

PUBLIC HEARING ON

THE MAYOR'S

PROPOSED FISCAL YEAR 2012 BUDGET AND

FINANCIAL PLAN

Before the

Subcommittee on Health Care, District of Columbia,

Census and the National Archives

Committee on Oversight and Government Reform

U.S. House of Representatives

The Honorable Trey Gowdy, Chairman

May 12, 2011; 8:45 a.m.

Room 2154, Rayburn House Office Building



Testimony of
Natwar M. Gandhi
Chief Financial Officer
Government of the District of Columbia

Good morning, Chairman Gowdy, and members of the Subcommittee. I am Natwar M. Gandhi, Chief Financial Officer of the District of Columbia. I am pleased to be here for the Subcommittee's hearing on Mayor Gray's proposed FY 2012 Budget and Financial Plan for the period FY 2012 through FY 2015.

This first budget process for Mayor Gray's administration was challenging because of the lingering effects of the national recession. On the revenue side, compared to the pre-recession estimates, by last September, the District's Local Source revenue projections had fallen by about one-quarter in both FY 2011 and FY 2012 compared to the June 2008 projections (see Attachment 1). Since last September, the Mayor and the D.C. Council took legislative and administrative actions to close a budget gap largely created by the drop in revenues reflected in the September 2010 revenue estimate.

By the end of February, however, the economic picture had brightened, and a new revenue estimate showed an increase in FY 2012 revenues of \$105 million, with larger increases in subsequent years. Still, the current revenue estimate for FY 2012 is over one billion dollars below the June 2008 estimate for that fiscal year.

Accordingly, the Office of the Chief Financial Officer (OCFO) worked closely with the District government's executive leadership team and agency program and finance staffs to resolve numerous budget issues to produce a balanced five-year financial plan. The FY 2012 policy budget reflects funding priorities by the Mayor and agency directors. We will continue to work collaboratively with the Mayor and the Council as they deliberate on the Mayor's FY 2012 Proposed Budget and Financial Plan.

After careful review, when the Budget was transmitted to the Council, I certified that the FY 2012 – FY 2015 Budget and Financial Plan, as proposed, is balanced.

BRIEF HISTORY

Attachment 2 to my testimony and the board before you tells the story of the District's successful return to fiscal solvency and financial stability. Between 1996 and 2008 we turned a cumulative \$550 million deficit into an impressive \$1.2 billion fund balance. Further, we transformed a nearly bankrupt District government plagued with junk bond ratings into a financially credible jurisdiction with strong ratings. Indeed, our turnaround from “junk bond” status to “A” category general obligation bond ratings was faster than that of any other major city that has undergone a similar period of financial crisis, including New York, Philadelphia, Cleveland and Detroit.

This turnaround is a case study in a commitment to improve financial management and practices. Our General Obligation (GO) bond ratings have increased at an unprecedented speed. They now stand at A+ from Standard & Poor's, Aa2 from Moody's Investors Service and AA- from Fitch Ratings. In addition, our Income Tax Revenue Bonds are rated AAA by Standard & Poor's, Aa1 by Moody's and AA+ by Fitch. This is indeed a record of which the District can be proud.

BUDGET AUTONOMY

I would now like to speak about why I believe, from a financial management perspective, the District should have discretion with respect to the allocation of funds raised from local sources.

Under current law, all District of Columbia spending is authorized by the Congress through the federal appropriations process, irrespective of the source of revenue underwriting such spending. In the District's FY 2012 proposed general operating funds budget of \$8.99 billion, about \$6.34 billion, or 71 percent, comes from revenues raised through local taxes, fees, fines, and user charges. Another \$2.45 billion or 27 percent comes from Medicaid and federal grants, which are mostly formula based and available to all jurisdictions. Only \$174.3 million or approximately two percent are from federal payments specifically requested in the President's FY 2012 Budget from federal revenues for programs and projects unique to the District of Columbia.

I suggest that only the federal payments specifically and uniquely earmarked for District programs or federal initiatives should be appropriated by the Congress. In the case of local funds, the Congress has rarely altered an allocation made by the District. Federal grants to the District have already been appropriated to the federal agency responsible for program administration and awarded to the District. Having already been appropriated to a federal transferring agency, these federal grants should not need to be "re-appropriated" to the District.

Were the Congress to modify current law by reducing its role in the District's appropriation process, a range of possibilities would still remain to allow for oversight of the District's budget and operations. These might include periodic audits, after-the-fact review of the District's locally enacted budget, or review of the District's locally enacted budget by the appropriate oversight group in the Congress. Federal payments directly appropriated to the District would remain within the federal appropriations process.

Benefits to the District

Faster and smoother enactment of budgets. Because the District currently receives all its authority to spend funds only through the federal appropriations process, the District cannot enact the budget approved by its elected representatives until Congress passes and the President signs the District's appropriations bill. This situation guarantees a four-month lag between local approval and federal enactment. Furthermore, federal appropriations bills are often delayed beyond this period, as was the case with the current FY 2011 fiscal year. There are adverse consequences for the District since it is tied to the federal appropriations cycle. In the case of new or expanded programs approved and financed locally or with federal grants, no action can be taken during the fiscal year until Congress passes its appropriations act, or includes language in the Continuing Resolution to permit the District to spend these funds at the approved level. For years, the CR's have included just this language, thereby removing the unnecessary and unfortunate delays in programs that had previously existed. This extra effort with the language in the CR is very much appreciated, but it is never certain. With budget autonomy, it would not be necessary.

Also, the more time that elapses between the formulation of a budget and its execution, the more likely the operating assumptions underlying that budget will not hold true. Thus another critical aspect of faster budget enactment would be that budgets could be based on more current revenue estimates. This became apparent two years ago when my office issued a new revenue estimate June 22, after the Council had approved the budget, but before Mayor Fenty had returned it to Council with a single line-item veto.

The June estimate showed a drop of \$190 million of revenue in FY 2009, and a projected drop of \$150 million in FY 2010, forcing the Mayor and Council to go back to the drawing board. To their great credit, both Mayor and Council moved swiftly to revise the budget to reflect the lower revenues, but this was far from an optimal way of doing business.

