Fiscal Turnaround of the District of Columbia through Federal-Led Adjustment Program

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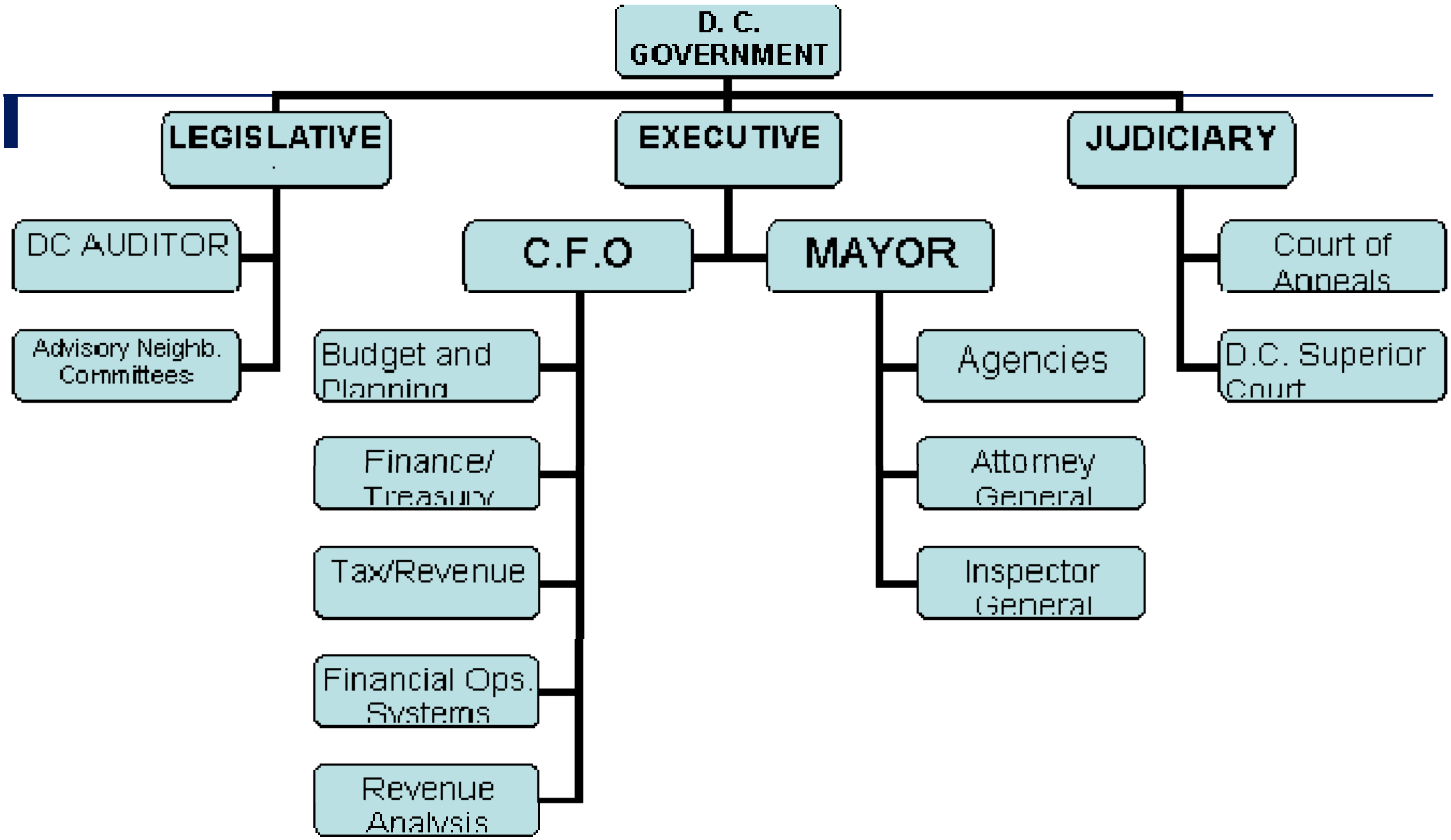
Overview

