



Office of the District of Columbia Auditor

Certification of Fiscal Year 2018 Total Local Source General Fund Revenue Estimate (Net of Dedicated Taxes) in Support of the District's Issuance of General Obligation Bonds (Series 2017B and 2017D), General Obligation Refunding Bonds (2017C) and General Obligation Bond Anticipation Notes (Series 2017)

April 6, 2018

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A Report by the Office of the District of Columbia Auditor
Kathleen Patterson, District of Columbia Auditor

April 6, 2018

The Honorable Phil Mendelson
Chairman
Council of the District of Columbia
1350 Pennsylvania Ave., N.W.
Washington, D.C. 20004

Letter Report: Certification of Fiscal Year 2018 Total Local Source General Fund Revenue Estimate (Net of Dedicated Taxes) in Support of the District's Issuance of General Obligation Bonds (Series 2017B, 2017C and 2017D) and General Obligation Bond Anticipation Notes (2017)

Dear Chairman Mendelson:

On October 13, 2017, the Deputy Chief Financial Officer and Treasurer of the District of Columbia requested that the Auditor certify the Office of the Chief Financial Officer (OCFO) fiscal year (FY) 2018 estimated total local source General Fund Revenue (net of dedicated taxes).¹ OCFO requested the Auditor's certification in connection with the District's issuance of \$100,000,000 in Multimodal General Obligation Bonds (Series 2017B) and \$521,705,000 in General Obligation Bonds (Series 2017D), to finance certain approved capital projects in the District's Capital Improvement Plan.

On December 5, 2017, the Deputy Chief Financial Officer and Treasurer sent another letter requesting the Auditor's certification for the issuance of General Obligation Bond Anticipation Notes, Series 2017 up to a maximum principal amount of \$200,000,000.

This report sets forth the results of the Auditor's analysis of the CFO's FY 2018 local source revenue (net of Dedicated Taxes) estimate at the time of the Auditor's Certification of \$7,493,617,000.²

Objectives, Scope, and Methodology

The objectives of this analysis were to:

¹ Request sent from the Office of the Chief Financial Officer's (OCFO) Office of Finance and Treasury (OFT) to the Office of the DC Auditor pursuant to D.C. Official Code, Section 1-206.03(b)(1).

² See quarterly revenue estimate letter from the Chief Financial Officer to the Mayor and Council Chairman, dated September 29, 2017 for local source revenue estimate. The Auditor's certification was issued on November 21, 2017 and December 22, 2017.

1. Assess the reasonableness and attainability of OCFO's fiscal year (FY) 2018 local source revenue estimate (net of dedicated taxes) of \$7,493,617,000.
2. Determine if the issuance of the proposed general obligation bonds would cause the District to exceed the 17 percent revenue limitation, as outlined in D.C. Official Code § 1-206.03(b)(1).

The scope of this review included financial records and data for FY 2013 through FY 2017, and FY 2018 estimated local source revenues and economic forecast.

In conducting our analysis, we analyzed actual local source revenues for FY 2013 through FY 2016, estimated FY 2017 local source revenues per the September 2017 cash report, and reviewed the estimated local source revenue for FY 2018 as laid out in the District's quarterly revenue estimates. We also reviewed the District's FY 2018 budget and economic data, continuing covenant agreements, revolving credit agreement, and final official statement supporting the bond and bond anticipation notes issuances.

To gain an understanding of the District's current economic outlook, we interviewed the OCFO Office of Revenue Analysis (ORA) staff, and an economist from the Stephen S. Fuller Institute for Research on the Washington Region's Economic Future who specializes in the structure of the Washington Metropolitan area economy.

Background

D.C. Official Code, Section 1-206.03 (b)(1) states, in relevant part, that:

*No general obligation bonds... or Treasury capital project loans shall be issued during any fiscal year in an amount which would cause the amount of principal and interest required to be paid both serially and into a sinking fund in any fiscal year on the aggregate amounts of all outstanding general obligation bonds and such Treasury loans, to exceed 17% of the District revenues... which the Mayor estimates, **and the District of Columbia Auditor certifies**, will be credited to the District during the fiscal year in which the bonds will be issued.(emphasis added)*

In compliance with D.C. Official Code, Section 1-206.03 (b)(1), OCFO requested that the Auditor certify the OCFO FY 2018 total local source General Fund Revenue (net of dedicated taxes) estimate. OCFO requested the certification in connection with the District's issuance of:

- \$100,000,000 aggregate principal amount of General Obligation Bonds (Series 2017B). The proceeds of the Series 2017B bonds will be used to finance capital projects expenditures under the District's Capital Improvements Plan.
- \$521,705,000 aggregate principal amount of General Obligation Bonds (Series 2017D). The proceeds of the Series 2017B bonds will be used to finance certain approved capital projects in the District's Capital Improvement Plan.
- \$200,000,000 maximum principal amount of General Obligation Bond Anticipation Notes, Series 2017.

