2.7 billion in fiscal year 1995. In inflation-adjusted 1995 dollars, the decline and, thus, the loss of purchasing power, was even greater. In inflation-adjusted 1995 dollars, the District's local revenues decreased about $315 million during this period, primarily due to the decrease in real property tax revenues. However, increases in income and business taxes and sales and use taxes helped offset the real property tax decrease. For fiscal years 1996 and 1997, the District projects local revenues to remain relatively flat.

From fiscal years 1993 through 1995, reported real property tax revenues decreased by $274 million to $654 million. There are two primary reasons for this decline. The first reason relates to the previously mentioned, one-time accounting change that artificially inflated fiscal year 1993 revenues but did not affect the cash received from real property

tax revenues. Specifically, the District changed its real property tax year-end, which caused an additional 3 months of revenue to be recognized for accounting purposes in fiscal year 1993. This change resulted in a small annual surplus in the District's financial statements. If the change had not occurred, as previously mentioned, the District would have recorded an annual deficit of about $165 million in fiscal year 1993. According to District officials, the tax year was changed so that the real property tax year-end would coincide with the District's September 30 fiscal year-end, which would ease reporting requirements. If fiscal year 1993 real property tax revenues had been adjusted by removing the additional 3 months of revenues, the decline between fiscal years 1993 and 1995 would not have been as great.

The second reason for the decline in real property tax revenue is a decrease in the assessed value of the District's commercial and residential property. Lower assessed property values generally equate to lower property tax revenues. From fiscal years 1993 through 1995, the assessed value of the District's taxable property declined by about 6.3 percent, with most of the decline attributable to commercial property. Consolidation of federal office space, increased competition from suburban office space, and the downward renegotiation of rents on existing space have contributed to the decline in the assessed value of commercial property. In addition, a declining population and falling employment among District residents have caused a decline in housing values and residential sales in all but a few District neighborhoods. The District forecasts real property taxes to decline slightly in fiscal years 1996 and 1997.

Operating Grants

Operating grant revenue has fluctuated in recent years. Operating grants increased from $760 million to $960 million from fiscal year 1993 through fiscal year 1994, but then decreased to $855 million in fiscal year 1995. Operating grants are primarily a function of the level of expenditures on social programs. As the level of expenditures in these programs increases or decreases, the level of revenues from operating grants increases or decreases accordingly.

In fiscal year 1995, over 75 percent, or about $653 million, of the District's operating grants were for health and welfare programs. In addition, a significant portion of the operating grant revenue is due to Medicaid expenditures--the District's largest health care expenditure. In fiscal year 1995, Medicaid expenditures for private providers of health care services totaled $744 million. The District is to receive 50 cents for each dollar spent on Medicaid from operating grants. Thus, at least $372 million, or 44 percent, of the total operating grant revenue for fiscal year 1995 represented reimbursements to the District for Medicaid expenditures.

The District forecasts operating grants to decrease from $855 million in fiscal year 1995 to $823 million in fiscal year 1996, due to an over $100 million decrease related to the housing authority being placed into receivership that was partially offset by increases to Medicaid and other grants. Further, operating grants are projected to increase from $823

million in fiscal year 1996 to $850 million in fiscal year 1997–a change of about 3 percent which is primarily due to the Medicaid program.

The Federal Payment

The District has been receiving a federal payment since the 1800s. Historically, the federal payment has fluctuated because of changes in the method and calculations used to determine its amount. Recent history shows that in fiscal year 1992, the Congress adopted a formula to set the general purpose portion amount of the payment to 24 percent of the second prior fiscal year's own-source revenues (local revenues) collected in the District. In addition to the formula, the Congress also funded certain initiatives as part of the federal payment. The general purpose portion made up about 97 percent of the total federal payment for fiscal years 1993 and 1994.

In fiscal years 1993 and 1994, using the aforementioned formula, the federal payments were $636 million and $648 million, respectively. In fiscal year 1995, this formula was discontinued and replaced with a federal payment of $660 million that District officials projected to remain level through the year 2000. Assuming the inflation rate of about 3.3 percent per year through 2000 that the District used in its budget projections and no adjustment to the federal payment, the District will actually lose about $116 million in purchasing power during this period.

Major studies[2] performed on the District have concluded that there are inadequacies in the federal payment. For example, it does not fully compensate the District for (1) the additional responsibilities it carries as a result of the federal government's presence or (2) the loss of revenue due to federally imposed restrictions. This structural issue affects the District's relationship with the federal government and is one of the issues the Authority is expected to focus upon.

The District's ability to significantly increase its revenue is limited by the Home Rule Act and a large federal presence. Section 602 (a)(5) of the Home Rule Act prohibits the District from taxing nonresident income. Studies performed by the Rivlin Commission, the Appleseed Foundation, and the McKinsey & Company/Urban Institute concluded that this limitation deprives the District of a substantial potential revenue. The studies reported that the District's inability to tax nonresident wages results in a loss of revenue because nearly $2 of every $3 earned in the District is earned by nonresidents. In addition, about 42 percent of the assessed value of all land and improvements in the District is tax exempt and about 23 percent of the total assessed value is federal property. Thus, the District is unable to obtain revenues from a significant portion of its land.

Many sources have estimated the impact of eliminating the restrictions that prevent the District from taxing nonresident income and federal property. The D.C. Appleseed Center

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[2]These studies include those by the Rivlin Commission, McKinsey & Company/The Urban Institute, and the Fair Budget Coalition.

for Law and Justice[3] concluded that the removal of these restrictions could have resulted in estimated revenues for the District of $471 million in nonresidential income tax and $694 million in additional property taxes in fiscal year 1995, which is $505 million more than the $660 million federal payment received.

District's Overall Expenditures

The general fund, at $4.2 billion, or 79 percent of the District's $5.4 billion in gross[4] expenditures/expenses for fiscal year 1995, far exceeded the expenditures and expenses of the other funds that comprise the District's budget and, thus, is the primary focus of our analysis. Overall, expenditures/expenses increased from $5.5 billion in fiscal year 1993 to $6.0 billion in fiscal year 1994 and decreased to $5.4 billion in fiscal year 1995.

The significant change from year to year was primarily due to shifts in Medicaid and employee benefits expenditures/expenses between the years. Fiscal year 1994 had particularly large human support services expenditures because Medicaid expenditures increased by almost $300 million, of which more than $200 million was due to Medicaid

[3]D.C. Appleseed Center For Law and Justice, The Case for A More Fair and Predictable Federal Payment for the District.

[4]These amounts are the sum of total expenditures from the All Government Fund Types and Expendable Trust Fund's Combined Statement of Revenues, Expenditures, and Changes in Fund Balance and total operating expenses from the All Proprietary Fund Types, Pension Trust Funds, and Component Unit's Combined Statement of Revenues, Expenses, and Changes in Retained Earnings/Fund Balances.

cost reimbursement settlements with institutional providers for fiscal years 1991 through 1993. District officials do not expect this large Medicaid increase to reoccur in future years because the District has moved away from cost settlements for in-patient hospital services and now reimburses these providers based on predetermined rates. The District projects cost settlements of $66 million and $59 million for fiscal years 1996 and 1997, respectively.

Also, for fiscal year 1995 expenditures/expenses, human support services showed a reduction of more than $200 million, primarily because of a decrease in the projected liability for disability compensation. An error in the way the amount had been computed in the past was corrected in the fiscal year 1995 financial statement audit. Previous computations of future disability compensation had failed to show recipients being deleted after the legally required time for receiving such compensation had expired and the recipient was required to retire or go off of disability. This reduction should not reoccur and, thus, for trend analysis and comparison purposes, was added back to the reported human support services costs for fiscal years 1996 and 1997 budgeted amounts.

Notwithstanding the large Medicaid increases in fiscal year 1994 and the disability compensation adjustment in fiscal year 1995, our review found that the District's proposed expenditures in its fiscal years 1996 and 1997 budgets were generally comparable to the trends in its expenditures/expenses for fiscal years 1993 through 1995, as adjusted for its proposed initiatives.

This means that the District's projected fiscal years 1996 and 1997 budgets show expenses that (1) are about the same as those reported in 1995 adjusted for the aforementioned changes and (2) have slightly decreased on an inflation-adjusted basis. This outcome is consistent with most of the proposed initiatives in the District's financial plan being management initiatives, as opposed to significant restructuring (eliminating services, for example). Also, because they are management initiatives, they may be more difficult to achieve and will require a detailed plan for implementation and close oversight. However, in an effort to control spending, the Mayor, in his Transformation Plan, has proposed reducing full-time equivalents (FTE) from 40,000 to 30,000 by the beginning of fiscal year 2000.

Our more detailed review of the District's expenditures found that two critical cost drivers of the growth in the District's expenditures are Medicaid and pension costs. In addition, much discussion in the District's budget deliberations has focused on the subsidy costs related to two aspects of the District's operations--the general hospital and university. Each of these expenditures has a significant impact on the District's financial condition.

The discussion of these four expenditures in our testimony is not intended to minimize either the impact or the need to revisit other areas of the District's operations for budget savings or revenue enhancement opportunities. Clearly, areas such as the school system (the third largest expenditure), the court system, capital project needs, and others should

be more closely evaluated. However, our review showed that Medicaid costs and pension costs are the greatest risks to the District's financial viability from a cost perspective. In addition, because deliberations on the District's budget by District officials and the Congress focused on the D.C. General Hospital and the University of the District of Columbia, we also focused on these costs.

Medicaid Expenditures

Similar to the current national trend, and as we recently reported,[5] Medicaid spending is consuming an increasing share of the District's total health care expenditures. From fiscal years 1991 to 1995, the District's records showed that Medicaid expenditures for private[6] providers increased from $427 million to $744 million, or approximately 74 percent. The District projected Medicaid expenditures of $776 million and $780 million for fiscal years 1996 and 1997, respectively, and has made efforts to contain Medicaid costs, such as moving from cost reimbursements for institutional providers to reimbursements based upon diagnostically-related groups (DRG). However, based on the recent growth history of these expenditures and the poor[7] condition of the District's

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[5]District of Columbia: Information on Health Care Costs (GAO/AIMD-96-42, April 22, 1996).

[6]GAO's health-care report figures for Medicaid included expenditures for both public–District-owned facilities, such as St. Elizabeth Hospital–and private providers. The District 1997 budget and financial plan does not provide the total Medicaid expenditures but rather only provides the amount for private providers. During fiscal years 1991 to 1995, public provider expenditures approximated between $71 and $100 million per year.

[7]GAO/AIMD-96-42, April 22, 1996.

financial records that track and account for Medicaid costs, we are concerned that so little growth is projected in Medicaid expenses.

The District is responsible for 100 percent of the nonfederal share of all Medicaid expenditures. In other jurisdictions across the nation, states assume responsibility for this nonfederal share or require local governments, such as counties, to pay a portion of these costs. As we previously reported,[8] only three[9] states require their local governments to pay more than 25 percent of this nonfederal share for Medicaid services. Most notable is New York state's requirement for its local governments, including New York City, to pay approximately 50 percent of this nonfederal share, except for the long-term care program, for which it pays 19 percent.

As noted, New York City pays a Medicaid matching percent significantly less than the District. In addition, Philadelphia pays nothing for Medicaid. If the District would pay 50 percent of its nonfederal share of expenditures, or the equivalent of a 25 percent match of its total Medicaid expenditures comparable to New York, or pay nothing, similar to Philadelphia, the impact on the District's financial condition would be significant. If the fiscal year 1997 budget submission, which included total private-provider Medicaid expenditures of $780 million, was modified to show either change, the District's financial

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[8]Medicaid: Local Contributions (GAO/HEHS-95-215R, July 28, 1995).

[9]New York, New Hampshire, and Arizona are the only three states that require a contribution of more than 25 percent of the nonfederal share from their local governments for Medicaid services, not administrative costs.

picture would shift from having a net cost of at least $390 million (100 percent of the nonfederal share or a 50-percent match) to a net cost of $195 million, when made comparable to New York City, or zero compared to Philadelphia.

While placing the District on comparable footing with New York City and Philadelphia would significantly improve its financial and cash position, longer-term solutions would have to address many other issues that would need to be considered in such a complex discussion.

The Unfunded Pension Liability

In looking at the District's financial condition, the unfunded pension liability represents one of its greatest long-term challenges. Today, the unfunded liability stands at $4.7 billion and is expected to increase to $7 billion in 2004.

The Congress created defined benefit pension plans for District police officers and fire fighters in 1916; teachers in 1920; and, judges in 1970. These funds were financed on a "pay as you go" basis. The responsibility for these payments and the related, and then undetermined, unfunded liability were transferred to the District as part of Home Rule. The District of Columbia Retirement Reform Act, Public Law 96-122, in 1979 committed

the federal government to pay $52.1 million annually from 1980 to 2004 to partially finance the liability for retirement benefits incurred before January 2, 1975.[10]

In 1980,[11] the federal government provided $38 million to the District in addition to the first of 25 annual payments of $52.1 million to the pension funds authorized by the Retirement Reform Act. The then present value of these payments equalled $649 million. The present value of the pension liability at the time of the transfer equalled $2.7 billion, resulting in an unfunded liability to the District of over $2 billion.

The District has funded[12] (that is, covered the costs of the benefits participants have earned in that year) all benefits that the pension plans' participants have earned after fiscal year 1979 and paid in an additional $1.2 billion towards the unfunded liability through the end of fiscal year 1995. Table 1 shows an analysis of the unfunded pension liability since the plan was transferred to the District and the estimated payments for fiscal year 1996 and 1997.

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[10]See District Pensions: Federal Options for Sharing Burden to Finance Unfunded Liability, pages 14-18 (GAO/HEHS-95-40, December 28, 1994).

[11]GAO/HEHS-95-40, December 28, 1994 and D.C. Appleseed Center, The District of Columbia's Pension Dilemma-An Immediate and Lasting Solution.

[12]D.C. Appleseed Center, The District of Columbia's Pension Dilemma-An Immediate and Lasting Solution.

Table 1: Unfunded Pension Liability

Dollar in millions

Fiscal year	Unfunded pension liability	District contribution	If fully funded 1979 net normal cost	Excess District contribution
1980	$2,006	$108	$89	$19
1981	$2,134	$110	$93	$17
1982	$2,336	$136	$89	$47
1983	$2,874	$143	$85	$58
1984	$2,936	$174	$103	$71
1985	$3,393	$165	$110	$55
1986	$3,594	$175	$119	$56
1987	$3,458	$173	$96	$77
1988	$3,614	$179	$103	$76
1989	$3,853	$193	$106	$87
1990	$3,820	$222	$118	$104
1991	$4,005	$225	$112	$113
1992	$4,249	$254	$121	$133
1993	$4,152	$291	$135	$156
1994	$4,337	$307	$142	$165
1995	$4,526	$297	$135	$162
1996	$4,780	$337	$133	$204
1997	$4,973	$321	$126	$195

Source: D.C. Retirement Board.