- Governance Structure of the District of Columbia
  - Creation of the District of Columbia: a short history
  - Current governance structure
  - Overview of the City's economic, demographic characteristics
- District - Federal Relations: Roles and Responsibilities
  - Degree of fiscal Autonomy
  - Evolving of the District – Federal relations
  - Revitalization Act
  - Role of the Independent C.F.O. and impact on city finances
- The District of Columbia Fiscal Structure: Lessons Learned
  - Problems resulting from Federal review of DC Budget
  - Challenges of maintaining a balanced four-year budget and financial plan
  - Preventing unfunded mandates

A short history of the District of Columbia

- Establishment of the Federal District goes back to the adoption of the US Constitution in 1787.
- Between 1820 and 1870, the city slowly took over its own management. During this time, the population swelled to 109,000 and infrastructure needs became dire.
- A new territorial government, established in 1871, invested heavily in the city but the city went bankrupt in 1874 and the control of the city and its finances were transferred back to the Federal Government, which appointed three commissioners to run the city.
- This form of government lasted until 1973.
- In 1973 the District was granted limited self-governance.
  - Within about two decades the District was facing bankruptcy.
  - Congress intervened through the creation of a Control Board and an independent CFO.

Organization of the D.C. Government



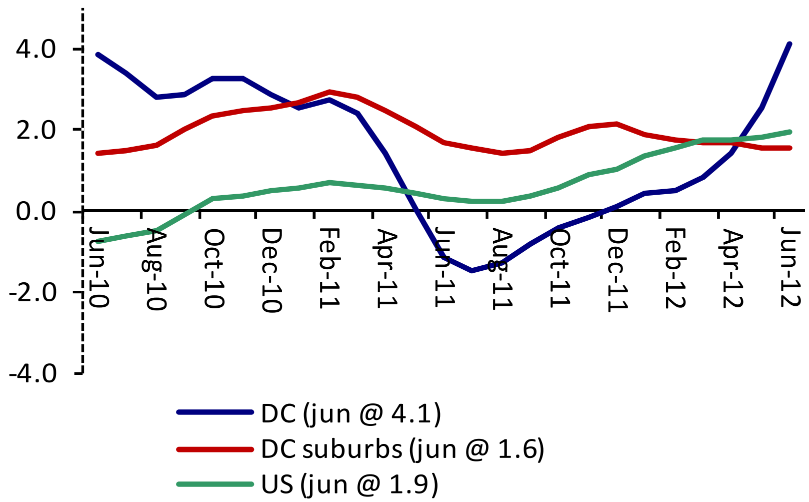
D.C. – Federal Relations

- The U.S. Congress has full authority—financial and otherwise—over the District of Columbia
- District Budget must be authorized by the Congress.
- The Congress can also overturn legislation passed by the D.C. Council.
- D.C. Residents can participate in presidential elections, but do not have representation in the Congress.
- The District receives some support from the Federal Government, but mostly the city provides a combination of state and local services.

District of Columbia and its Metropolitan Area

The District vs. The Metro Area

Resident employment in DC , the DC suburbs, and the US: June 2010 to June 2012
(% change from prior year in 3-month moving average)



- In June 2102, there were 749,900 jobs in the District—note that this is larger than the total resident population.
- About 70 percent of these jobs are held by commuters typically from the larger metropolitan area of Northern Virginia, Maryland, and to a small extent, West Virginia.
- District account's for 24.2 % of metro employment and 21 percent of metro private employment
- In June, unemployment in DC was 9.1 % (8.4% US, 5.2 % metro)

Sectors of the Economy

Sector	% of jobs	% of income
Federal government	28.5%	35.9%
Local Government	4.7%	4.3%
Professional/Business	13.9%	26.4%
Information/Finance	6.2%	6.6%
Education/Health	16.3%	9.7%
Trade/ Hospitality	11.9%	5.5%
Organizations	8.3%	7.7%
Other private	10.2%	3.9%

Federal Presence in the District of Columbia

- In addition to the U.S. Capitol and the White House, the Headquarters of all administrative offices of the U.S. government is in the District of Columbia.
- The city also has a number of national buildings, monuments, and museums.
- A very conservative assessment of the federally owned property is approximately $30 billion, at about 20 percent of the total property values in the District.