In conjunction with the requested review, we also reviewed the District’s issuance of \$99,935,000 aggregate principal amount of General Obligation Refunding Bonds (Series 2017C). The proceeds of the Series 2017C bonds will be used to refund certain outstanding General Obligation Bonds.

The Auditor’s certification was based on an evaluation of the \$7,493,617,000 in FY 2018 local source revenue estimated by the CFO on September 29, 2017. The CFO’s estimate was based upon information that can change rapidly, resulting in revisions to the CFO’s estimate after the Auditor’s certification. Thus, the Auditor only certifies that the revenue estimate, at the time of certification, appears sufficiently supported and achievable. This is particularly relevant for this particular certification, which took place just two months into the fiscal year being analyzed (FY 2018). As OCFO frequently revises projections throughout the fiscal year as a result of more detailed information, we stress that our report is based on the information available at the time.

Relative uncertainty in the overall estimating process or unforeseen national and local events may substantially change the District’s economic outlook and could result in changes to the revenue estimate that differ significantly from the estimate certified by the Auditor. Additionally, the validity and accuracy of the Auditor’s certification analysis are predicated upon the extent to which the OCFO provided a sound and reasonable FY 2018 local source revenue estimate; fully disclosed information to the Auditor; and provided reliable and accurate information to the Auditor regarding the District’s FY 2013 to 2017 revenue collections.

Results of the Auditor’s Examination

In reviewing the FY 2018 local source revenue estimate of \$7,493,617,000 detailed in Figure 1, the Auditor relied on revenue collection results for FYs 2013 through 2017, economic indicators and projections provided by the Office of Revenue Analysis, and an interview with a local economist.

Figure 1: FY 2018 Local Source Revenue (net of Dedicated Taxes) Estimate Submitted by the CFO and Certified by the Auditor on September 29, 2017

Revenue Source	CFO’s September 2017, FY 2018 Local Source Revenue Estimate (net of Dedicated Taxes)
Property Taxes	\$2,660,876,000
Sales Taxes	\$1,274,277,000
Income Taxes	\$2,490,923,000
Gross Receipts Taxes	\$237,329,000
Other Taxes	\$379,385,000
Total Taxes	\$7,042,790,000
Total Non-Tax Revenues	\$405,827,000
Lottery Revenues	\$45,000,000
Estimated Total Local Source Revenue	\$7,493,617,000

Source: Revenue estimate letter from the CFO to the Mayor and Council Chairman dated September 29, 2017. Available at: https://cfo.dc.gov/sites/default/files/dc/sites/ocfo/publication/attachments/September%202017%20Revenue%20Estimate%20Letter_09292017.pdf

To arrive at our conclusions and subsequent certification, the Auditor conducted detailed analyses of the following local tax and non-tax revenue sources: property tax; sales tax; income tax; gross receipts; other taxes; non-tax revenue; and lottery revenue. Key observations from our analysis conducted are noted below.

Property Tax

Property tax, the bulk or 96 percent of which is real property, has generally seen an increase in revenues from FY 2013 through FY 2017, averaging increases of \$143 million or 6.6 percent year over year for the last five years. OCFO's FY 2018 projection of property tax collection of \$ 2.661 billion reflects an increase of 4.5 percent or \$116 million when compared to the same period in FY 2017. We spoke with a local economist, who informed ODCA that demand continues to be strong for residential properties, with resale price increases for all housing types at four to five percent, which is higher than the previous year. Investment in housing in FY 2018 is expected to be stronger than in FY 2017. OCFO's estimate is in line with the projected modest growth in the area's housing market, rendering the FY 2018 property tax estimate both reasonable and achievable.

Sales Tax

For the period of FY 2013 through FY 2017, actual sales tax collections showed an average increase of 5.8 percent or approximately \$62 million per year. Based on OCFO's FY 2018 revenue estimate, issued on September 29, 2017, the District expects to collect approximately \$ 1.27 billion in sales taxes during FY 2018. The increase in sales tax collections estimated for FY 2018 represents a 2.1 percent increase over FY 2017 actual sales tax collections, which is a conservative estimate compared with the average increase calculated for the period FY 2013-FY 2017. In reviewing data for recent sales tax collections and forecasts, OCFO's sales tax estimate for FY 2018 appears reasonable and achievable.