If the District Council were able to set its own schedule to enact a budget, the Mayor and legislators could always rely on revenue estimates based on more current data. Currently, budgets are based in large part on revenue estimates completed in February, some seven months before the start of the new fiscal year in October and a total of 20 months before the end of that fiscal year. The District does not get actual data on how accurate these revenue estimates are, and whether budgeted expenditures are fully covered, until after the end of that fiscal year, almost 2 years after the original revenue estimates were made.

No Interruption of Local Government Services. As you are well aware, this year, the District government, along with the federal government, would have had to close down had Congress and the President not reached a budget agreement to extend the Continuing Resolution through the end of the year. The District would

have immediately lost revenue from a government shutdown – about \$5.5 million a week. For District residents, unlike any other Americans, a shutdown would have meant that they would have had only limited federal, state or local government services – no trash collection, no public recreation facilities like swimming pools or youth baseball leagues, no libraries, no driver’s license renewals or car registration, no parking enforcement, no building permits, no city university or community college access, no social services for needy families with children. In short, the potential effects of an extended shutdown would have been felt more immediately and far more severely by District residents than our fellow citizens in the rest of the nation.

Maximum Local Financial Flexibility. Providing the District with the authority to direct the spending of its locally raised revenue would substantially increase the District’s ability to react to changing program and financial conditions during a fiscal year. Under current law, the District must follow the federal supplemental appropriation process to appropriate additional revenues that become available during the course of the fiscal year or to make any significant realignment in resources among its appropriations. All program plans premised on supplemental appropriations are held in abeyance while Congress considers the request.

It should be noted that since the early part of the decade, Congress has provided increasing degrees of budget flexibility to the District. Currently, if our revenues exceed projections, the District is allowed to increase our appropriations ceiling. Specifically, if local tax base revenues increase, spending of that revenue source may be increased up to 6 percent. Similarly, if dedicated revenues or O-type revenues increase, spending in that category may be increased up to 25 percent. This authority, however, still requires a 15-day Congressional review

period during which the monies cannot be spent. Also, the authority is not permanent but is derived from a general provision in an annual appropriations bill that must be continually renewed.

As you can see from these examples, because of the lack of permanent budget autonomy, the District cannot always react as swiftly, appropriately or effectively as possible to meet the needs of residents and visitors. To the best of my knowledge, no other municipality in the nation functions under such restrictions.

Mechanisms and Safeguards for Assuring Financial Integrity

The District of Columbia Financial Responsibility and Management Assistance Act of 1995 (the Act), coupled with the continuation of an independent Office of the Chief Financial Officer, provides the framework for assuring financial integrity without the need for imposing the federal appropriation process on local fund budgets. The Act details specific benchmarks for financial management within the District and provides for the reinstatement of a control board and other constraints if the District fails to meet these major financial obligations. These financial benchmarks remain in effect under the proposed Budget Autonomy legislation.

Further, in October 2006, Congress enacted the 2005 District of Columbia Omnibus Authorization Act, which re-established, within the District's Home Rule Act, a permanent Office of the Chief Financial Officer. The Office of the Chief Financial Officer provides an independent assessment of key financial data – annual comprehensive financial reports, revenue estimates, fiscal impact statements, and all other consequential financial data. The Chief Financial Officer's duties are not changed by the proposed Budget Autonomy legislation. I believe that the existence of an independent Chief Financial Officer, chartered by

the Congress to oversee the fiscal stability of the District, along with the prudent financial leadership demonstrated by our elected officials, is sufficient to ensure fiscal discipline without the added complexity of putting local spending plans through the federal appropriations process.

Fiscal Condition and Financial Improvements

There is no question that the District has the financial infrastructure to permit it to manage its local funds effectively. Congress created the position of independent Chief Financial Officer to provide for fiscal responsibility apart from the political process. We have a strong accounting system linked to our budget oversight processes. Monthly closings and cash reconciliation are in place. Financial managers have a clear understanding of expectations. The improved financial reporting infrastructure has enabled the OCFO to supply elected leaders with sound fiscal analysis. Clean audit opinions by the District's independent auditors have become routine. Moreover, since the dormancy of the Congressionally created control board in 2001, the District's elected leaders have achieved an exemplary record of fiscal prudence. Financial markets have recognized it in the form of higher bond ratings and lower interest rates on our borrowing. The return of a control board is now highly unlikely.

HIGH NEEDS AND RESTRICTED TAX BASE

The District, as the urban center of a large metropolitan area, houses a disproportionately large share of very poor and needy citizens. The District's overall poverty rate of 17 percent and the child poverty rate of 26 percent are among the highest in the nation and more than three times the comparable rates

across neighboring counties.¹ Unlike other urban jurisdictions that provide services to a large share of the region's poor, the District cannot divert resources from wealthier suburban areas to serve its urban poor.

Higher costs of service delivery further threaten the District's fiscal health. Labor costs for public services in the District are 123 percent of the national levels, and capital costs (primarily buildings) are 1.54 times the national average. Because of this combination of a needy population and high service costs, our expenditure needs are very high. If the District were to offer a basket of public services similar to what is offered across all states and localities in the nation, for each of its residents, it would have had to spend 132 percent more than what other states and localities spend on average.²

In this environment of continuing expenditure needs, the challenge posed by reduced revenues is substantial. Now, here is where the U.S. Congress plays an important role. Kindly permit me to briefly note two areas that merit continuous attention. Both go to the unfunded mandates that restrict the District's own taxing power.³

- The prohibition on taxing the income earned by non-residents, including those who commute into the city on a daily basis. That 66 percent of the income is earned by non-residents makes the simple point.
- The District has an especially high concentration of non-taxable real property, much of it off the tax rolls due to the presence of the federal establishment. The value of property held by the federal government is 30 percent of non-residential

¹ Census Bureau, American Community Survey, 2008.

² District of Columbia, Office of Revenue Analysis, 2008.

³ In 2003, the General Accounting Office (now Government Accountability Office) calculated this preemption to be between \$470 million and \$1.1 billion annually. (GAO, District of Columbia Structural Imbalance and Management Issues, May 2003.)

property values. The District is also home to foreign embassies, national headquarters for charitable and religious organizations and numerous educational institutions, all of which enjoy exemption from our real property tax requirements.