Federal Presence in the District of Columbia

- The National Capital Planning Commission (NCPC) is the federal government’s central planning agency for federal land and buildings in the National Capital Region.
- NCPC develops planning policies and makes decisions that protect and enhance the extraordinary historical, cultural, and natural resources of the nation's capital.
- One major role of NCPC is to ensure that a balance between local and federal interests is achieved.

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Combined State and Local Revenue and Expenditure Authority

- In the U.S., the delivery and financing of government services is allocated across three levels of government: local, state, and Federal.
- The District of Columbia is a unique jurisdiction in the U.S. federal system because it has responsibility for ***both local and state services***.
- D.C. expenditure areas:
  - State-type: higher education and public welfare.
  - Local-type: primary and secondary education, police and fire, parks and recreation, housing and libraries.
- D.C. revenues:
  - State-type: income tax and sales tax.
  - Local-type: property tax.

- The District also receives ***grants and earmarks from the Federal government*** similar to other state and local governments.
- Uniquely the District receives grants that are typically disbursed directly to city and state governments.
  - Federal grant expenditures constitute about **24** percent of the District's gross funds budget (of about **$11** billion).
- The District also receives Federal payments that are earmarked for specific purposes and vary on a year-to-year basis.
  - Federal payments constitute less than 1 percent.

Home Rule Granted to the District (1973)

- U.S. Constitution grants full authority over national capital city to Congress
- Limited fiscal autonomy under the Home Rule Act:
  - Mayor submits budget to City Council, but Congress retained final authority over the District's budget.
  - The District is prohibited from taxing nonresident income. This is a significant reduction constraint on the income tax base as about 65 percent of income earned in the District belong to non-residents.
- HRA established a lump sum federal payment to the District (repealed in 1997)
  - $230 million in FY 1975, about 40 percent of own-source revenue. Until repealed, typically 20 to 30 percent of own-source revenue.
  - Transferred a large unfunded pension liability to the District.

Establishment of the Control Board and the Independent CFO (1995)

- The District experienced a fiscal crisis in the mid-1990s: by the end of FY 1996 the city had a cumulative deficit of over $500 million, almost 20 percent of general fund revenue.
- In response to the fiscal crisis, Congress established the Control Board and independent CFO.
- The Control Board
  - consisted of five presidentially appointed members, including a Chairperson.
  - was given powers to hold hearings, issue subpoenas, and enter into contracts.
- The Control period would only terminate when:
  - the District had adequate access to credit markets,
  - the District achieved four consecutive balanced budgets.

Temporary Suspension of Limited Fiscal Autonomy

- **Budget**: The Mayor was required to submit the proposed budget to the Control Board for approval prior to submission of the budget to Congress.
- **Fiscal Review of Legislation**: All laws passed by the Council and signed by the Mayor were required to be reviewed by the Control Board to ensure that they were consistent with the budget.
- **Borrowing**: The District was required to receive the certification from the Control Board prior to borrowing funds.

Functions transferred to the OCFO

- Preparing the budget and financial plan for Control Board's approval
- Preparing quarterly revenue estimates, with approval from the Control Board, for submission to the Mayor and Council
- Assuming responsibility for financial transactions to ensure adequate control of revenues and resources, and to limit overspending
- Maintaining systems of accounting and internal controls that provide transparency and adequate financial information for the management purposes
- Producing the District's audited comprehensive annual financial report
- Managing the levying and collecting of taxes including the assessment of property
- Managing the District's cash, investments and borrowing
- Certifying all contracts

The 1997 Revitalization Act and Changes in DC-Federal Fiscal Relations

- The Revitalization Act of 1997 was enacted to partially address:
  - the fact that the District must pay for many “state” services with a federally restricted tax base, and
  - to address the large unfunded pension liability transferred to the District from the federal government.
- Under the Revitalization Act of 1997, the federal government assumed responsibility for a number of District government services traditionally provided by state governments including:
  - incarceration of felony prisoners,
  - funding and administration of the courts (Court of Appeals, Superior Court, and D.C. Court System),
  - pre-trial services for defendants awaiting trial,
  - public defender service and parole services for adult offenders
- District’s Medicaid match rate was increased from 50 % to 70 %