Despite these efforts, the unfunded liability is now estimated at $4.7 billion,[13] and is expected to increase to $7 billion[14] in 2004 due to the accumulation of interest owed on the unfunded portion of the pension liability transferred to the District back in 1979. Similarly, the District's pension payment, which is currently approximately $300 million a year, is expected to increase to $490 million starting in 2004.

The Appleseed Foundation[15] concluded that these pension plans' unfunded liabilities should be the responsibility of the federal government since the liabilities are the results of federal actions predating the Home Rule Act. Our analysis shows that if the District did not have the responsibility for the costs of these plans related to the unfunded liability, the pension expense in its proposed fiscal year 1997 budget would be reduced by $195 million from the $321 million currently shown in the proposed budget to $126 million. This change would have a major impact on the projected budget deficit for fiscal year 1997.

Similar to the Medicaid discussion, many other factors also need to be considered longer-term in deciding the best way to address the escalating pension costs that the District will pay.

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[13] D.C. Appleseed Center, The District of Columbia's Pension Dilemma--An Immediate and Lasting Solution.

[14] GAO/HEHS-95-40, December 28, 1994 and D.C. Appleseed Center, The District of Columbia's Pension Dilemma--An Immediate and Lasting Solution.

[15] D.C. Appleseed Center, The District of Columbia's Pension Dilemma--An Immediate and Lasting Solution.

Subsidy Payments

Two other major costs for the District that have been regularly discussed in budget deliberations are the costs for D.C. General Hospital and the University of the District of Columbia. The District paid subsidies to the hospital of $59 million, $47 million, and $57 million for fiscal years 1993, 1994, and 1995, respectively. It has projected for fiscal years 1996 and 1997 that it will pay subsidies of $47 million and $52[16] million, respectively. Similarly, the District paid the university subsidies of $68 million, $66 million, and $50 million, for fiscal years 1993, 1994, and 1995 respectively, and projects to pay subsidies of $43 million and $44 million for fiscal years 1996 and 1997, respectively.

Our recently issued report on health-care delivery[17] in the District pointed out several challenges that confront the hospital if it is to remain viable, including major capital improvements. In New York City's effort to turn its financial problems around, it closed a municipal hospital, had massive layoffs at others, and relied on the other hospitals in the city to absorb some of the role it had in delivering hospital care for city residents. The District has proposed creating a Public Benefit Corporation to include the hospital's operations and that would allow the hospital to operate separately from the city entirely, including the city's personnel requirements and collective bargaining agreements.

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[16]The projected fiscal year 1997 amount includes $15 million for the public health clinics, which were transferred to the hospital.

[17]GAO/AIMD-96-42, April 22, 1996.

However, based on the projected budget subsidies, it is unclear as yet if this initiative will save the city money or, if so, how much.

The District has not yet evaluated the financial structure of its university system to identify ways to make it less costly. However, Authority officials stated that the University of the District of Columbia had raised its tuition to offset more of its costs. At the time of its financial crisis, New York City turned its senior university system over to the state to run and operate. New York City's presence in delivering this service was scaled back dramatically and, for the most part, involved delivering higher education at the junior-college level, charging tuition for the services, and providing the services at significantly less cost.

THE DISTRICT'S CASH POSITION

From the inception of its financial crisis, the District has had cash flow problems. In fact, District officials project that the District will run out of money this month. The District took several measures to address its cash flow shortage. For example, in fiscal year 1994, the District delayed pension, vendor, and Medicaid payments and borrowed internally from its capital projects fund. In fiscal year 1995, the District again deferred payments to its vendors and, as stated by the Chief Financial Officer (CFO),[18] the District began fiscal

[18]Testimony of District CFO Anthony A. Williams before the House Subcommittee on the District of Columbia, Committee on Government Reform and Oversight, March 28, 1996.

year 1996 with approximately $200 million to $300 million in delayed payments owed to vendors and Medicaid providers.

In fiscal years 1995 and 1996, the District also borrowed short-term from the U.S. Treasury to finance operations and capital projects. Fiscal year 1996 borrowings against the fiscal year 1997 federal payment are estimated to total $639 million of the $660 million fiscal year 1997 payment. Specific short-term borrowings for fiscal year 1996 are shown in table 2.

Table 2: Short-term Borrowings for Fiscal Year 1996

Dollars in millions

Fiscal 1996 Short-term Borrowings	
October 1995[a]	$96
January 1996 [a]	$283
Planned July 1996[b]	$260
Total	$639
Fiscal Year 1997 Federal Payment	$660

[a]District's Cash Flow Statements–D.C. Treasurer.

[b]Office of the Chief Financial Officer.

By borrowing against future revenue to pay for these goods and services already received, the District has not resolved its cash flow problems but has only postponed them.

During fiscal year 1995, the District's investment grade general obligation debt was down-graded to noninvestment grade. Because of this non-investment grade rating, the District's sources for obtaining long-term financing are limited and the interest cost of obtaining financing in the capital markets could be costly. The District's financial plan discusses two borrowing options, and another option was recently added for obtaining funds from capital markets. The District accepted a proposal to issue $220 million in general obligation tax revenue anticipation notes. The District expects these notes to be issued shortly. We did not review this proposal as part of our work.

The first option in the District's financial plan includes the District borrowing short-term from the U.S. Treasury using the subsequent year's federal payment as collateral to fund its operations and capital projects. The second option includes the District borrowing $500 million for accumulated deficit financing and $900 million (that is, $150 million in each of the next 6 years starting in fiscal year 1997) to meets its capital needs. In addition to these borrowings, the District will still need short-term borrowing for cash flow purposes.

Under the first option, the District projects that by April 1998, it will have borrowed against the entire fiscal year 1998 federal payment and will not have cash sufficient to meet its operating needs. Under current law, the District may borrow from the U.S. Treasury to meet its capital and cash flow needs, and such borrowings are payable from the subsequent fiscal year's federal payment.

There are no provisions in the current law for long-term borrowing from the U.S. Treasury or for deficit financing of the District's operating deficits. At present, the District must repay Treasury loans within 12 months. Also, section 461 of the Home Rule Act authorizes the District to enter into long-term borrowing by issuing general obligation bonds only for capital improvements or to refund outstanding indebtedness. The District of Columbia Emergency Deficit Reduction Act of 1991, Public Law 102-106, authorized the District (on a temporary basis ending on September 30, 1992) to issue general obligation bonds to finance payment of the $332 million accumulated operating deficit in the general fund at the end of fiscal year 1991. In addition, section 603 (b) of the Home Rule Act provides that the District may not issue general obligation bonds (other than to refund outstanding indebtedness) if the District's debt service in a fiscal year exceeds 14 percent of the estimated revenues during the year the bonds are issued.

By the end of fiscal year 1996, the District's debt service is forecasted to be at approximately 11.9 percent of estimated revenues. Thus, the District would need to seek additional legislative authority before it plans to issue long-term debt to fund capital improvements if it plans on exceeding the 14 percent limit or to finance the accumulated operating deficit. The District would also need to seek legislative authority in order to engage in long-term borrowing from the U.S. Treasury.

The New York City and Philadelphia control boards, during the first year that the boards were in place, obtained long-term borrowings to finance their respective accumulated

deficits. New York City, which at the time had an accumulated deficit of $6.2 billion, received about $3.6 billion as deficit financing and exchanging of notes. Philadelphia had both accumulated and projected deficits at the time its control board borrowed $475 million, as shown in table 3.

Table 5: Pennsylvania Intergovernmental Cooperation Authority Borrowing: Uses of Proceeds of Fiscal Year 1991 Serial Bonds

Dollars in millions

Funds to city for deficit reduction[a]	FY91 (cumulative)	$153.5
	FY92 (projected deficit)	$94.9
	FY93 (projected deficit)	$7.8
Subtotal		$256.2
Grants for capital projects		$120.0
Grants to productivity bank		$20.0
Debt service reserve fund		$47.5
Capitalized interest		$20.0
PICA expenses		$0.6
Financing costs		$10.9
Total		$475.3

[a]Philadelphia's actual deficit for fiscal year 1992 was $71.4 million, and it reported a surplus of $3 million in 1993. Thus, Philadelphia was only required to borrow $225 million for deficit financing.

Source: Offering Statement, June 1, 1992, p. 6.

Like New York City and Philadelphia, the District's accumulated deficit and any approved projected deficits should be fully funded through longer-term borrowings or other means,

including the need for any approved capital projects funding. In addition, a funding mechanism should be established that ensures sufficient funds for its immediate short-term cash needs. Along with this funding, the District's financial plan should be modified with enough revenue enhancement efforts and/or deeper budget cuts to fund the repayment of any long-term debt incurred and current operations without incurring further budget deficits.

THE NEW YORK CITY AND CITY OF PHILADELPHIA CONTROL BOARDS

We also reviewed the actions taken by the New York and Philadelphia control boards whose cities also faced serious financial problems. These were the New York State Financial Control Board (FCB) (including the Municipal Assistance Corporation (MAC)) and the Office of the State Deputy Comptroller (OSDC), and the Pennsylvania Intergovernmental Cooperation Authority (PICA).

New York City ended fiscal year 1976 with an annual operating deficit of $1.2 billion and was burdened with an accumulated deficit of approximately $6.2 billion. Throughout fiscal year 1976, numerous actions were taken with the assistance of FCB and MAC to prevent the city from going bankrupt.

During their first year in operation, in order to eliminate the budget deficits and cash shortages of New York City, the following MAC and FCB recommendations were

implemented: (1) the workforce was reduced by about 40,000, or 13 percent, from its June 30, 1975, level,[19] (2) remaining city employees' wages were frozen for 3 years, (3) tolls on bridges and tunnels were increased, (4) commuter and subway fares were increased, (5) municipal hospitals had massive layoffs, (6) the tuition-free policy of the City University of New York was terminated, and (7) taxes were increased by about $775 million. In addition, the FCB adopted a resolution urging the State to assume the costs of maintaining courts and correction facilities, and the State enacted legislation in that year to assume these costs. MAC helped to establish the New York Council on the Economy, which addressed, among other things: (1) relieving the stock transfer tax burden on state and city businesses, (2) developing Battery Park City, which represented a stimulus to the financial real estate market, and (3) constructing a new convention center.

A key component in New York City's plan of recovery was the comprehensive overhaul and reform of the city's accounting and budgetary practices. The objective was the installation of a new integrated financial management system (IFMS), a computerized system for accounting, budgeting, purchasing, and payroll, linking the myriad of city departments and operations for the first time into one system with a single database.

This project received the highest possible priority as fiscal year 1976 advanced. The OSDC was given oversight responsibility for this project. Professional personnel were

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[19]We did not receive sufficient information from New York City to quantify the savings that were realized from the FTE reductions, wage freeze, increases in transit fares, tolls, etc.

recruited, in some cases "loaned" by leading banks or corporations, and contracts were put into place with private accounting and systems management firms for work that could not be performed in-house. The system was implemented in July 1977. In addition, a management plan was implemented that enabled the city to monitor its operations continuously. The management plan and reports identified opportunities for improved performance. To strengthen management of this program, the Mayor, who was also a member of the FCB, established an office of operations.

In addition, the oversight boards helped New York City gain funding from various sources, such as the state, commercial lending institutions, city and state pension funds, and the federal government. Despite the highest degree of commitment evidenced by New York State to avert a bankruptcy, it became apparent that federal assistance was essential. As a former congressman, and Chairman of the FCB, the State Governor worked with New York City in the first control year to attract needed federal assistance, which was key to the City receiving federal loans and loan guarantees. By the end of fiscal year 1976, MAC bonds and notes outstanding on behalf of the city were approximately $3.9 billion, which stabilized the City's cash position.[20]

According to New York City officials, the control boards made significant contributions. The governor in his elected capacity and as chairman of the FCB committed himself fully to assist the city. The FCB and its professional staff and the State Comptroller provided

[20]Municipal Assistance Corporation 1976 Annual Report.

strong support and guidance. MAC carried out its distinctive role to finance the city and ease its debt obligations. The State Legislature and the U.S. Congress responded to New York City, and the U.S. Department of the Treasury expressed its faith in the City's plans and progress.

In fiscal year 1992, Philadelphia had an operating deficit of $98.7 million and an accumulated deficit of $153.5 million; however, by the end of the fiscal year, PICA had taken actions to eliminate the operating and accumulated deficit.

In PICA's first year, it borrowed about $475 million in Special Tax Revenue Bonds on behalf of the City of Philadelphia. The bond proceeds were used to fund the cumulative deficit, current year and subsequent year deficits, and certain capital projects and productivity enhancement initiatives.[21] In addition, Philadelphia imposed a 1 percent sales tax, renegotiated labor agreements, and collected back taxes. As a result of the 1 percent sales tax, revenues increased by $52.3 million for fiscal year 1992. The renegotiation with the labor union led to a 33-month wage freeze and extensive restructuring of health benefits agreements to achieve cost savings and reductions in paid holiday and sick leave. Delinquent tax collection increased by 10 percent annually.

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[21]Pennsylvania Intergovernmental Cooperation Authority, Financial Statements for the Period from June 5, 1991, to June 30, 1992, and Independent Auditor's Report, September 3, 1992.

A PICA "authority tax" was approved by the Philadelphia city council in June 1991. This is a 1.5 percent tax on wages, salaries, commissions, and other compensation earned by residents of the city and on the net profits earned by businesses, professions, or other activities conducted by residents of the City of Philadelphia. This revenue goes into a Special Revenue Fund collected by the Commonwealth of Pennsylvania. A portion of the PICA tax is used to cover PICA debt service and other PICA expenses, with the remaining revenues going to the "City Account."[22]

In 1992, Philadelphia began the process of updating its financial and information systems to enable operating departments to obtain more detailed management information on a daily basis. It also began contracting out custodial work in all of its central facilities, saving the city an estimated $700,000 annually, in addition to improving the quality of services in city offices and transit concourse areas. Other productivity measures, which began in 1992, included a competitive contracting program and renegotiation of real estate leases resulting in savings of $1 million for fiscal year 1993.

Finally, Philadelphia achieved a balanced budget in fiscal year 1993, 2 years after its control board was established, and has sustained it through fiscal year 1995. New York City achieved a balanced budget in the sixth year of its control board's operation and has

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[22]"The City account" is considered a trust fund for the exclusive benefit of Philadelphia, and is used to maintain the proceeds of taxes or other revenues pledged by the Authority to secure bonds.

sustained small surpluses through 1995. The FCB has been in an advisory role since fiscal year 1986, after the city had sustained 6 consecutive years of balanced budgets.