Because of the inability to tap these resources, our residents must shoulder a disproportionate share of the costs of public services, while the benefits generated by the city's taxpayers are shared by a much larger community. Our 14th consecutively balanced budget attests to the fact that we have not allowed these deficiencies to become an excuse for fiscal irresponsibility. The looming danger, given the economic conditions in the nation combined with the District's high expenditure needs is that, should our revenue growth fail to return to a level at least even with inflation, District services could be severely impaired.

Notwithstanding these issues, Mayor Gray has produced a fiscally sound FY 2012 Budget and five-year plan.

FY 2012 BUDGET AND FINANCIAL PLAN

The Mayor's Proposed Budget and Financial Plan was prepared at a time when the recession appears to have entered a sustained, although somewhat muted, period of recovery. Still, at the national level, there is a considerable amount of uncertainty, as unemployment remains high, and income gains are still weak. The District has avoided some of the worst problems of the national recession because of the presence of the federal government. During the recession and subsequent recovery, jobs located in the District have done relatively well compared to the rest of the nation, but the percentage decline in the employment of District residents has been

about the same as the U.S. average. Unfortunately, the unemployment rate for District residents is an unacceptably high 9.5%.

Rating agencies have expressed concern about the District's use of General fund balance to make up for losses in revenues. Since the June 2008 revenue estimate, we have lost about a quarter of what had been projected for Fiscal Year 2012. Furthermore, the expiration of the federal stimulus program added another \$228 million in revenue loss. The result has been a decrease in our General fund balance of \$695 million or 44 percent over five fiscal years. The FY 2011 Budget calls for use of \$186 million of fund balance, and although it is far too early to tell where we will actually end the current fiscal year, the fund balance will certainly see some degree of decline.

These challenges required that the Mayor and his Budget office make difficult decisions about how to balance current spending needs and current revenues in order to enable the District to "live within its means and meet our citizens' most pressing needs." We pledged to do this when we met with the rating agencies in February, and the Mayor has made this measure of fiscal responsibility one of the four priorities of his Budget and Financial Plan.

GENERAL FUND BALANCE

I have testified many times before this Subcommittee, other Congressional committees responsible for District oversight and appropriations and the District Council about the extraordinary turnaround the District has achieved since the 1990s. The journey from junk bond status to the highest possible rating of AAA

on our income tax secured bonds is indeed a remarkable story, and one of which we are proud. The story that is more relevant to today's hearing, however, is how we will continue to deal with the current economic situation.

The presence of the federal government has always provided the District a measure of protection from economic downturns. The lengthy recession of the past three years had a less negative effect on District finances than it did on most other states and large municipalities. But, we did suffer.

In order to continue funding critical programs in the face of greatly reduced revenue estimates, we used a substantial portion of our cumulative general fund balance, which was \$1.5 billion in FY 2007. By the close of FY 2010 the General Fund balance stood at \$890 million, a drop of over 40 percent in just three years. As I have noted many times before, this is why governments need to build and keep sizable reserves in fund balance – to cover needs in times of economic downturns.

The chart in Attachment 2 shows a history of the District's General Fund Balance and budgetary basis surplus. The use of fund balance left us not only with a lower total fund balance, but also the loss of any unreserved, undesignated savings, which, along with the Emergency and Contingency Funds, serve as our "Rainy Day" accounts to use for unforeseen events. (See Attachment 3) Further, as you can see from Attachment 4, with the erosion of the fund balance, our working capital situation has reduced the District's spendable funds to the equivalent of only about 20 days' expenses – far less than the two months' reserve recommended by the Government Finance Officers Association. As we have noted, rating agency analysts have expressed concern about the depletion of fund

balance. I commend the elected leadership of the city, who pledged to the rating agencies that we would restrict the amount of spending in FY 2012 to the level of revenues collected in that fiscal year, as well as all years in the Financial Plan. This Budget is consistent with that commitment.

MONITORING EXPENDITURES

The OCFO will continue to work with the Mayor and Council to monitor spending in FY 2011 and FY 2012 to ensure that the District ends each year in balance. To that end, the OCFO will closely watch the following items included in the FY 2012 Proposed Budget. Each relies on programmatic changes that have been difficult to attain in the past, and if the changes do not materialize, spending pressures could emerge:

- **Department of Health Care Finance (DHCF):** The FY 2012 Proposed Budget for DHCF includes a reduction in the Local funds for the D.C. Health Care Alliance program. The proposed cost-saving initiative requires that the Income Maintenance Administration (IMA) conduct face-to-face recertification every 6 months to disenroll non-eligible persons from the Alliance. Another initiative would strengthen trading of eligibility files with both Maryland and Virginia to support residency requirements.
- **Department of Human Services (DHS):** The FY 2012 Proposed Budget includes a provision to realize savings by implementing full family sanctions for families that receive Temporary Assistance to Needy Families (TANF) but are not compliant with the work requirements. In addition, the agency

believes that it can shift several TANF recipients to the federal Supplemental Security Income (SSI) program to realize Local savings.

- **Disability Compensation Fund (DCF):** The FY 2012 Proposed Budget includes several cost savings measures that resulted in a reduction of the FY 2012 budget. The OCFO believes that in order to realize these savings initiatives, the Office of Risk Management will be required to make dramatic programmatic revisions.
- **Unemployment Compensation Fund (UCF):** The FY 2012 Proposed Budget represents a 61 percent reduction in the number of persons receiving unemployment payments when compared with FY 2011.

REVENUE OUTLOOK

As I noted earlier, this budget was prepared at a time when we have seen an increase in revenues for the first time since 2008, yet there remain many downside risks and uncertainties to the outlook, including the possibility of a slowing down or reversal of national economic growth, further financial market problems, and national security concerns.

The FY 2011 baseline estimate of \$5.069 billion in total local fund revenue, which excludes Dedicated Taxes and Special Purpose Revenue, is \$7.0 million (0.1 percent) lower than FY 2010 revenue. The \$5.353 billion estimate for FY 2012 is an increase of \$283.1 million, or 5.6 percent, from FY 2011. Including restricted revenues and the Mayor's proposed policy initiatives, total FY 2011 General Fund

revenue in the financial plan is \$5.9 billion, which is \$38.4 million more than in FY 2010, and \$6.3 billion in FY 2012, or \$488 million higher than FY 2011.