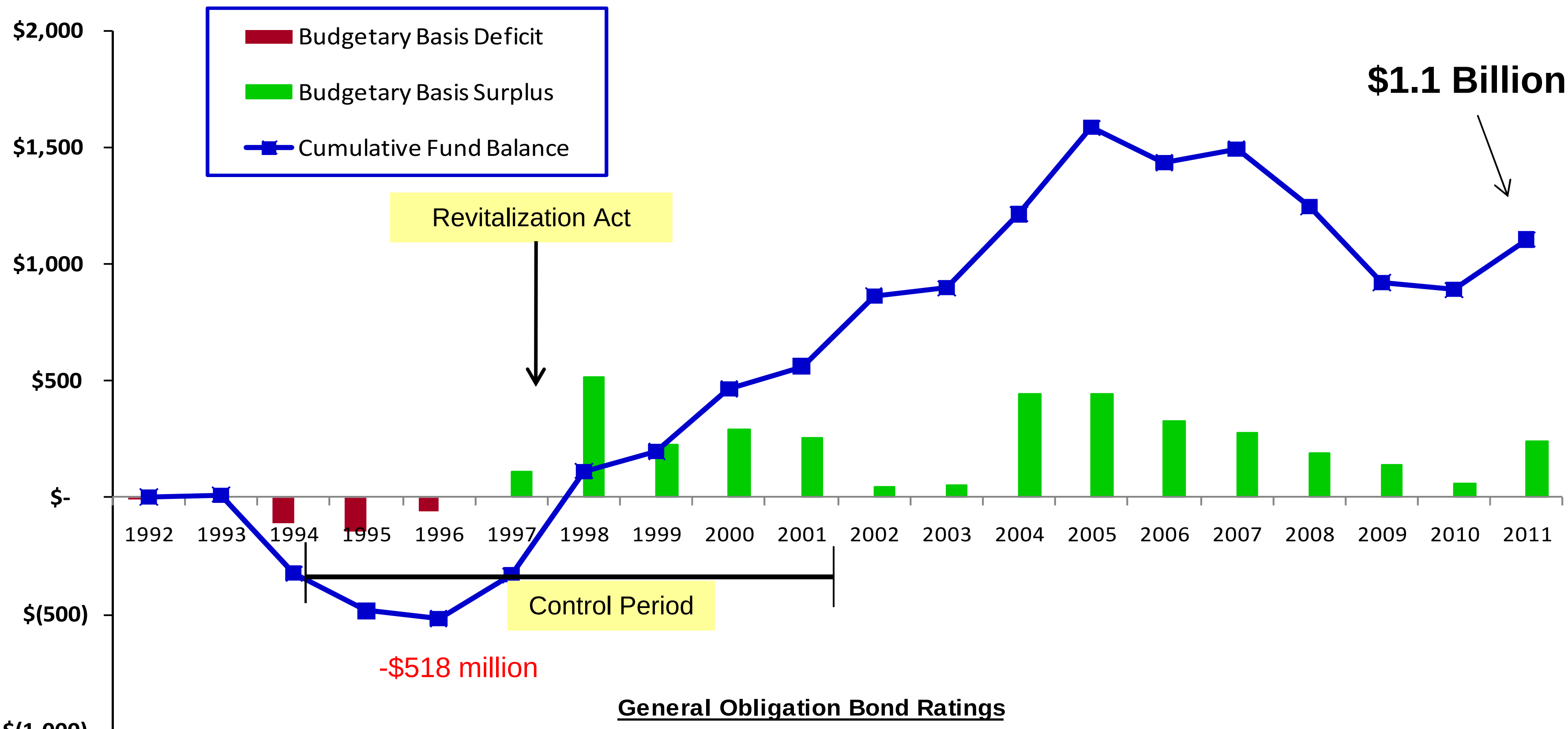
The 1997 Revitalization Act and Changes in DC-Federal Fiscal Relations

- In addition, the federal government assumed responsibility for the majority of the District's unfunded pension liability for retirement plans for teachers, police officers, firefighters and judges.
  - By FY 1997, the District's unfunded pension liability had grown to $3.7 billion.
- In exchange for the various types of expenditure relief, the annual federal payment to the District of $660 million in FY 1998 was eliminated.
- The net benefit of the Revitalization Act in FY 1998 was $201 million.
  - Since the enactment of the Revitalization Act, the inflation-adjusted annual net benefit has grown to $247 million in FY 2011