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Mr. Chairman, this concludes my statement. I will be happy to answer any questions that you or the other Members of the Subcommittee may have at this time.

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Mr. DAVIS. Ditto what I said to the other two. Thank you very much.

Mr. Hayden, thank you for being with us.

Mr. HAYDEN. Thank you very much. I am pleased to be here this morning and to be invited to speak with this group. It isn't often, I think, that investment bankers are involved in this type of discussion.

I have given written testimony, and I am going to comment on some of that this morning, particularly as it relates to investors in the tax-exempt market and the District of Columbia. I am not going to talk about budgetary or credit issues.

Let me preface my remarks by also saying that markets are a moving target. What may be valid one day may not be valid in another week or another 2 weeks or another 3 weeks. But the problems confronting the District are fairly broadly known in the capital markets and certainly within the tax-exempt market.

There are some things I may say today that are not in my written testimony which I think are also important. We have done, and I have done, a great deal of research in the marketplace in recent weeks and months, regarding the District's situation.

Part of that comes about because, as you probably know, we were the second bidder—or we would call it the cover bid—on the short-term notes. We structured our ability to underwrite the notes a little differently in that we canvassed the letter of credit opportunities within the marketplace exhaustively and came up with one bank that was willing to put an LOC behind the District's short-term notes.

I am not going to talk directly about that, other than to say that, when you are outbid, we take our hat off to those who structured a security as Lehman did for you, but it does show there was access to the short-term market. I think that access could continue, particularly when I hear about the kinds of covenants and securities that were put behind it, which the Control Board has the ability to do.

One might say that the assurances that the Control Board can give and is giving through its activities is clearly what is recognized in the marketplace and is the major factor that is opening up access to the markets. But there is a big difference between the short-term market and the long-term market.

I doubt if we could find today—and I am saying today very specifically—any significant amount of credit enhancement for the District's long-term debt, and that seems to be one of the major questions in front of us.

Let me focus a little bit on the long-term debt situation. You have asked what must happen for the District to attract reasonable conditions for its long-term borrowing. The answer is very clear. The District or whoever issues on its behalf, in other words the Control Board, would have at least one, preferably two, investment grade ratings. There would be a very small subset of buyers of unenhanced long-term District of Columbia bonds. And when I say a subset, I am talking about a universe of buyers of tax-exempt bonds around the 400 range. With an unrated, unenhanced security, that number of potential buyers drops off to the 20 to 25

range. So you can see the narrowness of the market obviously is considerable.

Do I believe—and I want to be very clear on this. This is not in my written testimony. Do I believe there's a market today for unenhanced District of Columbia securities? I would say yes. The caveat of that is at what rate?

But I do think that there is a market, and I can talk about where I think that market would be because of the other issues that are selling in the market. These are not credits, but we have seen unenhanced, unrated securities, which some call junk bonds, in the 7.5- to 9-percent range.

I cannot tell you there is an amount available in the market of $500 million—which would finance a deficit financing, but I think there would be a significant amount; approximately, say, in a range of 8 percent.

And I think, as I hear the other speakers here this morning as they go through the various steps and pieces of the puzzle over the next few months, and if various kinds of progress are made, that that potential market will continue to be there and be even stronger.

But I want to call to your attention, if you do not have it in front of you, a few other items in my written testimony.

I believe very strongly that the Control Board itself could achieve an investment grade rating and create a new security distinct from the District's name. One of the benefits of that happening, which has been done in the past both with Philadelphia and the city of New York, is that a new security under a new name is perceived differently by the buyers in the marketplace. Buyers that may not be able to buy the District's credit committees may not approve it, may very well approve a Control Board issued security with its name on it. This would expand the universe of buyers beyond what I indicated.

I understand and we have had the experience in New York of the political problems of another entity run by unelected officials taking out a revenue stream of the District's or, in the previous case, New York City's, and having control of that money.

I might suggest to you that—and it is in the law financing undertaken by the Control Board as presently enacted would extend its control over the pledged revenues for the period those obligations are outstanding.

I suggest to you that if anyone decides to change the act in certain ways, there may be a way to impact that concern. The Control Board has other mechanisms in its legislation go out of existence at some point.

The Control Board can also relinquish control of the administration and of the moneys held under any bond issue that they issued on the District's behalf if and when the District met all of the requirements presently outlined in the act. Bonds could be brought back under the control of the administration of the chief financial officer when the District returns to investment grade ratings or any other criteria that we outlined in any such amendment. I suggest that that may be a consideration.

Let me move on quickly. Obviously, there is concern about the District's ability to carry additional debt service in its existing reve-

nue base. In the absence of achieving additional budgetary capacity, a deficit financing program would have to be carried out and accomplished in conjunction with a debt restructuring program, which you asked about.

You have asked the question regarding restructuring. Determining the amount of outstanding GO debt that could be restructured is dependent upon the tax law of 1986 and the goals of restructuring.

Let me be clear that no one of these things can operate in and of itself. A deficit financing, a restructuring, the work that is being done by the Authority which is recognized as making tremendous progress in changing the techniques in the administration of the government, all are important together, and it is all of these things together that will put the District back on the road to recovery and ultimately an investment grade rating and acceptance in the marketplace. All of those techniques have to be done as a package and not independently.

In my testimony I have given a chart which will give you some idea of the current debt service payments, and it will show that in the next 8 to 10 years the debt service payment out of the operating revenues is quite onerous. We have shown in there an example of what would happen if you did a restructuring to move some of that debt out further. There is no present value savings. As a matter of fact, over a period of time there would be a dissavings.

But what a restructuring of that nature would do is allow some relief in the operating budget in the levels of money necessary for debt service over the next few years.

I show you that because, without debating whether or not there will be additional revenues made available to the District, given the present situation, the restructuring, the deficit financing, and obviously reducing expenses and other things the Authority do could all provide some relief under the amount of debt service done in the next few years, which is approximately $400 million per year. It could be brought down closer to the, say, $350 or $325 million level with some of them.

Let me close with one or two items. I want to go back again because I know you have a great interest in long-term financing, and it seems to me that there is and can be a viable way to do it. I am prepared, in questions and answers, to give you my best estimates today in terms of what the numbers would look like if the District had an investment grade rating or if it did not have one.

I would estimate that over the life of a deficit financing the difference between investment grade and noninvestment grade ratings would be approximately $125 to $150 million.

In summary, let me just say that I agree with the GAO report that you forwarded with your questions that the accumulated deficit needs to be dealt with as soon as possible, in the next fiscal year; further, that it needs to be dealt with in a plan to restructure existing debt service. A deficit financing is not a solution in and of itself. If this is done, I think the capital markets would view this as a substantial step forward in solving a fiscal crisis.

The chief financial officer of the District has initiated actions, reported in the press and in the Bond Buyer and other media that

investors read, with the strong support of the Control Board in the area of expense cuts and staff reorganization and management.

Further actions by the chief financial officer backed by the continued strong support of the Control Board are necessary. These actions, as well as cooperation and agreement to a plan from the District government, would result in further market acceptance quite rapidly and put the District on a significant road toward recovery and improved capital market access.

I hope these comments, which are made to be constructive, are helpful, and I would be pleased to try to answer your questions.

[The prepared statement of Mr. Hayden follows:]

Testimony of

William H. Hayden
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New York, New York

Before the

District of Columbia Subcommittee
Committee on Government Reform and Oversight
U.S. House of Representatives

July 19, 1996

I am pleased to appear before you this morning to comment on the credit market's perception of the District of Columbia (the "District") and the Financial Responsibility and Management Assistance Authority (the "Control Board"). I will comment on those matters relating to my expertise in the credit markets and as they relate to investors in the tax-exempt market. I will leave budgetary and credit rating issues to those who are more directly responsible for and involved in those matters.

I can with certainty say that the District's ability to accomplish its recent short-term borrowing says nothing about the District's ability to access the private financial markets for long-term borrowing. The two markets are entirely distinct. It is my belief that the District cannot at the current time complete a long-term borrowing of any significant size, at any reasonable interest cost. Whether it can do so in the foreseeable future depends on the ability of the District, the Congress and the Control Board to assist the District in regaining investment grade status through the structural reforms and leadership initiatives now being implemented. Further, until investment grade status is achieved, I do not believe the District will be able to attract any significant amount of credit enhancement for its long-term debt.

I can be fairly clear on these points because Bear Stearns is a major participant in and is knowledgeable about both short-term and long-term market sectors.

The District's recent experience with an unenhanced short-term borrowing illustrates the challenges. The 5.48% rate being paid on these notes, which have only a $2^1/_2$ month maturity, is close to the cost of an insured 20 year bond at approximately 6%. This is not to suggest, however, that credit enhancement is available for long-term District debt. Bear Stearns prepared a competing proposal for the District's short-term financing that would have resulted in a public sale of District notes that were credit enhanced by a major international bank. We

canvassed 14 banks to ascertain their interest in enhancing the proposed $2^1/_2$ month District note, and identified only one potential source of credit enhancement. It is very unlikely that any of those creditworthy financial institutions would be willing to enhance District long-term bonds at the present time.

Now, I will turn to the appetite of long-term investors for long-term unenhanced District debt. We have canvassed a number of major institutional investors as to their interest in buying unenhanced District bonds. Investor demand is very limited and would be very expensive. You may be aware that there is a $2-3 billion annual market for nonrated high yield tax-exempt debt. These tend to be corporate-type issues that are sold on a nonrated basis. The purchasers typically derive from 20-30 high yield bond funds and investment managers, who independently determine that the issues meet a minimum credit standard. As a result, these issues are sold on a nonrated basis. The typical tax-exempt borrowing cost under current market conditions for a 30 -year term bond is a range 150 to 350 basis points higher than an insured issue, ($7^1/_2$% to 9%).

In contrast, the District is publicly rated below investment grade by all three rating agencies ("Ba" by Moody's, "B" by Standard & Poor's and "BB" by Fitch Investors Service). These public ratings provide little or no room for high yield buyers to evaluate the District's credit and independently to determine that it is minimally investment grade. As a result, the universe of potential buyers declines further to a very small number, severely limiting the amount of debt that could be sold on this basis. Correspondingly, with the lack of demand the cost of the District's borrowing would increase.

You have asked what must happen for the District to attract reasonable conditions for its long-term borrowing. The answer is that the District must obtain at least one, preferably two, investment grade ratings. Short of the rating agencies' determining that the District's own general obligation credit has been restored, there is a small subset of buyers of unenhanced long-term District bonds in the tax-exempt market.

We believe strongly that the Control Board can achieve an investment grade rating for a new credit that is distinct from the District's. One should look to instances where separate agencies issued debt on behalf of their financially troubled cities. The Municipal Assistance Corporation For The City of New York was the first such entity. The Pennsylvania Intergovernmental Cooperation Authority ("PICA"), which assisted the City of Philadelphia in its financial crisis, is a more recent example. Investors will want assurance that the Control Board which creates a

new security, has complete control over a pledged revenue stream and that the pledged revenues are predictable and of strong credit quality. These are facts with clear cut examples that have been done successfully.

The importance of the Control Board having complete control over the collection and disbursement of pledged revenues for a new security is illustrated by Standard & Poor's rating for the District of Columbia Land Redevelopment Agency's Sports Arena Special Tax Revenue Bonds. S&P rated the Agency's Special Tax Revenue bonds the same as the District's general obligation bonds, explaining that the lockbox mechanism does not protect against the alternative use of pledged taxes which remain under the control of the District. It does not appear feasible for the District to establish its own dedicated tax credit, based on this experience. Moreover, our survey of several institutional investors revealed that buyers would prefer a new Control Board credit rather than another District name.

Any financing undertaken by the Control Board under the Act as presently enacted would extend its control over the pledged revenues for the period that obligations were outstanding. With improvement of the District's credit quality, the Control Board's control over other District financial matters will terminate. According to Section 209 of the Act, termination of the control period occurs when,

> " the District government has adequate access to both short-term and long term credit markets at reasonable interest rates to meet its borrowing needs and,
>
> for four consecutive fiscal years (occurring after the date of the enactment of this Act) the expenditures made by the District government during each of the years did not exceed the revenues of the District government during such years (as determined in accordance with generally accepted accounting principles, as contained in the comprehensive annual financial report of the District of Columbia...)"

With the termination of the control period, the District would have demonstrated a high degree of fiscal responsibility, which has demonstrably allowed the District to successfully manage its finances. However, the pledged revenues would still remain in the lockbox mechanism under the control of the Control Board and its trustee.

Because the District has no authority to borrow from the Treasury for operating purposes, and because there is limited market access for the District's long-term unenhanced securities and because no new revenue source appears likely, it would appear to me that the most viable source of long-term financing available to the District is for the Control Board to issue long-

term obligations to finance the deficit. I believe such a financing could be constructed to receive an investment grade rating which in turn would receive strong market acceptance. Unless, a new source of revenue is created to be used as a pledge for the new "Control Board" security, the new security would have to use monies from the current revenue stream.

There will obviously be some concern with the Control Board issuing debt securities and the effect it would have on the longevity of the Control Board.

Let me suggest that if this committee saw fit to change the existing Act there may be a way to impact this concern. The Control Board could relinquish control of the administration and monies held under the bond issues if and when the District met all of the requirements presently outlined in the Act. The bonds could be brought under the control and administration of the Chief Financial Officer when the District returns to investment grade ratings and the criteria to be outlined in any amendment.

There would also be serious concern about the District's ability to carry additional debt service payments in its existing revenue base. In the absence of achieving additional budgetary capacity, this deficit financing program would have to be carried out and accomplished in conjunction with a debt restructuring program.

You have asked the question regarding restructuring. Determining the amount of outstanding District General Obligation debt that could be restructured is dependent upon current tax law and the goals of the restructuring. The Internal Revenue Code of 1986, as amended, imposes limitations on municipal issuers of tax-exempt bonds with respect to when and how many times tax-exempt bonds can be refunded.

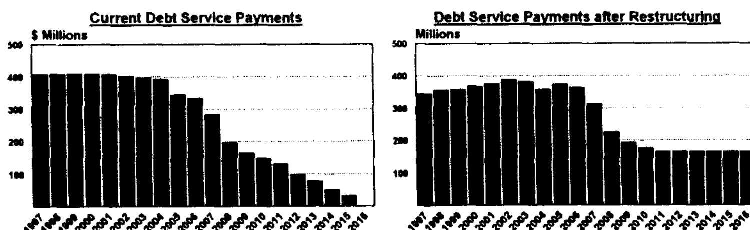
Municipal issuers often restructure or refinance debt to achieve objectives other than pure interest rate savings. For example, financing techniques can be used to achieve a more levelized overall debt structure or to provide cashflow relief in a certain number of years by shifting a portion of the debt service to later years. These are techniques that we believe may be necessary to assist the District in providing responsible budgetary reforms and eventually achieving investment grade ratings and market access.