Various proposed policy initiatives increase total General Fund revenue in FY 2011 by \$2.0 million and in FY 2012 by \$158.6 million. Some of the major proposals impacting FY 2012 are:

- \$35.4 million from a new top income tax bracket and a limitation on itemized deductions;
- \$19.2 million from a change in apportionment methods for multi-state business taxpayers and a two-tiered minimum tax (\$250 for businesses with less than \$1 million of sales and \$1,000 minimum tax for those with over \$1 million of sales) that replaces the current \$100 minimum franchise tax;
- \$65 million for changes to withholding and estimated payments that results in a one-time increase in income tax revenue;
- \$18.2 million for an increased sales tax on parking; and
- \$5.3 million for increasing the tax on alcohol purchases for consumption off-premise and allowing stores that sell alcohol to sell until midnight.

Also, the budget repeals over 75 Special Purpose Revenue funds and shifts a net \$55.7 million of associated revenue to unrestricted Local fund revenues.

EXPENDITURES

Local Funds (including Dedicated Taxes)

The FY 2012 Mayor's Proposed Budget includes \$5,924.1 million in Local source (including Dedicated Taxes) spending supported by \$5,925.5 million of resources, with an operating margin of \$1.4 million, as shown in Table 1.

Table 1	
Proposed FY 2012 Budget Summary -	
Local Source	
(\$ in millions)	
Taxes	\$4,905.6
Dedicated Taxes	371.4
Non-Tax Revenues	366.9
Lottery	69.4
Other Interfund Transfers (Net)	-1.7
Revenue Proposals	212.9
Appropriated Fund Balance	1.0
Total Local Fund Resources	\$5,925.5
Local, Operating Expenditures	5,489.7
Transfers to Enterprise Funds	324.6
Transfer to OPEB for FY 2012 costs	109.8
Total Local Fund Uses	\$5,924.1
Projected FY 2012 Operating Margin	\$1.4

Special Purpose Revenue Funds

The Mayor proposes a \$418.8 million Special Purpose Revenue Fund budget for FY 2012, financed with (a) \$405.9 million of FY 2012 revenues (\$460.2 million of certified revenues, plus \$1.2 million of new revenue sources, less \$55.5 million of revenues transferred to Local as the associated Special Purpose Revenue funds

were abolished, and (b) \$12.8 million of fund balance (\$39.7 million of fund balance originally certified, less \$26.9 million of fund balance that was not budgeted).

Gross Funds

The proposed FY 2012 gross funds operating budget (excluding intra-District funds) is \$10.8 billion, an increase of \$322.2 million, or 3.1 percent, from the FY 2011 approved gross budget of \$10.5 billion. The Local and non-Local funding components of the proposed FY 2012 gross budget and the changes from FY 2011 are summarized in Table 2 below.

Table 2				
FY 2012 Gross Funds Budget by Fund Type				
(\$ in millions)				
Fund Type	FY 2011 Approved	FY 2012 Mayor's Proposed	Change	% Change
Local	\$ 5,286.8	\$ 5,537.5	\$ 250.7	4.7%
Dedicated Tax	337.8	386.6	48.8	14.5%
Subtotal, Local and Dedicated Tax	5,624.5	5,924.1	299.5	5.3%
Federal	2,701.9	2,620.3	-81.5	-3.0%
Private	5.0	23.2	18.2	365.2%
Special Purpose	490.2	418.8	-71.5	-14.6%
Total, General Operating Fund	8,821.7	8,986.3	164.7	1.9%
Enterprise and Other Fund	1,682.0	1,839.6	157.5	9.4%
Total Gross Funds	\$ 10,503.7	\$ 10,825.9	\$ 322.2	3.1%

Note: Excludes intra-district funds.

MAJOR COST DRIVERS – LOCAL FUNDS

Overall, the FY 2012 Local Source Component budget (Local and Dedicated Tax funds) increased by \$299.5 million, or 5.7 percent, over FY 2011. Table 3 provides a snapshot of the major cost drivers associated with the increase.

Table 3	
FY 2012 Local Source - Cost Drivers	
FY 2011 Approved Local Source	\$ 5,624.5
Major Changes:	
Department of Health Care Finance	77.9
DC Public Schools	67.0
DC Public Charter Schools	55.8
Repayment of Loans and Interest	31.4
Metropolitan Police Department	25.9
Department of Youth Rehabilitation Services	16.6
Other	24.9
Total Changes	\$ 299.5
FY 2012 Proposed Local Source	\$ 5,924.1

Primary Cost Drivers

- Department of Health Care Finance Local expenditures increased primarily because of the District’s loss of enhanced Federal Medicaid Assistance Percentage (FMAP). Local funds were increased to replace the loss of federal funds.
- Additional Local funding was provided to the Department of Youth Rehabilitation Services to account for the increase in the projected average daily committed youth population.

- D.C. Public Schools (DCPS) increased Local funding to align the budget with the actual funding needs of special education and because of the increased projected student enrollment.
- Additional Local funding was added to D.C. Public Charter Schools to keep the funding formula equal between DCPS and DCPCS. In addition, the FY 2012 projected student enrollment in DCPCS will increase.

CAPITAL IMPROVEMENTS PLAN

The District is addressing its continuing infrastructure needs through its Capital Improvements Plan (CIP). We are, however, limited by constraints on our levels of General Obligation (G.O. bond) and Income Tax secured (I.T. bond) borrowing. Taken together, these factors place a premium on developing a sound CIP to make the best use of limited resources.

The total proposed CIP for the FY 2012 through FY 2017 CIP is \$4.98 billion for all sources. The increased CIP will be financed with I.T. or G.O. bonds, Pay-As-You-Go (PAYGO) transfers from the General Fund, the Master Equipment Lease Program, Federal Grants, a local match to the grants from the Federal Highway Administration, a private donation, and local transportation fund revenue.