Current Role of the CFO and Impact on City Finances

- The OCFO remains an independent fiscal office with all of the responsibilities performed during the Control period.
  - In addition, the *2005 District of Columbia Omnibus Authorization Act* includes the preparation of Fiscal Impact Statements as one of the duties of the OCFO.
- Between 1996 and 2007 the District experienced a remarkable fiscal turnaround.
- By the end of fiscal year 2007 the District had a cumulative fund surplus of $1.5 billion and had achieved eleven consecutive balanced budgets.
- Since 2007, the District has used fund balance to offset the loss of revenues caused by the national and global economic downturn, resulting in a fund balance of $920 million by the close of 2009. This practice ended recently, and the fund balance
- The OCFO has been a critical element in the current fiscal environment, requiring that budgets continue to be balanced.

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+	A+	A+
Moody's:	Baa	Baa	Baa	Ba	Ba	Ba2	Ba1	Ba1	Baa3	Baa3	Baa1	Baa1	A2	A2	A2	A1	A1	Aa2	Aa2	Aa2
Fitch:		A-	BBB+	BB	BB	BB	BB+	BB+	BBB	BBB	BBB+	A-	A-	A	A	A+	A+	AA-	AA-	AA-

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

Key Areas Where the OCFO Positively Impacts the Administration of the District's Finances

- **Independent revenue estimates** that are the starting point of the budget development process and ensure the budget is built on a solid foundation.
- The development of a **realistic baseline budget** that ensures that full program costs are captured in the budget.
- Close attention to **budget execution** and the early identification of spending pressures.
- **Improved tax administration** that ensures revenues are collected in a timely and professional manner.
- **Financial reporting** that consistently results in clean audit opinions.
- **Improved debt management** practices resulting in bond rating upgrades.
- **Fiscal impact statements** that prevent unfunded liabilities from putting the budget out of balance.

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Problems Resulting from Federal Review of DC Budget

- Budget must be completed 3 months prior to start of the fiscal year to allow time for Federal review
- Schedule requires Mayor's proposed budget to be based on February revenue estimate – 8 months prior to the start of the fiscal year.
- Congressional delays in approving the budget have impacted service improvements
- Delays in supplemental appropriations and reprogrammings
- District does not conform to standard state/local government fiscal year of July 1 to June 30

Budget Timeline

- **January through March** – Mayor prepares budget (based on the December estimate)
- **Last week in March** – Mayor's budget submission to Council (adjusted for the February estimate). This includes the Budget Request Act, which is the appropriations bill, and the Budget Support Act, which is all the legislative changes necessary to implement the budget.
- **April through early May** – Council holds public hearings on Mayor's proposed budget
- **Mid May** – Council Committees mark up the Mayor's budget
- **Early June** – Council approves budget
- **Late June** – Mayor signs the budget
- **Early July** – Budget transmitted to the Congress for approval
- **October 1** – Start of the fiscal year

Challenges of Maintaining a Balanced Four-year Budget and Financial Plan

- The CFO is responsible for maintaining a balanced four-year financial plan.
- Mayor and Council typically will ensure legislation with a fiscal impact is funded in the first year.
- The CFO must ensure that the out-years remain in balance.

Preventing Unfunded Mandates

- In some cases, the OCFO prepared Fiscal Impact Statement indicates that "funds are not sufficient" to implement proposed legislation.
- In many cases such legislation is passed "subject to appropriation."
  - Legislation cannot be implemented until funds are identified to pay for the legislation
- Legislation passed "subject to appropriation" causes confusion:
  - Public assumes that since legislation has passed, it will be implemented immediately.
  - Lawmakers may argue that CFO is responsible to "find the money" to implement the legislation

Conclusion

- The District of Columbia is unique in the governmental structure of the United States
- As the nation's capital, it is not part of any state
- The powers given to the independent Chief Financial Officer of the District of Columbia by the Congress of the United States have resulted in a fiscally stronger District of Columbia
- Ensuring that the District continues to be financially sound is more challenging in the current economic environment, but the CFO has the means to prevent budget imbalance