The District has approximately $3.4 billion of General Obligation bonds outstanding. Approximately $1.2 billion of outstanding District General Obligation bonds could potentially be restructured, assuming the existing limitations of the Internal Revenue Code of 1986, as

amended. Theoretically, all of these refunding candidates could be restructured, however, restructuring only a portion of the debt can achieve near term budgetary objectives. The restructuring should be undertaken within the context of the District's and the Control Board's long-term comprehensive financing and budgetary plans.

The District's General Obligation debt service schedule is onerous over the next eight fiscal years, with annual debt service payments of approximately $400 million per year. Without an additional revenue source, the District's current revenue base would have difficulty in paying principal and interest on the existing General Obligation debt and also on any debt issued to fund the District's cumulative deficit. A restructuring could be undertaken to provide budget resources for deficit bond amortization and other economic recovery purposes such as tax reductions and other economic development efforts.

By restructuring approximately $391 million of outstanding District General Obligation bonds maturing in the eight years between FY1997 and FY2004, and moving the principal out to as much as 20 years, approximately $321 million of net debt service payments can be removed from these eight years, given current tax laws and market conditions. Under the District's Chief Financial Officer and the Control Board's strong leadership, cashflow savings could be used to amortize the proposed deficit bonds or expended on capital improvements and other needs. A restructuring will achieve a more level aggregate debt structure since principal (and the interest thereon) is shifted to later years, although the overall life of the District's General Obligation debt would not be significantly lengthened. We note that reducing debt service payments in the early years results in higher debt service payments (i.e., an economic loss) in the later years. See charts below.



It would appear that such a restructuring of debt on behalf of the District would provide some relief in the operating budget for debt service over the next few years.

In summary, I would agree with the GAO report that the accumulated deficit needs to be dealt with as soon as possible and further that it needs to be dealt with in a plan to restructure existing debt service. A deficit financing is not a solution in and of itself. If this is done, the capital markets would view this as a substantial step forward in solving the fiscal crisis. The Chief Financial Officer of the District has initiated actions with the strong support of the Control Board in the area of expense cuts and staff reorganization. Further actions by the Chief Financial Officer, backed by continued strong support from the Control Board, are necessary as well. These actions, as well as cooperation and agreement to a plan from the District government, would result in further market acceptance quite rapidly and put the District on the road towards recovery and improved capital market access.

I hope these comments which are meant to be constructive are helpful.

Mr. DAVIS. Bill, thank you very much.

Let me give you a special thanks for being here today. Bankers usually don't like to testify alone. I want to thank you for your willingness to appear here. We appreciate your being here and your very insightful remarks.

I thank all of you for being here. I just have a few questions I want to go through for the whole panel. Let me ask, what is the difference now from a year ago?

A year ago the city could not have gotten any short-term lending; is that correct? I want to mark the measure of progress. A year ago the city could have received the short-term lending that they were able to get?

Mr. BRIMMER. My judgment is, a year ago the city would not have gotten any short-term money. They would have had to borrow from the Treasury.

Mr. HAYDEN. My view is that the market perceives the Control Board to be the trigger. It has provided strong leadership, and that is the difference.

Mr. DAVIS. Thank you very much.

Let me address a couple of key questions. I find it compelling, that the accumulated operating deficit and the cash shortage of the District of Columbia is a constant and burdensome drag on the city. It has prevented both the city and the Control Board from making reforms and the progress you could make if you weren't consistently battling to pay old bills and find the cash to meet the next payroll. Does everybody agree with that?

Mr. HOLLOWAY. That is correct, Mr. Chairman.

Mr. DAVIS. Considering the present nature of the deficit and the cash issues, the projected future deficits, and the narrow surplus that is currently forcasted after the year 2000 it appears there is no way to cut spending or raise revenues in a fashion to deal with this problem. It seems absolutely imperative that some way be found to fund deficit and secure the city with a reasonable cash position.

Dr. Brimmer.

Mr. BRIMMER. I agree with that conclusion, Mr. Chairman. I would also like to stress a matter as pointed out earlier by Mr. Williams. That is, the city is already borrowing to cope with the deficit. It is borrowing from vendors and others who are providing goods and services to the city on credit. And so that is the nature of the requirement, that the shifting—that the way this is shifting, it should be taken off the backs of vendors and others and funded in the capital market.

Mr. DAVIS. Good point. There are a lot of vendors that won't even deal with us. That ends up making the city pay more because of competition.

Tony, do you agree with that underlying thesis?

Mr. WILLIAMS. It is definitely true, Mr. Chairman, and a number of our vendors want to be paid in advance, and that is clearly, as you know, an inefficient way to do business. Your optimal way to do business is to manage your cash on a turnaround in payments of 30 to 45 days, not payment up front. To the extent we have to do that to get any kind of service, we are at a disadvantage.

I would also say the city is at a disadvantage—something about the Control Board is a trigger. I want to emphasize that I think in terms of this retirement of this long-term debt or the effective management of this long-term debt, I think if I look at the past year, at least my 9 months here, I think one the biggest problems we have had is that we put in place a Control Board without the firepower it needs to effectively do its job.

It has been—I don't want to imply it has been ineffective—to more efficiently do its job in the way boards in Philadelphia and New York have done, both in the kinds of securities that they pledge of revenues or resources it can grant to borrowings, but, even more importantly, the ability in the first instance to effectively get rid of the security deficit so it can effectively direct the city, with the Mayor, to the resolution of important management problems.

And rather than doing that, we spent the last year trying to get a budget, talking about whether we need long-term financing. It is a very disruptive way to do business.

Mr. BRIMMER. Mr. Chairman, may I go back and comment on the question about the ability——

Mr. DAVIS. If you would move the mic closer to you, we will hear you better.

Mr. BRIMMER. I would like to address the question of the Control Board's ability to borrow in the market on its own. In my prepared statement, I mentioned——

Mr. DAVIS. I read your comments, and showed them to my chief staffer seated here. I think he went out and talked to Mr. Hill. I am very interested in what you have to say on this.

Mr. BRIMMER. That is right. Under the act, the Mayor would have to make a request to the Council to approve to borrow. If the Council approved that, then the matter comes to the Control Board.

If the intent is to borrow on behalf of the city—that is, if the city is to be the one taking on the obligation—I believe that would have to be approved by the Congress. However, if the Control Board is to be the one taking on the obligation, the process would require that the Mayor make the request, go to the Council, and if the Council approves it, then the board could decide to go into the market and issue the bonds itself. That would not require congressional authority.

Mr. DAVIS. Correct.

Mr. BRIMMER. However, in my judgment, market participants, investors who are going to buy these long-term bonds, would probably expect to see some indication at least that the Congress would not oppose this. So that is just my judgment.

Mr. DAVIS. Mr. Hayden, do you agree with that? Do you think it would strengthen it?

Mr. HAYDEN. I think this would strengthen it.

Mr. DAVIS. I am not sure of the best way Congress could do that. We didn't want to write this in the legislation because you know how tough it can be to do things up here.

Mr. HAYDEN. At every instance I think the markets and bankers perceive this: The Control Board, the District, and the Congress

have to work together cooperatively, and every time that comes forward, it strengthens the position.

Mr. DAVIS. OK. That is fine. That is what we are here to understand. We were hesitant to put that in originally because we wanted to give you full authority, and because moving anything through the House and the Senate in tandem can be difficult sometimes and time consuming.

Mr. BRIMMER. Mr. Chairman in operation, I can assure you that while we would not come to the Congress and say, should—will you—do you believe we should do this? We would clearly inform you of our intention and seek your reaction.

Mr. DAVIS. What about a comment period where Congress would have days to overturn it if they didn't like it? That wouldn't have the same effect as a positive?

Mr. BRIMMER. This is an interesting question as I raised it with Mr. Hill. If the Council passes legislation, the legislation itself has to be approved by the Control Board and, second, has to come to the Congress for a layover period for a comment. So I believe that the fact that the Council passed enabling legislation would automatically give the Congress an opportunity to reflect on that.

Now, Mr. Chairman, if the board concludes that a borrowing is necessary, it would have the authority to identify the collateral and to divert or put a claim on a revenue stream available to the city to provide the collateral. So that, in itself, would give additional enhancement and security to borrowers taking that paper.

So I wanted to make those comments, Mr. Chairman.

Mr. DAVIS. I appreciate that. We will further explore that too, our staff to yours, and if we need to put some additional legislation in, we will try to do that.

Mr. HAYDEN. I agree exactly with what Dr. Brimmer said, and I want to call your attention to a remark that I made earlier. As I understand the act, there are several ways in which the Control Board can work itself out of its job, which I am sure some of them would like to do.

Mr. DAVIS. They are listening.

Mr. HAYDEN. There are several ways, but one of the things in this act, as I read it, is that if the Control Board—the Authority—were to issue securities, that it must stay in existence the length of the term of those securities. Now, if this were 15- or 20-year bonds, this may go well beyond the period of time that there are other triggers within the act that would put the Control Board out of business.

What I am suggesting to you is that you seriously look at, in conjunction with what Dr. Brimmer said of the Congress putting its stamp of approval on it, that I think the market would be willing to accept any changes you wanted to make in the act that would allow those securities to be issued, but the administration, the transfer and the control of those moneys put back to the District and the chief financial officer at some time prior to the longest maturity of the security. That may be important for political and other reasons, and I recognize that.

Mr. DAVIS. But couldn't the city at that point, in their strengthened position, refinance the debt?

Mr. HAYDEN. They may have a better deal even in place.

Mr. DAVIS. That would depend on where the interest rates are at the time and other things.

Mr. BRIMMER. Mr. Chairman, one additional comment about the long-term prospects of the city regaining access to the capital bonds, and that is the shadow, the overhang of the unfunded pension fund.

Mr. DAVIS. No question.

Mr. BRIMMER. It is my conviction, if I were a long-term investor looking at buying a long-term bond issued by the city under any auspices, the city or the Control Board, extending beyond 2004 or thereabouts, or whatever the date is that is set to trigger the transfer to the District from the Federal Government of the obligation to fund or otherwise manage that unfunded pension fund, I would see the following.

Currently, the city is required to set aside some $350-odd million a year to contribute to the pension fund. At some point down the road, around the date I mentioned, if the plan—the law continues to operate and is now on the books, the city will have to set aside $700 or $800 million a year to provide for the funding of that pension plan.

Now, if I were an investor, I would see that as a potential claim on the city's resources and ability to service any debt, and that would be a negative for me.

Mr. DAVIS. Right.

Mr. BRIMMER. Therefore, I believe that as we look ahead, one of the things we have to do, strictly from the point of view of financing and market access, is to remove that uncertainty and those fears generated by that kind of overhang.

Mr. DAVIS. Mr. Hayden, would you agree with that?

Mr. HAYDEN. I do, especially because I have not read any credit report from any credit-rating agencies that doesn't put that issue right up front.

Mr. DAVIS. Thank you very much.

Mr. Holloway, I had talked earlier about funding deficit and securing the city in a reasonable cash position. Do you agree with that? It appears no way to cut spending and raise revenues in a way fashioned to deal with this problem, and it seems absolutely imperative that some way be found to fund the deficit so the city is in a reasonable cash position.

Mr. HOLLOWAY. I think it is crucial that this be done, and if I were to make a couple of comments without saying ditto, I would comment on what Mr. Hayden said as well as Dr. Brimmer.

There is a final point that I would want to make. At least as I hear Mr. Hayden—I certainly don't want to put words in his mouth—it seems to me that what he is suggesting, that to whatever extent that the Congress would be willing to confer to the Control Board and the CFO its confidence and the freedom and capacity to borrow whatever they thought was necessary and to execute it, I think it would be viewed as a good thing and something helpful toward improving the investment grade and the other things associated with that. So I think that is important.

I guess if I didn't register what I will call the concern for shortsightedness and not looking beyond the year 2000, and particularly if people are talking about deficits coming back again, I have to

come back to the structural issue, as Dr. Brimmer alluded to at least part of it, in regards to the pension.

But I think there are a number of other structural issues that need to be dealt with so that you have a financial plan that extends beyond the year 2000 that is going to deal with that, because otherwise what you are going to end up with, even if you refinance and stretch out the note, is the burden on future generations. It is just something to think about, be mindful of, as you go into this debt scenario, the need to really deal with all of those structural issues.

Mr. DAVIS. Thanks.

Let me try to, if I can—I think there are a lot of ways that we could deal with this issue, and I am going to ask Ms. Norton to join me as we try to address it.

Congress could appropriate about $650 million for the District now, but I don't think that is going to happen. You have just been through the appropriations process, and I don't think that is likely to happen.

Ms. Norton, do you?

Ms. NORTON. I concur, Mr. Chairman.

Mr. DAVIS. The District could go to the private market, making long-term borrowing, but I think today's testimony has clearly demonstrated that the District cannot do this and receive favorable treatment and interest rates.

Does everybody on the panel concur with that?

Mr. BRIMMER. Mr. Chairman, I believe at this juncture the District trying to borrow in its own name without the explicit undertaking of the Control Board, I don't think it could do it.

If the decision were made to rely on the Control Board as the borrower, I believe there are certain conditions under which that could be done sometime in fiscal year 1997. So I put it that way. Anything can be done in the remainder of fiscal year 1996. But I believe in fiscal 1997, this could be done if the Control Board were prepared to certify that there had been enough progress in the management of the District's finances typified by progress on the deficits and so on; it could be done.

Now—but, I believe that even with the Control Board's name and authorities, it would be very, very difficult to get the highest investment-grade rating, and for this purpose I am thinking of a rating at least BAA using Moody's classification as investment grade, and how much beyond that is another question. But even then, it would be a question of how much premium, what the spread would have to be on that. And I think conditions could be fashioned under which that could take place, but it would take a great deal of care and crafting and providing the kind of security the market would require.

Mr. DAVIS. At this time; right. And we know what our job is the next few months to try to get that rating.

Is there no disagreement with that, Mr. Williams?

Mr. WILLIAMS. Mr. Chairman, let's see. OK, first of all, in any of this borrowing I think it is important to look at the fundamentals. We talk about "credit structure this," "credit structure that," but fundamentally you have District agencies, District vendors, agency heads, and indeed the District public contributing to this problem, because there have to be sacrifices made to achieve the

budget discipline to support the debt service behind all these obligations. I think that is very, very important to understand.