Income Tax

It is projected that the total FY 2018 income tax revenue will remain relatively flat when compared to FY 2017 actual revenue. In the three most recent fiscal years, FY 2015 to FY 2017, total actual income tax revenue has exceeded the September revenue estimates. Individual Income Tax is the largest Income tax category, which accounts for 79 percent of the FY 2018 tax projection, is projected to slightly increase in FY 2018 when compared to FY 2017. According to OCFO, changes to the federal tax law will result in changes in the District standard deduction and personal exemptions which will offset additional revenue. Based on the information reviewed, the Auditor has determined that the FY 2018 revenue estimate for income taxes of \$2.491 billion is both reasonable and achievable.

Additional Observations

The Auditor also considered the following data on other tax and non-tax revenue sources in analyzing the FY 2018 local source revenue estimate of \$7,493,617,000:

- Between FY 2013 and FY 2017 other tax revenue (consisting of deed recordation, deed transfer, estate, and economic interest taxes) fluctuated year over year, but generally increased over the period, from \$359 million to \$435 million. OCFO projects a decline in FY 2018, with a revenue

projection of \$379 million. At the point of our review this was mainly due to the uncertainty of the federal tax reform.

- Non-tax revenue (composed of licenses and permits, fines and forfeits, charges for services, and miscellaneous revenue) has experienced changes of large magnitude, ranging from a decrease of 10.05 percent for FY 2014, to an increase of 22.19 percent FY 2016. ORA attributes these changes to various causes, including: a two-year cycle in license revenue (licenses and permits), changes in collections from traffic enforcement that depend on traffic officer staffing levels and red light camera operability (fines and forfeits), and one-time payments (miscellaneous). Actual revenue was \$509 million in FY 2016, and OCFO estimates that FY 2017 revenue was only \$451.5 million. For FY 2018, OCFO expects to collect \$405.8 million from non-tax sources, a decline of 10.12 percent compared to FY 2017 collection estimates.

Debt Limitation

D.C. Official Code, Section 1-206.03 (b)(1) sets forth a debt limit of 17 percent of the District's revenue. Specifically, it states, "...the amount of principal and interest required to be paid both serially and into a sinking fund in any fiscal year on the aggregate amounts of all outstanding general obligation bonds and such Treasury loans [cannot] exceed 17% of the District revenues...."

Per the D.C. Official Code, the District is only required to include the debt from all outstanding general obligation bonds and Treasury capital project loans in the debt limit calculation. Nevertheless, the District has taken a more conservative approach and included the principal and interest payments related to outstanding income tax secured revenue bonds in the debt limit calculation. Based on our review of the limitation on borrowing calculation provided by OCFO, the District's projected aggregate general obligation bond and income tax secured revenue bond debt service (principal and interest) for all bonds outstanding is projected to be 8.16 percent of the District's FY 2018 estimated revenue of \$7,493,617,000. During the period in which the District has outstanding debt from both this issuance and other previous debt issuances (2018-2042), the percentage of revenue necessary to pay debt service ranges from 10.30 percent (2022) to 1.73 percent (2042). As such, it is not likely that the 17 percent limitation will be exceeded as a result of the issuance of the general obligation bonds (Series 2017B and 2017D) and the general obligation refunding bonds (Series 2017C) and General Obligation Bond Anticipation Notes (Series 2017).

Conclusion

Based on an analysis of information provided by the Office of the Chief Financial Officer of the District of Columbia, as of November 21, 2017 and December 22, 2017, the assumptions supporting the fiscal year (FY) 2018 revenue estimate, and other relevant economic data, the Auditor concludes that the September 29, 2017, FY 2018 local source revenue (net of Dedicated Taxes) estimate of \$7,493,617,000 appears to be both reasonable and achievable. Further, the issuance of the new bonds is not likely to exceed the District's 17 percent limitation on debt service payments.

Therefore, the Auditor certified the \$7,493,617,000 FY 2018 local source revenue (net of dedicated taxes) estimate submitted by the CFO for the issuance of the District's Issuance of General Obligation Bonds Series 2017B and General Obligation Refunding Bonds Series 2017C on November 21, 2017; and

District's Issuance of General Obligation Bonds Series 2017D and General Obligation Bond Anticipation Notes Series 2017 on December 22, 2017.

Sincerely,

A handwritten signature in blue ink that reads "Kathleen Patterson". The signature is written in a cursive style with a large initial 'K'.

Kathleen Patterson
District of Columbia Auditor

cc: Betsy Cavendish, EOM
Jeffrey DeWitt, Chief Financial Officer