The proposed FY 2012 capital program includes \$844.8 million in planned capital expenditures to be financed by \$580.8 million in new I.T. or G.O. bond issues , \$5.8 million of PAYGO transfers for a Department of the Environment project required by the Environmental Protection Agency, \$45 million from the Master

Equipment Lease Program, \$143.2 million in federal grants, \$37.3 million in the Local Match to the Federal Highway Administration grants, \$1 million in a private donation from DC Water (the D.C. Water and Sewer Authority), and \$35.7 million from the Local Transportation Revenue Fund. (See Attachment 6.)

Total debt service for all tax-supported debt as a percentage of total General Fund expenditures is estimated to be below the District's 12 percent debt limit within the FY 2012 – 2017 CIP period.

SUMMARY

In summary, the District's leadership has the will and the necessary resources to make informed decisions and the District has a proven record of functioning in a fiscally responsible manner. Based on this commendable record, our elected leadership deserves a greater degree of confidence in the form of budget autonomy.

As a final note, I would like to take issue with a recent editorial in *The Washington Post* regarding the competitiveness of the District in attracting new businesses to the nation's capital. They based this on several reports by Ernst & Young and others that compared the tax burdens of the fifty states and the District. I strongly disagree with their contention that the District is not competitive because of prohibitively high business taxes. There are many factors other than taxes that go in to a corporate decision to locate here, most notably, proximity to Congress. In response to the editorial, I sent a rebuttal, which the Post published on May 1st. A copy is included as Attachment 7.

The leadership provided by the Mayor and the Council, along with the hard work of the Office of the Chief Financial Officer, allowed us to produce this balanced budget. I would like to thank this Subcommittee for its diligent and continuous oversight work on the District's finances during this sustained recovery period. We look forward to continuing to work with you during the forthcoming budget deliberations.

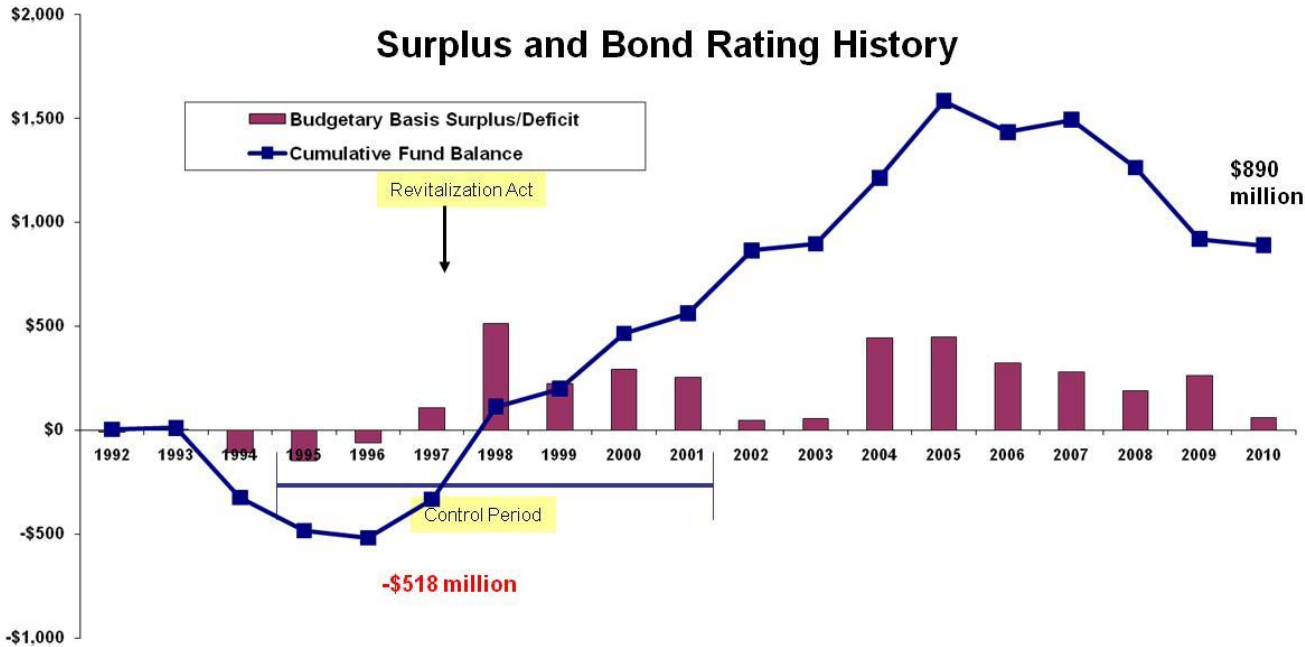
This concludes my remarks. I would be pleased to answer any questions you may have.

Changes in Revenue Estimates (\$ in millions)
Changes Since June 2008, Local Source, General Fund Revenue Estimates

	<u>Actual</u>	<u>Estimated</u>		<u>Projected</u>		
	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
June 2008 Budget	\$ 5,831.7	\$ 6,099.2	\$ 6,402.5	-	-	-
Changes in revenue estimate June 2008 to September 2010	\$ (1,032.6)	\$ (1,432.1)	\$ (1,614.6)	\$ (347.3)	-	-
Percent change from June2008	-17.7%	-23.5%	-25.2%	-	-	-
Estimates as of September 2010 (excluding policy changes)	\$ 4,799.1	\$ 4,667.2	\$ 4,788.0	\$ 4,941.4	-	-
Policy changes to address revenue decrease (Combination of spending cuts and revenue enhancements)	\$ 344.6	\$ 363.5	\$ 375.8	\$ 363.8	-	-
Estimates as of September 2010	\$ 5,143.7	\$ 5,030.7	\$ 5,163.8	\$ 5,305.2	\$ 5,401.8	\$ 5,539.3
Legislative and administrative changes to revenues		35.3	83.4	85.0	86.0	68.1
Changes in February 2011 estimate		3.5	105.4	203.7	238.7	232.0
February 2011 Revenue Estimate	\$ 5,076.4	\$ 5,069.4	\$ 5,352.5	\$ 5,593.9	\$ 5,726.5	\$ 5,839.4
Percent change from prior year	0.5%	-0.1%	5.6%	4.5%	2.4%	2.0%