I am not a big fan of the notion of District versus Authority. Maybe it is because of my position. I think that the Authority is indispensable in terms of sponsorship and authorship of this borrowing. But the District is important as well, because the Authority—indeed, the CFO—can only direct. It is the District agencies and the District government that have got to achieve the follow-through that makes all of that occur. I think it is very, very important to understand that and that we not get into this District versus Authority issue.

Mr. HAYDEN. Mr. Chairman, if I may try to round that out. The way in which people are going to look at this, any financing, today, not 6 months from now but today, the existing amount of revenues that the District has to spend, now if you are going to issue debt—and I am saying that this is now without any new sources of revenues—the existing source of revenues would have to be earmarked to repay the debt, whether the District issued it or whether the Control Board issued it.

Either way, you are playing now with the same amount of revenues. The only way within the budgetary cap or even the debt issuance cap, given the existing revenues that are going to fit all of that in, as Mr. Williams has just pointed out, is going to be a very stringent budget process of cutting expenses or, as I mentioned before, restructuring debt, which would give some level of relief in the next few years in order for that new debt service to be absorbed in the operating budget.

If you do it with an investment grade rating or if you do it without an investment grade rating, the difference over a period of time, as I mentioned before, could be $125–$150 million. I subscribe that any investment grade rating, whoever gets it, even the lowest investment grade rating, is what is needed, because you can then use other financial techniques such as insurance or whatever, to improve the rate in the marketplace to a AAA rating.

Mr. WILLIAMS. I guess what I am saying, Mr. Chairman, is that the board has a leadership role in this but it has got to be a cooperative, collaborative venture with the District. That is the point.

Mr. DAVIS. It is the city that wants to get back in the market, more than anybody, I would think, by themselves, and not have to go through the Control Board.

Mr. WILLIAMS. I think the board would admit, the District has training wheels right now. That is the way we have to ride around. We need it, but in the long term we need to be able to ride on our own. You can't win the Tour de France on training wheels.

Mr. DAVIS. That was well spoken. I guess Congress could also pass legislation opening a Treasury borrowing window for the District for long-term borrowing. We initially had a 10-year window in the Control Board legislation, but we had to delete it when the Congressional Budget Office scored it and said that it cost the Federal Government money.

While the Treasury may be working on such a proposal, nothing has been forwarded to us at this time. I feel compelled to state that I am not sure Congress would pass that at this juncture. I just haven't found significant support.

Ms. Norton, would you care to comment on that, or not?

Ms. NORTON. Mr. Chairman, that is a matter that I really do think should be revisited in light of what the Treasury is trying to do and in light of what you and I have seen happen on the aqueduct proposal. Initially when this matter was brought up in the last session of Congress, the scoring kept us from moving ahead on aqueduct. The fact is that Mr. Warner has been able to get a review by the CBO which resulted in a no scoring for borrowing——

Mr. DAVIS. For a couple of years.

Ms. NORTON [continuing]. For the aqueduct.

And I do think—I agree with you about the difficulty of getting congressional approval, but everybody has to understand that leadership from this committee and from the Appropriations Committee, I think, would be determinative there, because people don't look very closely at DC matters, and I don't blame them.

So if this committee had full confidence that Treasury borrowing or long-term borrowing was, in fact, necessary, I believe we could get the support of the Speaker, I believe we could get the support of the minority leader, and I think that might work, and it is worth exploring.

Mr. DAVIS. We will continue to work with the administration to try to get some language that will do that.

Under the provisions of Public Law 104–8, the Control Board could borrow on behalf of the city if the District requests such action. It seems that this is a very viable option at this time, which is one of the reasons I called this hearing. I think that the Control Board and the city have to figure out what needs to be done for the Control Board to borrow and proceed to do so. I will let Ms. Norton respond if she would like to, or she can wait until it is her time. You have sketched out carefully that this has to be a collaborative effort between the Control Board and the city to convince the markets, whichever way we move forward.

Mr. Hayden, in your testimony you said that the Control Board would need to secure control of significant District revenue in addition to the 20 percent that it already controls in order to receive favorable treatment. Is that a fair position?

Mr. HAYDEN. What I mentioned—this is one part of revenues, and a portion—a necessary portion of those revenues would be diverted to be the security behind any issuance of bonds that the Control Board would do, whether it be a sales tax or what other revenue source. And I have looked at various things, and it gets complicated to get into it. There are ways to do it.

Obviously, you want to minimize the amount of money that you would have to divert to secure it, and I mentioned before that the control of those moneys under the act very strictly stays with the Control Board, if that answers your question.

Mr. DAVIS. Mr. Williams or Mr. Holloway, do you have any comment on that?

Mr. HOLLOWAY. I would agree with you.

Mr. DAVIS. Ditto.

Mr. HOLLOWAY. Ditto.

Mr. DAVIS. Dr. Brimmer, have you had any discussions with industry officials about the situation, whether they will be willing to

allow the board to go forward with this arrangement, or do you think it is premature?

Mr. BRIMMER. I missed the last part of your question.

Mr. DAVIS. Did you have any discussions with the city in which they said they will be willing to allow the board to go forward with this arrangement to secure greater debt?

Mr. BRIMMER. No, we have not had any discussion; we have not raised the question. My comments were based strictly on the reading of the statute.

Mr. DAVIS. I understand. We have to look at reality.

Mr. BRIMMER. Yes, and of course, Mr. Chairman, if the question of borrowing were to be raised, we would definitely have to raise those questions.

Mr. DAVIS. I think they probably ought to be raised. I am speaking as one member of our committee that believes that this is something that has to be raised with the city at this point, and if you need any persuading of the city to cooperate, I will be happy to help out.

Just a couple of other questions.

Mr. Hayden, you referred to the political difficulty of the city turning over revenue streams with the condition that the control board stays in place until the debt is retired. Isn't that the same situation as in New York?

Mr. HAYDEN. That is a continuous issue in New York. The moneys that were diverted to the bonds that were issued there have a surplus behind them, and it becomes a political question year in and year out. When the city needs money to meet its existing budgetary things, the control of how that money is spent becomes an issue, and civic groups and others take different sides as to which way to go.

But clearly, legally, it is under the control of the board that issued the securities, and the city has to, in turn, negotiate with them as to how this money is ultimately spent in any given year. If they refund something and they have $100 million that they can make available to the city, they sometimes attach strings to it and it becomes an issue.

Mr. DAVIS. My understanding is, the city could always refinance when it gets an investment grade rating, but it may not be advantageous to do so, and you believe there may be some legislation we could write to bridge that gap.

Mr. HAYDEN. I think that you could, and I think it would be acceptable in the marketplace.

Mr. DAVIS. I am intrigued by that suggestion, and we may be more fully exploring that in the weeks to come.

Finally, Mr. Hayden, let me end right there and just say that I appreciate all of you being here today. I may have a couple of questions following Ms. Norton's, but at this point I appreciate your comments. I think you shed a lot of light on where we are today, what exactly the short-term borrowing means, and what the city, the control board and Congress we need to do together to move forward in the next few months.

I now yield to the ranking minority member. I appreciate her forbearance as I used over my allotted time to try to complete my questioning.

Ms. NORTON. All time is your time, Mr. Chairman. Thank you very much.

Let me first try to get some basic facts down. The numbers, the amounts, involved for long-term borrowing are almost always said necessarily in large generic numbers. What is the amount? And how much has it increased this year from last year in the deficit borrowing that would be necessary?

Yes, sir; Mr. Williams?

Mr. WILLIAMS. I would just throw out very briefly, Congresswoman Norton, the fact that you could, I think, using an accounting approach or using the approach of simply adding up yearly deficits, come to an actual cash need by the industry on the order of magnitude of $650 million.

It then becomes a question of, what is the city's capacity to meet all or part of that need? And it was our judgment—and Dr. Brimmer can speak for the board, but it was our judgment that the city, that the District—that is, either the District or the Authority—had the capacity to only address a part of that need. I think it is on the order of $500 million. So the ability to meet more or less of that depends on the rating, the structure, and all of these factors that we are talking about today.

Ms. NORTON. What makes it—what would make it unwise or impossible for long-term borrowing to meet the full need? Security? What is it that prompts——

Mr. WILLIAMS. I think it is a question always for the issuer of what terms, what costs, what schedule, what are the circumstances of the borrowing?

And the secondary question, in terms of one issue, getting it to an investment grade, what is the overall impact, short-term and long-term, on the District's recovery to investment grade ratings?

And I think it is the judgment here—and Dr. Brimmer can speak to this—that the best way to move in this direction is for the District to work with the Authority, and the Authority issue debt.

Mr. BRIMMER. Ms. Norton, may I comment on that, please?

I would frame the question in two parts. One is, what is the present size of the cumulated deficit? What are the prospects for the cumulated deficit, say, over the next several years? And then second, what are the limits, if any, on the ability of either the city or the board to borrow to meet that cumulated deficit?

The figures I have suggest that the deficit—and this is an estimate made by our staff—that in 1994 the cumulative deficit was $324 million; in 1995, that rose to $379 million; in 1996, $495 million. The estimate is, for 1997, $594 million; 1998, $688 million; 1999, because of the modest surplus received for that time, the annual surplus, the deficit would be $686 million; and in the year 2000, $685 million.

Now, the second question to this at any point in time: How much can be borrowed to finance or cover part or all of that cumulated deficit? It is my understanding that there is a ceiling on indebtedness which the city can undertake, and that is determined by reference to a number of factors, one of which, I believe—is it 14 percent or something of that sort?

Mr. HOLLOWAY. Fourteen percent, and it is a specific definition for current revenues, but you cannot have debt service in any given year that would exceed that 14 percent.

Ms. NORTON. Unless we raise the——

Mr. BRIMMER. That is the factor that generates the limit. And given revenues and that 14 percent factor, that appears to be—appears to produce a borrowing capacity in the neighborhood of $500 million. That is how I would—that is borrowing by the Authority under the cap.

Ms. NORTON. Under the cap, yes.

I note that the figures escalate as the years go by on the order of $100 million or so a year. Is that a function, in part, of declining revenues?

Mr. BRIMMER. Well, basically what you see there—and, again, as Mr. Williams mentioned, depending on which accounting method or approach you use, the increment you see is substantially due to the annual deficit.

So basically—and I am going to say this, although there isn't precise precision here—basically, what is happening is that you start with a deficit in one given year, and then, depending on how—and then you run a deficit next year, and depending on how you treat that with some offsets or modifications, you add that net to the previous year, and that is what you see, Ms. Norton.

The jump, for example, you see—and if you don't mind, I would like to share this chart I have.

Mr. DAVIS. We welcome it. Thank you.

Ms. NORTON. Because I am trying to understand why—if the jump takes place in part because you don't have offsets included in the figures for the latter years.

Mr. DAVIS. Without objection, the chart will be put in the record.

Mr. BRIMMER. What you see, the figures I gave you from the box at the lower right-hand side, and the graph, the bars, show—if you notice, and you look quickly at the arithmetic, you will notice, for example, the rise from 1995 to 1996, that captures mainly the deficit of $168 million.

Let me repeat, my statement is a general statement. Greater precision would explain that more fully, but at this juncture I would not like to go into the details behind the arithmetic. But that is what you are seeing; that is the profile of the cumulated deficit over time.

Mr. HOLLOWAY. Congresswoman, may I amplify on what Dr. Brimmer said? Simplistically stated, the incremental increase he is talking about is, you start with what the actual deficit was at the end of 1995, and then you just effectively are adding the projected deficits for 1996, 1997, and so on, that have incrementally increased that.

I think the important thing to note is that what the deficit is believed to represent, and for the most part does, are goods and services that you have already received that you owe somebody for because your expenditures have exceeded your revenues. So the arithmetic of adding those projected deficits to the existing one is what creates the amount that is needed in terms of projected finance.

Ms. NORTON. In light of what you just said, Mr. Holloway, when the Mayor testified here as recently as March, he indicated that

the city was about $300 million behind in payment to vendors. Now, I don't know what that figure represents, whether that is, in fact, a figure that Mr. Williams would stand behind, and, if we are talking about $600 million deficit at this point, what the other $300 million is about by years.

I would like to get some sense of what is owed to vendors now and whether the remaining $600 million, assuming we are working with that figure, represents prior years or represents something else.

Mr. WILLIAMS. Congresswoman, the situation that we have now is that we are essentially rolling forward this accumulated deficit by using Treasury short-term borrowing.

Now, what that means is that even though we have made substantial progress over the last 9 months in getting our vendors essentially down to good business terms, our vendors right now, with the exception of vendors who are victims of the procurement financial mess process, which is a caveat—with the exception of that, vendors are on good payment terms.

So the problem is that these vendors always face the specter of some calamity. They face the specter, but for the short-term borrowing debt, a calamity, boom, we are back 6-, 7-months vendor wait. Or, indeed, by 1998, if we continue to use the Treasury short-term window for capital and short-term cash-flow needs, that source of funds evaporates by 1998. That is the problem that our vendors face. It is this constant anxiety and this notion that, by 1998, that is it.

Ms. NORTON. What is the—is the $300 million then an amount currently owed to vendors?

Mr. WILLIAMS. No. It is not an amount currently owed to vendors; it is the fact that we are rolling it forward and the vendors constantly face the specter of disaster.

Mr. HOLLOWAY. As Tony uses the phrase, "rolling it forward," you are borrowing against next year's money, so that when you get to next year, the money is already spent, so you end up back in the hole. And even though by doing that you currently can pay people, where it appears that they are current, you recognize that there is a shortfall that at some point is going to come home to roost.

Mr. WILLIAMS. It is like you had a house and you took out a second mortgage and now you are using Visa/Mastercard to pay your mortgage on the house rather than just refinancing the house.

Ms. NORTON. All of us, seeing this hole and the accumulated deficit, of course, have fastened upon the only thing we can think of. When the chairman asked his rhetorical question to me, did he believe the Congress would finance the deficit? I should have added, Mr. Chairman, that not only do I not believe this Congress, but if I get my wish and it is a Democratic Congress, it will not finance the deficit either.

Having put off the table all of the immediate sources of any possible——

Mr. DAVIS. That is present company excepted.

Ms. NORTON. Always. Always, Mr. Chairman.

I do want to make sure that I am not walking down a road whose true implications I don't understand, and I guess my question really is a question of whether it is worth it.

If all that we see that is possible, but as I understand the testimony of one of you—I don't know if it was Mr. Hayden or who—that 20 percent of our revenues go to secure debt now. So one thing I would like to know is whether that is typical.

Mr. WILLIAMS. It is about 12 percent, Congresswoman—somewhere in there.