District of Columbia Surplus and Bond Rating History



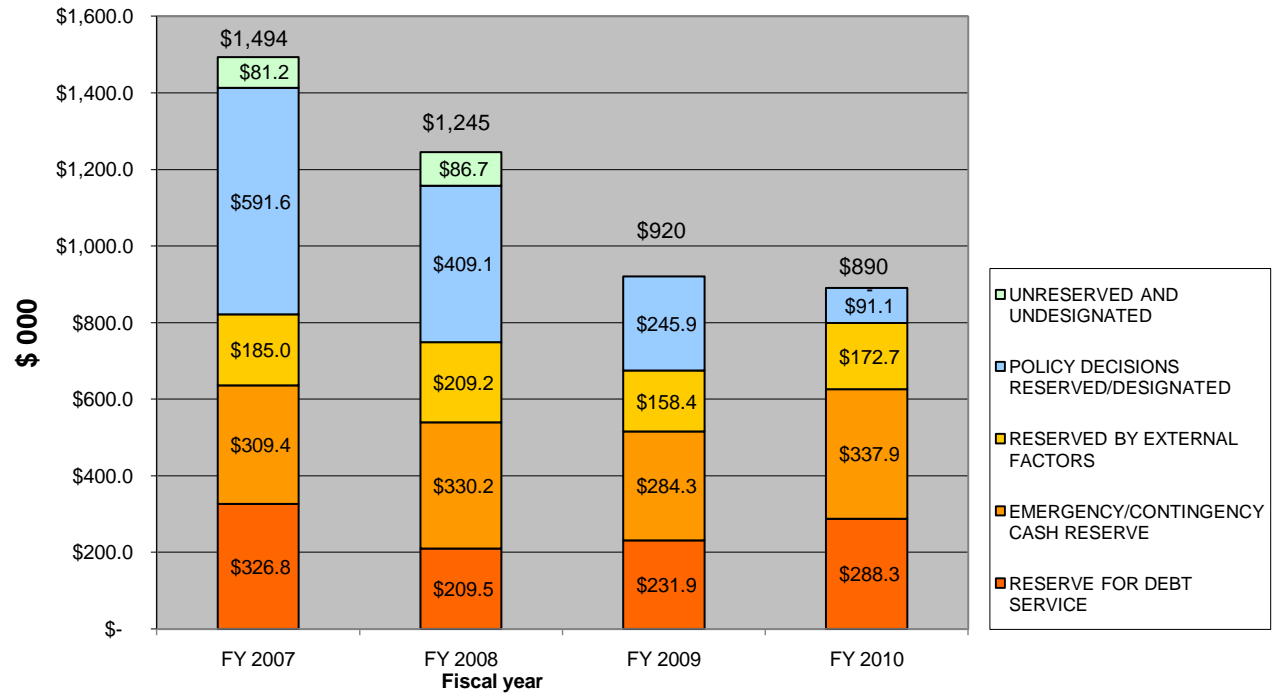
General Obligation Bond Ratings																			
S&P:	A-	A-	A-	BBB-	B	B	BB	BBB	BBB	BBB+	BBB+	A-	A	A+	A+	A+	A+	A+	
Moody's:	Baa	Baa	Baa	Ba	Ba	Ba2	Ba1	Ba1	Baa3	Baa3	Baa1	Baa1	A2	A2	A2	A1	A1	Aa2	Aa2
Fitch:		A-	BBB+	BB	BB	BB	BB+	BB+	BBB	BBB	BBB+	A-	A-	A	A	A+	A+	AA-	AA-

Income Tax Secured Revenue Bonds: S&P: AAA Moody's: Aa1 Fitch: AA+



Composition of General Fund Balance

FY 2007 – FY 2010





Total Working Capital

Unreserved/Undesignated Fund Balance Plus Congressionally Mandated Emergency/Contingency Reserves as a Percent of Next Year's Budgetary Expenditures

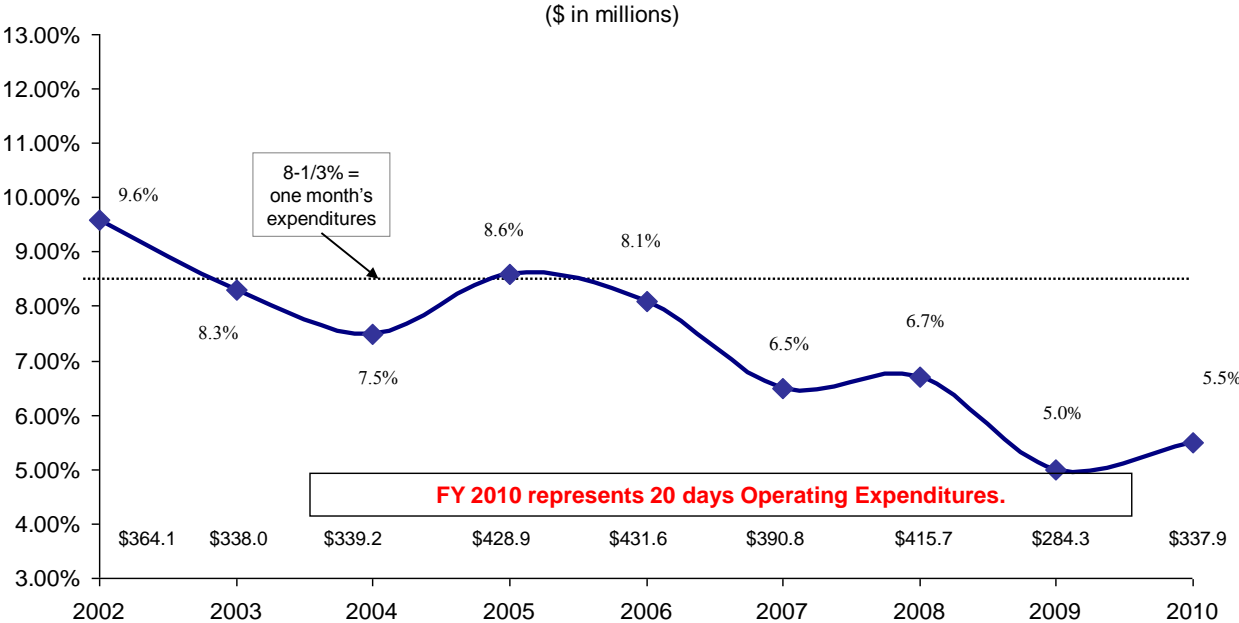


TABLE 3-1, BUDGET AND FINANCIAL PLAN

FY 2012 - 2015 Proposed Budget and Financial Plan: GENERAL FUND							
(\$ thousands)							
	FY 2010	FY 2011	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
	Actual	Approved	Revised	Proposed	Projected	Projected	Projected
1 Revenues							
2 Taxes	4,645,088	4,538,225	4,582,427	4,905,607	5,137,236	5,279,237	5,446,616
3 Dedicated Taxes	258,779	349,071	354,431	371,375	384,177	429,958	438,240
4 General Purpose Non-Tax Revenues	338,208	409,053	403,113	366,862	368,252	355,688	317,461
5 Special Purpose (O-type) Revenues	439,908	478,777	426,615	460,173	457,984	462,189	482,950
6 Transfer from Lottery	66,750	68,500	63,007	69,415	71,586	73,675	75,349
7 Inter fund transfer	0	14,889	20,889	10,636	16,797	17,934	0
8 Sub-total, General Fund Revenues	5,748,733	5,858,515	5,850,482	6,184,068	6,436,032	6,618,681	6,760,616
9 Bond Proceeds for Issuance Costs	5,079	15,000	15,000	6,000	6,000	6,000	6,000
10 Revenues setaside for subsequent years' expenditures	0	0	0	0	(29,000)	0	29,000
12 Transfer from Federal and Private Resources	1,589	3,497	3,497	3,497	3,497	3,497	3,497
13 Transfer from Enterprise and Other Funds	22,697	78,745	69,817	4,196	5,532	0	0
14 Fund Balance Use	138,421	195,784	200,501	(12,163)	0	0	0
15 Revenue Proposals	0	(25,956)	3,674	158,624	133,715	139,145	145,886
16 Total General Fund Resources	5,916,520	6,125,585	6,142,971	6,344,223	6,555,776	6,767,323	6,944,999
18 Expenditures (by Appropriation Title)							
19 Governmental Direction and Support	349,803	464,043	467,266	537,561	545,493	555,959	567,131
20 Economic Development and Regulation	252,827	242,500	243,464	221,995	221,698	223,846	226,340
21 Public Safety and Justice	1,018,243	976,196	976,196	961,404	976,318	992,427	1,009,516
22 Public Education System	1,406,991	1,485,843	1,500,043	1,560,895	1,580,311	1,612,712	1,638,237
23 Human Support Services	1,487,270	1,453,130	1,455,261	1,499,565	1,537,720	1,577,487	1,622,658
24 Public Works	565,731	540,670	540,670	464,309	484,289	488,930	488,911
25 Financing and Other	469,610	538,993	538,993	603,172	642,970	669,597	693,850
26 Bond Issuance Costs	5,079	15,000	15,000	6,000	6,000	6,000	6,000
27 Operating Cash Reserve	0	40,000	25,191	0	0	0	0
28 Sub-total, Operating Expenditures	5,555,554	5,756,375	5,762,084	5,854,902	5,994,798	6,126,957	6,252,644
29 Paygo Capital	14,933	12,071	12,071	37,448	84,055	126,757	164,911
30 Transfer to Trust Fund for Post-Employment Benefits	90,700	98,700	98,700	109,800	117,500	125,700	133,900
31 Repay Contingency Reserve Fund	0	3,000	3,000	3,000	0	0	0
32 Transfer to Enterprise Funds	197,203	244,644	244,644	337,703	348,510	374,437	379,845
33 Operating impact of CIP	0	0	0	0	9,498	11,986	11,861
34 Total Expenditures and Transfers	5,858,390	6,114,790	6,120,499	6,342,853	6,554,361	6,765,837	6,943,161
35 Operating Margin, Budget Basis	58,129	10,795	22,472	1,369	1,415	1,486	1,838
37 Composition of Cash Reserves							
38 Emergency Cash Reserve Balance (2%, formerly 4%)	109,704	109,872	109,872	110,041	110,209	111,023	113,667
39 Contingency Cash Reserve Balance (4%, formerly 3%)	228,241	228,549	228,549	228,858	229,167	229,476	229,786
40 Total cash reserves - emergency & contingency	337,945	338,421	338,421	338,899	339,376	340,499	343,453