Ms. NORTON. It is a 14 percent cap.

Mr. WILLIAMS. We cannot go over 14 percent debt service to local revenue.

Ms. NORTON. Is it true that it doesn't go over? How does that compare to other cities?

Mr. WILLIAMS. I think Dr. Brimmer, Mr. Hayden, or Mr. Holloway had commented on this. But right now we have a heavy debt load compared to other cities, and I think this 14—personally, I think 14 percent is a good disciplinary device. I don't think we want to go far over that. Maybe 14 percent itself is not the right figure, but we need that kind of discipline.

Mr. BRIMMER. I do not know what the figures are, but the concept is one that is very clear. What we are saying is that no more than 14 percent of current revenue can be used for debt service. I believe there ought to be some restraint on that.

But think about it; up to 14 percent of current revenues not used to pay for goods and services but to service your debt. If we were a developing country, for example, and looking out to the world's capital market, we would say that that is a heavily indebted country, and I think we ought to look at it in the very same way.

Ms. NORTON. As a raw figure, it makes sense to me, but I am left to say, compared to what?

Mr. HOLLOWAY. I think that the challenge is, I don't know that there is any magic to the 14 percent, but I kind of share what Tony said, that there needs to be some limit that someone has economically looked at, because there is a longer-term financial burden on the District that will continue to the extent that you allow that to rise, which obviously restricts the current year moneys at any given point in these future years.

And think of it as a fixed cost, something that you have to pay, which now means that, there is now money that you cannot use in a discretionary way to do other things.

But I think that the challenge that keeps coming back to this, at least from where I sit, is the desperate need to deal with the structural aspects of the budget. I think it would be foolish to just borrow the money without looking at, how do we create the relationship of our revenue to the expenditures?

And you have to recognize the current flow of the revenues which we have some control over to know that either you have got to do something about those expenditures, whether it is enhancing them by reducing them through some subsidy of Medicaid or assistance on the pension or whatever form, or actual additional budget cuts, because the revenue stream, at least to the extent that the District controls it—which I will style local revenues—is clearly on the flat line.

So unless you deal with some of those other structural things that get that budget in balance to where it can support that, I think you are an accident waiting to happen to just borrow the money without consideration of that.

Ms. NORTON. Dr. Brimmer.

Mr. BRIMMER. Ms. Norton, may I go back to the question of the 12, 14 percent ceiling. I just learned from Mr. Hill that the GAO did a study recently; in fact, he was responsible for it. We did compare the debt service burden's ratios of the District with a number of other jurisdictions, and one problem that arose in trying to measure that is this.

The District has some local revenue, some Federal revenue sources, and other cities cannot duplicate that precisely. But there is in the report a third description and analysis of what those are. I will get a copy of that report and submit it for the record, and hopefully that would answer your questions somewhat more fully.

Ms. NORTON. I would appreciate it, because having some basis for comparison also elucidates the issue.

Mr. Holloway mentioned that revenues have a flat line. Actually, as I understand it, our revenues have been going down, and I would like to know to what degree revenues have been going down and from what year. Did it begin in 1993? Did it begin in 1994? I understand we are at least $100 million, some say $150 million, down this year. I would like to know how much at this point is revenue down; how many years prior to this have we had a year in which revenue has been going down; and, what is the major source of the decline in revenue?

Mr. BRIMMER. Ms. Norton, I have in front of me a report from the budget we submitted which shows our revenue for the last couple of years at a projection out to 2000 with some detail on the sources of the revenue.

In general, the revenues captured for the budget, these are the major sources: Taxes, nontax revenue, fees and a lot of other things; the Federal payment; and certain transfers into the city; there is a line for grants, private and other sources; and there is the Inter-District fund, and there is the Enterprise Fund.

In combination, all of those sources provided revenue of $5.1 billion in 1994. In 1995, the total revenue was $4.9 billion. For 1996, the projection is again $4.9 billion. For 1997 the budget we just submitted, it is $5 billion; 1998, $5.1; 1999, $5.3, and the year 2000, $5.5.

How would I characterize that profile? I would say it is stagnation through the interim period with a slight rise anticipated for the outyear, the year 2000.

With respect to the components, I will simply say we start off with tax revenues in 1994 of $2.5 billion, and that stream remains essentially stagnant throughout the entire period; just $2.5, $2.4, $2.3, $2.4, $2.4, $2.4, $2.4. And that is the principal source.

The other major source of revenue, of course, is the Federal payment, and for this projection we have assumed it remains constant at $660 million.

Those are our figures on revenue sources and prospects, Ms. Norton.

Mr. HOLLOWAY. Congresswoman Norton, I think the short answer to your question is that property tax revenues are going down. Effectively, that has been somewhat offset by sales tax revenues and some other things, but the principal driver that is declining in the revenues is the property tax revenue. If you want to get into inflation-adjusted dollars by leaving the Federal payment flat, that means a loss of economic——

Ms. NORTON. Is this basically commercial or residential?

Mr. HOLLOWAY. It is basically commercial, for obvious reasons. You see consolidation of the Federal Government; you see rents declining, which lower assessed values, which lower the amount of tax you can collect even if you retain the same base.

The principal driver that is pushing it down is property taxes, and that is one of the concerns, even in the budget, is that the difficulty of that is, you just don't know what direction that market is going to go. And the thing that you alluded to earlier, if you lose the middle income people, that is going to push personal property tax down; you have more housing that is available and unoccupied. All of those factors devalue your property taxes, because it lowers your assessed base, and that is the primary driver of the decline.

Ms. NORTON. And we cannot know, from what you say, that—particularly when you consider where you say the commercial drops come from, we cannot project that those will turn around.

Mr. HOLLOWAY. Absolutely, that is true, and that is one of the things that you have to be ever mindful of, and I think that is why there is the need to revisit the entire structural aspects of the District's budget, is because there are those kinds of things that you need to be mindful of, how much more of that middle-class population you might lose, that could be a detriment of the assessed value of how many homes that are here. There are so many things right now that could have an effect on that, but that is clearly the aspect of revenue that is declining.

Mr. BRIMMER. Ms. Norton, I have in front of me from the budget, the full document we submitted, a table which shows each of the tax revenue sources in great detail. They confirm what Mr. Holloway just said, but several of them stand out and are quite striking, given our recommendation and what I stressed in my testimony about the need to have some secure revenue sources down the road.

Real property—just benchmark—the real property taxes, $640 million in 1996, that drops to $600 million in the year 2000. Sales taxes in fiscal year 1996 generated $507 million. By the year 2000, that is up to $530 million. The income tax—and this is one of great interest to me—the income tax yielded $658 billion in the year 1996; next year, $656, $667, $576, and projected $682.

Now that is the District's share—that is the tax revenue from the District's taxation, of that portion of personal income which the District can tax, and there are other sources, but I want to stress, those are the three principal ones, and they show stagnation. As I look at that profile, I see no boom in any of those tax sources. I see stagnation to decline.

Mr. HOLLOWAY. If I could just amplify that just for one other point—and I think it goes to something I have at least heard on a couple of occasions you to say—which is, there is also, in addition

to a need to tighten up expenses and the other things, you have to look at a way to enhance revenues, and when you start focusing on the key one that is going down right now, it begs the question, to have as part of whatever strategy you have to look for opportunities for economic stimulus to the District, whether that is keeping businesses in there or keeping people in there. And as I said before, Congressman Walsh, if you will pass that 15 percent Federal tax for the District, I will be the first middle-class person to move in—lower-middle-class, but middle-class person, to move in.

Ms. NORTON. Let me ask about the security on any long-term loan and what the option for security on any long-term loan may be.

Mr. HOLLOWAY. I think Mr. Hayden would probably be in the best position to talk about it, but the most obvious one is, it would have to be some form of a tax revenue stream, more likely than not. But I would defer to Mr. Hayden to provide his professional advice on that.

Mr. HAYDEN. Well, let me first say once again, whatever the revenue stream is, it is coming out of existing revenues, whichever it may be. So any one of these revenue streams that has been spoken about is possible.

Mr. BRIMMER. While he is doing that, may I just comment briefly that any long-term debt, any debt that is offered in the marketplace, must have collateral. Let me repeat, it has to be collateralized. There has to be some way to provide the debt service and ultimately to assure that the principal will be repaid.

So, for the city, the question is, what kind of collateral can it provide? I suppose under certain circumstances—I find it hard to visualize what they might be—the city could mortgage some of its property and provide collateral. Alternatively, the city would have to provide——

Ms. NORTON. Some of its property, Dr. Brimmer?

Mr. BRIMMER. If it were a going business, how can you provide collateral? You can provide collateral by giving the debtor a claim on your assets, or you can assure the debtor that there would be an income stream sufficient to provide the collateral and assurance to assure that the debt service will be paid and that eventually the principal will be paid. For this city, that is a revenue stream, and then it is a question of which revenue stream and so on.

I just wanted to say that that is my conception of how to frame the question.

Mr. HOLLOWAY. The one other thing you might be mindful of, and my recall is that PICA, which was the Philadelphia one, they have effectively created a new tax that at least in part repaid the debt that was dedicated to support that borrowing.

So it is not only your existing streams, but even as you look at structurally how the District is set up, I know a favorite discussion that a lot of people throw out is a commuter tax and some other things that I am not advocating, and please don't interpret it that way.

Mr. DAVIS. Calling it a favorite, I think, is——

Ms. NORTON. Your mouth has just been washed out with soap by the chairman.

Mr. HOLLOWAY. I think it is a mistake to just solely look at existing revenues; you need to look at the whole package. And Dr. Brimmer is right; I don't know that you could get enough District buildings put together to come up with sufficient collateral.

Mr. WILLIAMS. Congresswoman Norton, I would just make the important distinction to not further confuse this but just to add a little more clarity between structured debt and generality obligation pledged by the Authority or the District or some combination.

General obligation pledge, you are just generally relying on the good faith and credit of the underlying District to perform, ability and willingness to pay. In a structured situation, you would be dedicating some kind of sales or income tax or property tax or revenues; that is the distinction. Mr. Hayden can probably go into it better than I can.

Mr. HAYDEN. A dedicated tax bond is the language. The credit quality of the revenue stream, debt service coverage levels, and management and control over those revenues, are what are going to be important to the rating agencies and the ultimate buyer.

There are at least three revenue streams of the District which would bear consideration, individually or combined, as primary sources of security for principal and interest payments on either the Control Board's bonds or a dedicated issue by the District. One would be the real property tax; two, general sales and use tax; and three, the individual income tax.

Ms. NORTON. Are any of those revenue streams already pledged in any significant amount to secure debt?

Mr. HAYDEN. Well, yes, they are pledged under the general obligation tax revenue. This would have to be carefully structured, as I say, it is all in the same pot of money, in that 12 percent that they say is outstanding debt, does have a claim on all the revenues in a general obligation basis.

So the question, will there be some concern? Yes, there will be concern on the part of present bondholders and the rating agencies as to how we structure this and where we get that revenue stream.

Ms. NORTON. Especially what has been said about the revenue streams for the foreseeable future.

Mr. HAYDEN. I am very confident that it can be done.

Mr. BRIMMER. Ms. Norton, there are also other short-term tactical arrangements that can be made to help out. For example, as you know, the District has given thought to a securitization to some of its tax means. That says you could use claims if you could sell them in the marketplace, and in this case, at some discount, you acquire some short-term accommodation for cash-flow. So you could do things like that. Clearly, that is not a long-term—that is not a solution for a long-term borrowing.

Mr. HAYDEN. Probably the best would be a combination of a number of things. My colleagues just point out to me receipts tax on utilities. There is a whole number of revenue streams that can be mixed and matched and patched together to do this.

Ms. NORTON. That is very helpful.

Could I just note for the record how much revenues have declined below the initial projections that you made for fiscal year 1996. Are we on target? Obviously, we saw a decline in revenues.

Had the decline in revenues been as much as you projected for fiscal year 1996?

Mr. WILLIAMS. Congresswoman Norton, we made a revenue projection for 1996 as part of the revenue projection for 1997. It stands at $116 million in terms of gap between expenditures and revenues for 1996, and I have been instructed by this Congress and this Board that that is a nonnegotiable number. In other words, we will hit that $116 million target. In other words, revenues are declining at the projected forecasted rate.

Ms. NORTON. Right, because you are making a decline in the projected forecasted rate; I get it.

Mr. HOLLOWAY. I think he is saying he is also modifying expenditures to keep the gap.

Mr. WILLIAMS. To maintain that gap.

Ms. NORTON. He is making his decline at the projected rate, and I understand what that means.

Mr. BRIMMER. May I suggest that what the CFO is doing is entirely consistent with what was anticipated in the act. Our guidance to the Control Board is that if a gap is emerging between expected revenues and actual revenues, then we must review that and take note of it, then make some suggestions as to what, if anything, should be done to correct the situation.

Mr. Williams had made that review. We asked for information. He supplied it, and we reviewed the information and concluded that it was necessary to take steps to assure that that gap was closed, and what he described in our actions he has taken to meet that requirement.

Ms. NORTON. Can you tell from that whether the problem was that agencies didn't make their targets, whether the problem was that tax receipts were lower than you anticipated, or whether the problem was that costs exceeded anything we had any reason to expect?

Mr. WILLIAMS. Congresswoman, I think when the Authority set the established fee budget for 1996 in March, I know it was a little late, but there were lots of long stories, as you know. When it established the budget for 1996, it had cognizance of a gap of $116 million, and what we are simply saying is that agencies now must maintain spending at the budgeted level which will keep that gap consistent.

Ms. NORTON. I understand what you are saying. I am trying to find what it is that is a major contributor.

Mr. WILLIAMS. Can I answer that? The major contributor to our problems—and I think Dr. Brimmer has commented on this and Mr. Holloway as well—is that expenditures overall in the out-years in this financial planning budget are increasing at 6 percent and revenues are increasing at only 1 percent and in real terms are declining, and therein lies your basic problem.

Ms. NORTON. You have to come to grips with the gap in those two numbers before we get to 1990 or the year 2000, because those numbers simply don't vanish by themselves unless there is going to be a gold rush boom in the District. Those are emergency numbers, as I hear them. That gap is extraordinary.

Mr. WILLIAMS. I think Dr. Brimmer has talked about the structural issues and economic issues, and I would let him speak to that.

Ms. NORTON. I am describing the gap to you, and what Mr. Holloway said earlier has everything to do with that. My concern is that we continue to hear these figures from you and we sit here assuming there is something you can do to close that gap.