Attachment 6

CAPITAL FUND PRO-FORMA

Capital Fund Pro Forma								
(Dollars in thousands)								
	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	Total	Percent of FY 2012
Sources:								
G.O. / I.T. Bonds	\$ 580,784	\$ 526,884	\$ 501,298	\$ 475,677	\$ 445,323	\$ 388,053	\$ 2,918,019	68.7%
Master Equipment Lease	45,000	26,500	16,000	14,406	27,425	16,338	145,669	5.3%
Paygo	5,800	49,265	89,994	131,951	161,221	195,598	633,829	0.7%
Local Transportation Fund Revenue	31,648	34,225	34,225	34,225	34,225	24,003	192,549	3.7%
GARVEE Bonds	-	50,000	-	-	-	-	50,000	0.0%
Local Highway Trust Fund	37,310	37,310	37,310	37,310	37,310	37,310	223,858	4.4%
Federal Grants	143,249	133,249	140,249	133,249	133,249	133,249	816,492	17.0%
Private Donations	1,000	-	-	-	-	-	1,000	0.1%
Total Sources	\$ 844,790	\$ 857,432	\$ 819,075	\$ 826,817	\$ 838,752	\$ 794,550	\$ 4,981,417	100.0%
Uses:								
District of Columbia Public Schools	\$ 267,036	\$ 299,071	\$ 315,596	\$ 307,473	\$ 268,112	\$ 278,973	\$ 1,736,262	31.6%
Department of Transportation	255,496	292,496	244,343	233,986	243,946	227,043	1,497,310	30.2%
<i>Local Transportation Fund</i>	84,938	121,938	73,784	63,427	73,388	56,485	473,959	
<i>Highway Trust Fund</i>	170,558	170,558	170,558	170,558	170,558	170,558	852,792	
Washington Metropolitan Area Transit Authority	126,678	117,968	122,635	116,625	107,161	118,833	709,900	15.0%
University of the District of Columbia	43,220	39,340	25,080	25,873	43,627	45,000	222,140	5.1%
Department of Public Works	26,226	5,400	6,316	6,850	6,789	3,900	55,481	3.1%
Fire and Emergency Medical Services Department	22,296	16,146	12,298	10,648	14,836	3,500	79,724	2.6%
Department of the Environment	16,800	-	-	25,000	25,000	24,000	90,800	2.0%
Office of the Deputy Mayor for Planning and Economic Development	14,400	8,500	10,500	30,500	53,500	4,100	121,500	1.7%
District of Columbia Public Library	10,400	11,136	11,275	8,000	1,500	17,865	60,176	1.2%
Office of Unified Communications	10,121	-	-	-	-	-	10,121	1.2%
Special Education Transportation	7,219	6,657	6,021	6,223	6,388	6,729	39,237	0.9%
Department of Parks and Recreation	7,070	13,670	24,054	17,989	25,800	23,150	111,733	0.8%
Office of the Chief Financial Officer	6,600	12,600	6,800	5,500	4,200	-	35,700	0.8%
Office of the State Superintendent of Education	6,500	5,100	-	-	-	-	11,600	0.8%
Office of the Chief Technology Officer	5,898	6,104	3,427	4,450	10,240	13,000	43,119	0.7%
Metropolitan Police Department	5,400	7,200	6,899	7,550	10,700	10,700	48,449	0.6%
Office of General Services	5,030	8,543	5,131	6,951	8,253	7,057	40,966	0.6%
Department of Corrections	3,300	2,300	1,500	-	-	-	7,100	0.4%
Commission on Arts and Humanities	2,700	2,700	2,700	2,700	2,700	2,700	16,200	0.3%
Office of Planning	2,400	2,500	2,500	3,500	4,000	4,000	18,900	0.3%
Department of Employment Services	-	-	12,000	6,000	-	-	18,000	0.0%
Department of Consumer and Regulatory Affairs	-	-	-	1,000	-	4,000	5,000	0.0%
Department of Housing and Community Development	-	-	-	-	2,000	-	2,000	0.0%
Total Uses	\$ 844,790	\$ 857,432	\$ 819,075	\$ 826,817	\$ 838,752	\$ 794,550	\$ 4,981,417	100.0%
Note: Details may not sum to totals due to rounding.								

The myth of D.C. anti-competitiveness

By Natwar M. Gandhi, Published: April 29 | Updated: Wednesday, April 27, 1:30 PM

It is conventional wisdom that the District's high business taxes keep firms from locating in the city. This was evident in [an April 10 Post editorial](#), which stated: "The District, according to a report prepared by Ernst & Young in conjunction with the Council on State Taxation, is tied for last place in the nation as the least competitive place for new investment because of its taxes."

That study, "[Competitiveness of State and Local Business Taxes on New Investment: Ranking states by tax burden on new investment](#)," ranked the District and the states on attractiveness for new investments. In a hearing of the D.C. Council's Finance and Revenue Committee, this study and [a similar one by the Small Business & Entrepreneurship Council](#) were cited as evidence that high taxes are hurting the District's competitiveness.

These last-place rankings conjure up an image of a District in decline, with fleeing businesses leaving behind empty office buildings, undeveloped lots and boarded-up storefronts. Except that is not true. Today, the District's private sector is vibrant and growing. D.C. businesses are recovering from the recession much faster than businesses are anywhere else.

[Bureau of Labor Statistics figures show](#) that private-sector employment in the city is now virtually the same as it was at its pre-recession peak (in the D.C. suburbs and the United States as a whole, private-sector employment is off its peak by 2.3 percent and 6.5 percent, respectively). The Bureau of Labor Statistics figures show that from 2005 to 2011, the District's private sector had a net gain of 20,300 jobs — about the same as the gain in the suburbs — while the United States as a whole lost 2.6 million jobs.

In addition, occupied office space increased in the January-March quarter just ended by 4.85 million square feet from a year earlier, and the District has one of the lowest vacancy rates in the country (8.4 percent in the quarter ending in March 2011, compared with 12 percent in the D.C. metropolitan area overall). And, it is not just U.S. investors who find the District attractive. Foreign investments are key components of many property sales and projects — the convention center hotel and City Center DC, to name two.

So what is going on here? Why do these studies rank the District dead last as a place to invest, despite such strong evidence to the contrary?

First, the studies' narrow focus on taxes as a driver of business investments excludes more important factors, including the built-in advantages of the federal presence, population demographics and residents' education levels.

Many businesses locate in the District for access to the federal government (e.g., lobbyists, federal contractors). They are also here because of the District's unique amenities, such as the national institutions and cultural attractions. National and local retailers are attracted to a significant growing population of younger, wealthier and well-educated residents. While high taxes certainly can affect competitiveness, we cannot forget the District's strong competitive advantages.

Second, the studies have a methodological flaw. They take a "representative firm" and apply statutory tax rates, ignoring the reality of aggressive tax planning by businesses, which reduces what they actually pay. In the District, almost two-thirds of businesses pay only the minimum of \$100 a year. When actual business taxes paid are ranked, the District falls in the middle of the pack.

Another Ernst and Young/COST report, [from March 2010](#), showed that D.C. business taxes as a percentage of private-sector gross state product were slightly below the national average, with the District at 4.2 percent vs. 4.7 percent for the United States as a whole. The District ranked the same as Maryland, but below Virginia. This is consistent with our [own 2009 study](#) comparing the District's household tax burden with that of 50 other U.S. cities. For a hypothetical family of three with income of \$150,000, the District's tax burden ranked in the middle (22 out of 51) with a tax burden of 9 percent, a bit higher than the average of 8.1 percent.

Finally, it must be recognized that the federal government's restrictions on the District's ability to tax commuters and property create a constricted tax base that leads to an additional tax burden on the individuals, families and businesses that choose to live and operate here. It is my hope that the business community will use its significant voice to help us deal with these issues.

The writer is chief financial officer of the District of Columbia.