Mr. BRIMMER. When you say close, that gap is enormous. I hope you are putting the emphasis on 1996. If you look through the outyears, the gap does decline and turns into a surplus in the outer years. We have projected that the $116 deficit for 1996; 1997, $99 million; 1998, $37 million; 1999 a $42–$43 million surplus, then a $5–$6 million surplus in the year 2000.

So what we are seeing here is a modest growth in revenues but substantial slowdown in the rate of increase in spending.

Ms. NORTON. I remain very skeptical not because—the reason I remain skeptical is, obviously, you have had to do your projections without—I take it, since there has been no signal from this body—without any changes in the heavy obligations and liability, the State obligations—the other State obligations, and it really stretches credulity for me to believe that somehow, by cutting away at the government, that gap is going to evaporate, and, if so, that is great, I don't think I need to continue to go at Medicaid and pension liability, because I think you all can cut yourself down.

That is why I am skeptical. It is hard for me to believe, on the one hand, those expenses are so compelling and, on the other hand, that by 1999 we will be not only solvent, in effect, but ready for 3 good years, which is the number—I guess 3 or 4 good years it will take to get out from under the Control Board, and we will even have a surplus.

Mr. BRIMMER. Let me try it this way. As I look at this profile for deficit, I ask this question: What are the risks that we fail? What are the risks that the outcome will be different from what I describe? And what are the sources that have risk?

In my judgment, the biggest risk to this forecast is the revenue side. I have less confidence in the revenue forecast than I have in the expenditure forecast. Why? Because we, the Control Board, have a lot to do with the spending side. The Congress has a lot to do with the spending side. So our actions can impact the spending side much more directly than our actions can impact the revenue side.

So, again, I am more confident in the expenditure projections than I am in the revenue projections.

Let me put it another way. If there is one set of actions that we can take collectively to reduce the risk of an unfavorable outcome, I would say the efforts should be concentrated on trying to expand, first to assure there is no further decrease in revenue growth, but to try to assure that there is an increase in availability of revenue. That is how I would characterize the issue.

Ms. NORTON. If I could borrow an approach from the metaphor king of the users, Mr. Williams, it seems to me that you are being put to a very unfair test, and you have got a patient on the operating table, and the District—the Congress every year says meet that $116, Mr. Williams, here; meet it, no matter what you have to do.

You have got him on the operating table. You have got a leg that has gangrene in it. So you cut off the leg. The patient is dying. You have not cut it off in a way to save the rest of the body, and that is obviously going to take some revenues from someplace.

I have a pension liability, and it hasn't gotten pip-squeak from anybody in this body. That would free up revenue perhaps approaching $180 million for the District to begin to use on the side that Dr. Brimmer says correctly that he can't cover, but I see it coming.

There are blinders on this body because he doesn't want to hear it and they don't want to see it, and they are cutting the District to death, and if they think residents are remaining here in light of those cuts, they need to look at the tax rolls the way I have, and they will see that at the end of this period they may have a government that has been brought down to size. But I cannot tell you that there will be many people who pay taxes here to enjoy it.

I am very concerned with what I believe is a completely unfair burden you are being put to. You are meeting it, and everybody is turning their face to what it is doing to the city, to its residents and taxpayers.

I don't know any way to call greater attention to it, but I certainly am not going to sit here and pretend that because the Authority and the city are doing what they are mandated to do, and that is to cut the government each year to stay within congressionally mandated revenue limits, everything is all right.

On the contrary. We are going to find that you have been put to a great deal of work. The city has been put to a great deal of sacrifice, and we are not going to have a viable city in 1999.

I want to be on the record as saying that, saying that not because the Control Board hasn't been doing what the Congress had mandated but the Congress isn't meeting its obligation.

I have only a couple more questions. I am concerned with what Mr. Hayden said about the lockbox. The chairman and I have worked very hard on this revenue-producing initiative. The city has worked very diligently. Mr. Poland has. We had a little problem there when it looked like the city did an entirely—the council didn't understand what its role was. We fixed that problem.

Mr. Hayden, you expressed concern about the lockbox, and what I hear from you—and maybe I am reading between the lines—bothers me. It bothers me because it sounds as if, no matter what the District has in terms of a revenue stream with respect to an independent authority, everybody may look at the control board and say that will give us more security, so why don't we really force the District to make all of its borrowings somehow come out of that mechanism?

I wish you would clarify what your testimony says about lockbox, page 3 of your statement.

Mr. HAYDEN. Yes, I know it is in my statement, but I was looking to see if I have with me the credit reports when the city last used the lockbox approach which did not give any relief.

Ms. NORTON. Does not protect against alternative use of pledged taxes which remain under the control of the District. You say that even though we have a Control Board and a Congress. I don't understand that.

Mr. HAYDEN. If you look at the top of that page—I believe you are on page 3—the importance of the program having complete control is illustrated by what Standard & Poor's did when the District created that lockbox regarding one of the redevelopment land agency's issues.

S&P rated the tax revenue bonds the same as the GO, explaining from their point of view the lockbox mechanism does not protect against the alternative use of pledged taxes which remain in the control of the District. In this case, which we are talking about in the future, those taxes will not remain under the control of the District if you are going to create a better security. You have to get away from that control that Standard & Poor's mentions in this report.

Ms. NORTON. You are saying that a better security is the lockbox?

Mr. HAYDEN. The lock box as it was done by the District still did not remove the control of those revenues from the District. So it was not seen as strengthening the credit.

In the case of the Control Board, they have the ability to control those revenues. There is absolutely no question about it.

Ms. NORTON. You say the buyers would prefer a new Control Board credit rather than another District name, meaning an independent authority?

Mr. HAYDEN. That is right. Let me explain to you in several ways. A buyer—say you are a bond fund, and you are administering the bond fund, and you have the ability to buy securities to fill up your bond fund. One is, you may have your board, or your superiors may say to you, "You can buy anything as long as it is investment grade." Then your universe of what you can buy to put in that fund is such-and-such. Or you buy because of the District of Columbia, we are concerned about it. You can have no more than $15 million of their credit in your portfolio.

However, that does not apply to a security now subsequently issued by the Control Board. So you get a whole new security that a buyer can look at from a whole different perspective because of the way the security is created and because of the name and responsibility that is on it. It is a combination of both structure and credit and how the market is going to perceive it and how they can buy it.

Mr. BRIMMER. May I illustrate that point, Ms. Norton, with respect to the financing that has just been concluded with Lehman Brothers. One of the agreements we made and I described is as follows:

There is an escrow schedule provided so that the city would be required, beginning in late August, to set aside certain amounts on certain days of the tax revenues flowing in. The question is, Who controls that account? The answer is, We do. Who controls the use of the funds in that account? We do. We covered it and agreed that we would see to it that those funds flowing into that account will be held and used in such a way to assure that they would be available.

If the vendors said it was very important that those controls exist, that was one of the ways to assure the viability of this. That is one of the ways we use our capacity to provide assurance. So I

agree with the control of those kinds. In a sense that is the lock-box.

Ms. NORTON. I believe there is some misunderstanding. First of all, I don't know if the covenant that Dr. Brimmer has been talking about has been understood, is known, or has been fully——

Mr. HAYDEN. Very much understood and very much taken into account.

Ms. NORTON. Why then would there be a belief that the money would be in the control of the District and not the control board, as Dr. Brimmer has stated it is?

Mr. HAYDEN. Because the facts show that when the District created a previous security for the Redevelopment Land Agency and created a lock box, that technically the pledged taxes remained under the control of the District, and that was no other——

Ms. NORTON. Was it the before the creation of the Control Board?

Mr. HAYDEN. It was after the creation. This was after that, and it was a subject of a major report of the credit agencies. I don't have it with me, but I will see that you get it. It is in some detail, a number of pages long, and my remarks here are quoting from that, and that is—the controlling language is, "It does not appear feasible for the District to establish that credit based on that factual experience that happened in the Redevelopment Land Agency issue."

Ms. NORTON. So where does that leave the special tax revenue bonds arena, in your view?

Mr. HAYDEN. Just where they are. Exactly where they are. It was not perceived and the credit agencies wrote it up that way.

Mr. WILLIAMS. Congresswoman Norton.

Ms. NORTON. Yes.

Mr. HAYDEN. Let me put it this way. Normally, a dedicated tax revenue would get a rating higher than the underlying credit. You had a dedicated tax bond. It would normally get a higher rated piece of paper than the underlying credit.

In the instance of the Redevelopment Land Agency, if that were viewed as a valid dedicated tax lockbox, it would have gotten a higher rating. It did not. It got the same underlying rating as the city.

Mr. BRIMMER. And if translated you could say it was higher rating and a lower interest rate.

Mr. HAYDEN. The reason you are dedicating that is to get a higher rating and a better rating. It didn't get it in this instance. That is why I say it is a difficulty in the District creating it without the authorities.

Ms. NORTON. Mr. Hayden, I would be interested in having further conversations when you members of the Control Board and the city, and this committee because there are other bonds also. We have already taken some steps recently and we would like to deal with this question once and for all. I appreciate the testimony, but it is clear from your testimony that there may be some more work that is needed included. It seems to me to be capable of being fixed.

Mr. HAYDEN. It is a key point that you have focused on and it even goes to my remarks earlier when I said that the political problem and the perception of who has control over that dedicated stream of revenues and any surpluses it may create because when

you create a new security for the Control Board, you are going to have probably 1.5 times coverage. You may not need that extra .5 year in and year out so you are going to be accumulating some surpluses there and your coverage may go to 1.75.

The political question is who gets to spend that money between 1.5 and the 1.75 and that all goes to the very heart of the question you are asking: who has control—lock control and legal control over that dedicated stream of money. That is a very important issue.

Ms. NORTON. You just spun off Blue Plains. That may be—may or may not be different because, after all, it remains the property of the District of Columbia. I believe this all has——

Mr. HAYDEN. Congresswoman, I might even tell you, you know probably some of my experiences and was involved as financial advisor of the District going way back to the period of home rule. I can tell you when the Home Rule Act was first enacted, the District was not able to issue any bonds under the original act because this very question of control, who had control of the funds, was never answered on day one.

Ms. NORTON. It is time to ask that.

Mr. HOLLOWAY. Congresswoman Norton, one thing you may want to consider, and I think Mr. Hayden's point is certainly valid perspectively, without question, one of the things you have with the sports arena that would maybe even be a measure of what he is saying is that arguably if it's believed that those bonds were issued as a rate higher than what could otherwise have been accomplished, one thing you may want to revisit is attempting to refinance them at a lower rate, but under the Control Board controlled account, but it would also—that is a two-edged sword in that it is already in place for that borrowing.

I think their timing issues, I am not sure the control board was fully in place then or not. If it was, it was in the early going of the control board.

Mr. BRIMMER. I think we were in place, but the—our ability to engage, I think, came in October 1. Physically there but didn't have the authority.

Mr. HOLLOWAY. That process was kind of already in motion when some of this stuff was happening. One of the things you need to look at, because one of the things that come from borrowing from anybody is what your experience and history is. Mr. Hayden may be right that is under the District's control, it also creates for the District, if you believe the interest rate is reasonable, an opportunity to demonstrate its discipline, because I shared with Tony at some point the strategies the District has to do. And whether or not it makes sense to refinance or bother with what was done on that sports arena deal, to me, that is just an economic question of can you get a better interest rate.

If the answer to that is no, it seems to me that it also creates an opportunity to demonstrate your discipline that you, in fact, are going to keep that money dedicated and not mess with it aside from the fact I think political pressures that would come to bear if the city even thought about going to that money, and I know Mr. Williams would be much more responsible than that I think would preclude and effectively it will create the control factor that Mr. Hayden speaks to.

Ms. NORTON. But it may not, as he has already spoken to and anyway, I get the point. Then I see what needs to be done.

One final question. I was surprised, as I believe he was, that testimony that there has been no discussion between the District of Columbia and the control board on long-term borrowing considering that we have heard nothing but a mantra about long-term borrowing.

Mr. BRIMMER. Excuse me, that is not what I meant. Maybe I interpreted your question incorrectly. I thought you were asking me whether we had had a discussion over some technical details. My answer was, no, to that, because that has not happened, but clearly there has been substantial extended discussion between the Control Board and the chief financial officer and the Mayor over the question of long-term borrowing. So, yes, we have had extensive discussion here, but as to specific details about how to structure such borrowing, the answer is, no.

Mr. DAVIS. The question specifically was had you had discussions with the city government in terms of them giving you some control over city revenues for bonds that you would issue?

Mr. BRIMMER. If that was the issue and the answer to that was, no.

Ms. NORTON. Considering that the testimony here has tended to be that the control board would have to be the major factor, I would like to ask you when do you think those questions would be raised to the city? When do you think you might have a proposal and whether or not there has been any thought given to restructure existing debt service? I think Mr. Hayden discussed it so that you might even finance long-term borrowing through such restructuring.

Mr. BRIMMER. Ms. Norton, I believe strongly that we should take up questions about the form and strategies for fashioning a bond issue when we are not just talking abstract, but when we have a real prospect.

Second, with respect to control of revenues, I believe, again, we should not talk about that on a hypothetical or theoretical context, but when we are actually confronted with the issue—with the question and I assure you that when those questions arise, we will, in fact, have detailed discussions. We will engage in them directly and he will personally engage in those. As to when we will do that is when the question of borrowing becomes real.

Ms. NORTON. Then I am totally confused. Everyone has testified here that the District cannot, in fact, get out of the present hole without refinancing its deficit. Therefore, I thought that everyone agreed that it was ripe, and we assume therefore that there would be—that by now discussions on options and how to do it. And I am confused when you say there is a real prospect.

This Congress isn't going to give anybody anything. We are going to have to wait to see what, in fact, you propose and you can have an effect on what happens. If nothing is happening on it and yet there is complaint about it and agreement that it must be eliminated then I am totally confused.

Mr. BRIMMER. Ms. Norton, perhaps we are failing to communicate. Perhaps it is some deficiency on my part and I am not really understanding your question. Mrs. Norton, our staff, not the

board, not the members of the board, but our staff has been engaged in numerous detailed discussions of options with the CFO and the city.

You might recall some debate we had last spring about the wisdom or appropriateness of trying to borrow short-term or long-term at that time. And one of the outcomes of that discussion was an instruction to the staff through exploring detail, options for going into the short end of the market into the long end of the market, and if so, what kind of arrangements would have to be made to accomplish access in either of those cases. That work is going on.

Ms. NORTON. When can we expect that work to be completed?

Mr. BRIMMER. I would have to ask my colleague, Mr. Hill, who is in charge of it and knows the exact status of it. May I introduce Mr. Hill to respond to that?

Ms. NORTON. Yes, Mr. Hill, I would like you to respond to that. While these discussions have been going on, according to your own figures from 1995 to 1996, we have had more than a $100 million increase in that deficit from 37 and 494 and some, it is projected from fiscal year 1996 to fiscal year 1997 is another $100 million. This is costing people who live here money and all I want to know is when will there be a proposal? It might be controversial. We may have to fight like anything to get it, but we have to have something to fight about.

Mr. BRIMMER. May I try to answer? There are several questions I heard you ask just now and I would like to separate them out by saying with respect to the character of the work that is being done at the staff level, and when we expect to complete it, ask Mr. Williams, who is very familiar with that. Our staff is cooperating with his staff.

Mr. Williams, could you cast some light on that please?

Mr. WILLIAMS. Congresswoman Norton, for some time we have worked cooperatively with the board in engaging the Congress in a discussion over the overall need for borrowing, working with the staff of the Authority, the Mayor, of the board itself, and discussions with the Treasury on the possibility of the Treasury as a vehicle for borrowing with the understanding that either the board—that potentially and certainly some months back neither the board nor the city had access to the public markets.

We were engaged in extensive conversations with the Treasury. Indeed, we are working with the Treasury on drafting legislation that would permit a Treasury borrowing over the last couple of months as indications have signaled potential entry into the public market. We have been working with the staff of the port authority in constructing a competitive process that would allow this engagement to occur under joint effort by the District and the authority and the authority auspices for the authority on behalf of the city to borrow money.

But I will admit this has been at a staff level, not a board or Mayoral level. I would endorse what Dr. Brimmer has said. There have been extensive conversations between the board and the Mayor on the need for borrowing and on a strategic level.

Ms. NORTON. Mr. Williams, when can we expect a proposal? That is my question. I know you all have been busy. My question is when can we expect a proposal?

Mr. WILLIAMS. I think you can expect by this fall the board working with the city to develop a competitive process to entertain a wide variety of ideas from the market.

Ms. NORTON. I am going to look at when the fall begins. I don't know if it is September 22. I think this amount of money here puts a fire under my behind and I hope it begins to get people to working on this issue. I want to ask if there is going to be—considering the amount of time it is taking, whether or not it will include Mr. Hayden's notion of restructuring the existing debt service generally, which might lower the annual cost to the city and might even help finance the long-term borrowing.

Is that part of your discussion?

Mr. WILLIAMS. Yes, it is. We have received proposals that involve refinancing, restructuring, as well as a long-term debt.

Mr. BRIMMER. Ms. Norton, may I address a couple of additional questions you asked?

Ms. NORTON. Thank you, sir.

Mr. BRIMMER. First, with respect to debt restructuring. Because of the cap—14 percent cap we described, there would have to be a restructuring of the existing debt in order to find room, and one element of that restructuring would have to be stretching maturities. And they would—there also needs to be some way to assure that the newly issued debt; that is, the debt issued in the restructuring, because what it would mean is replacing an old security with a new one, substantially, so effort needs to be made at least to get it recouped in some ways. Those are technical matters that would have to be worked out in detail at the time. So, yes, restructuring is not only contemplated, but it would be a precondition.

Second, with respect to when we would contemplate trying to borrow in the long end of the market, in our testimony—in my testimony today in the budget submission, we said the following; that we believe it would be not only appropriate, but highly desirable that the borrowing take place after the end of this fiscal year and end sometime, I would say, early in the new fiscal year.

We have said and we have said that further that when Congress takes up the matter, and we are hopeful they would take it up very early in the new fiscal year. We would then make a proposal as to amount and we plan to do that. So as to when we believe that the first quarter of fiscal 1997 will be an appropriate time to focus on these issues with the kind of detail and precision that you have in mind.

Mr. WILLIAMS. I think there are three powerful reasons for that. One is I think we will have shown we have repaid this short-term note, which I think is a powerful demonstration of ability to pay. We will have shown that we have made progress in the 1996 budget in terms of keeping it under control. I think that is a tremendous credit statement and I think we will show a progress on the 1996 audit and those, I think, will make for lower cost borrowing.

Mr. DAVIS. Thank you all very much.

Any more questions?

Ms. NORTON. Thank you, Mr. Chairman.

Mr. DAVIS. Without objection, I will hold the record open for 2 weeks. The subcommittee will continue to work with all interested parties in an ongoing effort to continue the progress that has been

made. We thank all of you for your time here and your continued efforts on behalf of the city. These proceedings are closed.

[Whereupon, at 11:35 a.m., the subcommittee was adjourned.]

[Additional information submitted for the hearing record follows:]

Moody's Investors Service

99 Church Street
New York, NY 10007

August 5, 1996

The Honorable Tom Davis, Chairman
District of Columbia Subcommittee
Committee on Government Reform and Oversight
House of Representatives
2157 Rayburn House Office Building
Washington, D.C. 20515-6143

Dear Chairman Davis:

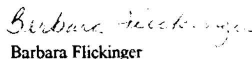
George Leung and I appreciated your invitation to provide testimony for your oversight hearing on July 19, 1996 regarding the District of Columbia's cash status, operating deficit, and private financial market access. We regret that we were not able to appear in person, but would like to submit testimony for the record.

As you may know, Moody's has been rating tax-exempt municipal debt since 1918. Today we maintain over 56,000 ratings on the short and long-term obligations of about 22,000 municipal issuers in the United States and Canada. We currently maintain a below investment grade rating of **Ba** on the District's general obligation debt and an investment grade rating of **Baa** on the District's Redevelopment Land Agency Sports Arena Special Tax Revenue Bonds, Series 1995.

I have enclosed copies of some of our recent publications regarding the District's credit standing, including a report on the Arena financing, as well as a list of our ratings and their definitions. If you have any questions, please call any of the analysts listed on the reports.

Thank you for the opportunity to provide testimony.

Sincerely,


Barbara Flickinger

Enclosures

Moody's Investors Service

Testimony to:
District of Columbia Subcommittee of the
Committee on Government Reform and Oversight

Hearing July 19, 1996

1) What is the impact on the District and its ability to implement needed reforms of the accumulated operating deficit and cash shortage?

The accumulated deficit and cash shortage are both the consequence of past District practices and an impediment to, as well as an indication of the need for, much-needed structural and management reforms. The District's severe financial condition is evident in its constant struggle to meet short-term cash needs, diverting attention from addressing fundamental reforms.

The cash stringency makes it difficult for the District to invest in technology, training, and other areas that could improve financial controls, increase worker accountability and productivity, and improve the quality of information which managers should use to make informed decisions about structural changes.

The limited cash also impedes the District's ability to provide basic services including street repairs, public health, maintenance of police and fire vehicles, and prompt addressing of taxpayer inquiries, such as assessment appeals. This is not only expensive, as small problems left unattended compound into larger ones, but diminishes public support for the District and its government.

2) In what way is the District's cash situation impacted by the announced borrowing from Lehman Brothers and what does that transaction represent or not represent about the District's ability to access the private financial markets for long-term borrowing?

This short-term borrowing of $220 million eases the District's cash situation through the end of the fiscal year, permitting more timely payment of vendors and reducing the level of distraction from longer-term matters. However, the District's own projections indicate that cash pressures remain; as our report dated July 18 explains, Moody's believes that there are speculative elements to the District's ability to repay this borrowing in full and on time.

The District projects a cash balance of $12.5 million after note maturity on September 30, a very narrow margin representing less than 0.3% of general fund revenues. Further, the cashflows indicate that this nominal cash balance is to be accomplished only through the

deferral of over $26 million of vendor payments, which reflects the very tight cash position of the District. The temporary nature of the relief provided by the TRAN borrowing is indicated by the District's need to borrow against its fiscal 1997-98 federal payment almost immediately in fiscal 1996-97, beginning on October 1.

Whether the District can access the market again for a long-term deficit financing will be determined by market and credit factors. From our perspective, the credit features of the two transactions are very different. The note borrowing spans a short 73 days, where events are much easier to predict. On the other hand, the structure and security of the deficit financing have not yet been determined.

The source and adequacy of revenues pledged to bondholders and the debt structure are key factors that will influence both the credit quality of, and the market receptivity to, the debt. These factors, along with broader District efforts to regain fiscal control, will also influence our view of the District's general credit situation. It would ill serve the District to divert for many years the revenues needed to repay a large deficit borrowing, if it cannot first manage its spending down to the level allowed by the revenues that remain after such a re-allocation. The interest rate paid to bondholders, while less of a credit factor, will also influence market receptivity.

3) With a below investment grade bond rating can the District complete a long-term borrrowing at reasonable conditions at this time? In the foreseeable future?

Whether the District can complete a financing on reasonable terms, given its below investment grade rating, is better answered by the investors in the marketplace who will be setting the interest rate and determining the conditions under which they would purchase the District's debt and provide market access, and by District officials who will have to decide if the conditions set by the market are reasonable and affordable.

4) What must happen in order for the District to regain an investment grade rating and be able to attract reasonable conditions for long-term borrowing?

At this point, the District's rating remains under review. While credit conditions are poor, the establishment of the Control Board and the creation of the post of the Chief Financial Officer (CFO), along with the CFO's recently expanded powers, have put in place a structure that could assist the District to regain solvency. A number of steps have been taken to that end.

However, it is not yet clear that the District's financial position has stabilized, even at its current poor level. Recently, the CFO reported unfavorable fiscal 1996 performance as expenditures are running about $23 million over budget, year-to-date; as a result, additional steps are being taken to curtail spending. Apparently, the newly-implemented cost-containing efforts have not been fully effective. It is our understanding that there may be some relief from additional revenues, such as proceeds from the securitization of

property tax liens, which have not yet been factored into the budget. However, these are one-time revenues, and would provide only a temporary fix to the budget imbalance.

To regain an investment grade rating will take time. The District will need to develop credible financial strategies and, most important, demonstrate that it has restored financial control. While management changes are taking place to strengthen financial controls and curb spending, we will not be able to evaluate fully their effectiveness until final results for the current year are available.

Rather than specify policy choices, Moody's can outline what accomplishments will be needed for the District to regain an investment grade rating on its debt. Some of these include:

- **demonstrate effective financial control**

The District must demonstrate that it is able to set appropriate budget targets and meet them. This requires an ability to collect relevant financial and operating data in a timely manner, organize it in usable formats, and then have the analytical and managerial resources to interpret it and implement corrective actions. The District needs a reliable foundation of management and financial information with which to make informed decisions. The District's current information and financial management systems are inadequate to the task.

- **achieve structural budget balance**

Structural balance means achieving operating balance, or a surplus, without the use of one-time measures such as changing the accounting for property tax collections, delaying vendor payments or deferring pension contributions. The relentless and rapid growth in expenditures for Medicaid, corrections, education and pension contributions have outpaced sluggish growth in local revenues. Either the current revenue structure must be changed, or the District must re-examine its responsibilities to eliminate those functions which it can no longer afford, or it must make great strides in productivity and efficiencies, or it must accomplish a combination of these tasks.

- **eliminate the accumulated deficit**

The overhang of the accumulated deficit, and the cashflow problems that result, must be addressed. This can be accomplished by the District's generating sufficient operating surpluses over time to retire the accumulated deficit. Or, a more likely alternative for the District is to issue long-term debt to erase the deficit. In order to borrow for this purpose, however, the District must first convince investors that budgetary balance has been restored so that investors in these obligations and the District's other debt will be repaid on time. Eliminating the deficit would not, in and of itself, return the District's general obligation debt to investment grade, but must be accompanied by progress in the other areas outlined here.

- **operate without significant assistance from the Authority**

The District's ability to demonstrate effective financial control, eliminate the accumulated deficit, and achieve structural balance would be critical considerations in an investment grade rating. The District's relationship with the Authority will be considered as well. In our analysis, the benefits of the District reaching the milestones we have discussed will be discounted if they are achieved only through constant intervention by the Authority.

This does not mean that the District cannot regain an investment grade rating before the Authority's formal oversight role has ended. Rather, it means that Moody's will be looking to see that the District has truly institutionalized the improved financial and management practices that will stabilize its course.

- **debt levels and the economy should be improved as well**

In addition to action on financial and management issues, the District's debt level and economic health are matters that need to be addressed. The erosion of the District's tax base and stagnation of its economy are areas of concern, since these factors will continue to drive demand for services as well as inhibit revenue growth. According to the General Accounting Office, from 1993 to 1995 the assessed value of the District's taxable property dropped over 6% and is expected to remain flat, at best, through 1997. The District's total general fund revenues, including the federal payment, have dropped from $4.5 billion in 1993 to $3.9 billion in 1997, when adjusted for inflation.

The District also suffers from high debt levels, even before attempting to undertake a deficit financing. The GAO estimates that by the end of 1996 debt service will equal 11.6% of revenues, compared to the legal limitation of 14%. This high level of fixed costs limits budget flexibility, particularly when pension costs are included. In 1996, the District is expected to contribute $337 million toward its unfunded liability, or about 8% of revenues. As a result, approximately 20% of the District's budget is fixed even before accounting for education, Medicaid, and other essential needs.

5)Can the control board attain an investment grade rating? Under what conditions?

There are a number of factors that Moody's would evaluate to determine whether a deficit financing issued by the Authority on behalf of the District could attain investment grade. While it should be possible for the Authority to structure an investment grade financing, as it should be for the District, this would depend on many variables. No decisions have been made as to the amount of debt to be issued, its amortization schedule, or the security to be pledged to bondholders. Given the current credit standing of the District, the issuer -- whether Authority or District -- would need to demonstrate that the revenues available for debt repayment would be both reliable and insulated from the District's financial problems.

At the same time, an attempt to intercept or isolate an existing revenue stream of the District for repayment of new debt could impair the District's ability to meet its existing

service and debt obligations. This, in turn, could lead us to further downgrade the District's general obligation bond rating. Policy makers will need to weigh the trade-off between structuring a stand-alone financing to attain investment grade and, in the worst case, potentially weakening the security afforded the District's general obligation bonds.

If the Authority were to issue debt on behalf of the District, some of the features of the transaction that we would evaluate include:

- Nature of revenues pledged;
- Amount and amortization rate of debt;
- Reliability and adequacy of pledged revenues to cover debt service requirements;
- Degree of insulation from District's general operations;
- Control over flow of revenues and disposition of surplus revenues (i.e., does excess accrue for the benefit of bondholders, or is flow to be used for another purpose?); and
- Expertise and management structure of Authority to monitor and manage a debt program

6)Another suggestion for generating cash other than a direct borrowing would be to restructure or refinance existing obligations. How much of the District's outstanding debt could be restructured? At what annual savings and at what long-term additonal costs? Is there a reasonable mechanism to increase the amount of outstanding obligations which could be restructured?

This question is better answered by the District's financial advisor.