



**Certification of Fiscal Year 2017 Total Local Source
General Fund Revenue Estimate (Net of Dedicated
Taxes) in Support of the District's Issuance of General
Obligation Bonds (Series 2016D)**

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

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 2017 Total Local Source General Fund Revenue Estimate (Net of Dedicated Taxes) in Support of the District's Issuance of General Obligation Bonds (Series 2016D)

Dear Chairman Mendelson:

On October 13, 2016, 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) 2017 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 \$398,910,000 in General Obligation Bonds (Series 2016 D), to finance certain approved capital projects in the District's Capital Improvement Plan and \$190,635,000 in General Obligation Refunding Bonds (Series 2016 E) to refund a portion of the District's outstanding General Obligation Refunding Bonds, Series 2007C.

This report sets forth the results of the Auditor's analysis of the CFO's FY 2017 local source revenue (net of Dedicated Taxes) estimate of \$7,170,180,000.²

Objectives, Scope, and Methodology

The objectives of this analysis were to:

1. Assess the reasonableness and attainability of OCFO's fiscal year (FY) 2017 local source revenue estimate (net of dedicated taxes) of \$7,170,180,000.
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 2012 through FY 2017, as of October 31, 2016, and FY 2017 estimated local source revenues and economic forecast.

In conducting our analysis, we analyzed actual local source revenues for FY 2012 through FY 2016 (as of September 30, 2016), monthly cash collections for the first month of FY 2017 (October 2016), and reviewed the estimated local source revenue for FY 2017 as laid out in the District's quarterly revenue

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 revenue certification letter from the Chief Financial Officer to the Mayor and Council Chairman, dated September 30, 2016.

estimates. We also reviewed the District's FY 2017 budget and economic data, and the final official statement supporting the bond issuance.

To gain an understanding of the District's current economic outlook, we interviewed the OCFO Office of Revenue Analysis (ORA) staff, reviewed external local economic data sources, and interviewed an economist from George Mason University's Center for Regional Analysis who specializes in macroeconomic forecasts of the District and surrounding areas.

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 2017 total local source General Fund Revenue (net of dedicated taxes) estimate. OCFO requested the certification in connection with the District's issuance of:

- \$398,910,000 aggregate principle amount of General Obligation Bonds (Series 2016D). The proceeds of the Series 2016D bonds will be used to finance capital projects expenditures under the District's Capital Improvements Plan.
- \$190,635,000 aggregate principle amount of General Obligation Refunding Bonds (Series 2016E). The proceeds of the Series 2016E bonds will be used to refund certain outstanding General Obligation Bonds (Series 2007C).

Based on an analysis conducted by the OCFO Office of Finance & Treasury (OFT), it was determined that the issuance of the General Obligation Refunding Bonds (Series 2016E) would generate a net present value savings of \$20,229,588.08. To realize this cost savings, the proceeds of the Series 2016E bonds will be used to pay the principle and accrued interest on the refunded bonds (Series 2007C).

The Auditor's certification was based on an evaluation of the \$7,170,180,000 in FY 2017 local source revenue estimate certified by the CFO on September 30, 2016. 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 takes place just two months into the fiscal year being analyzed (FY 2017) and based on just one month of cash collections (October). 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, which for FY 2017 is limited.

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 ORA provided a sound and reasonable FY 2017 local source revenue estimate; fully disclosed information to the Auditor; and provided reliable and accurate information to the Auditor regarding the District’s FY 2012 to 2017 (as of October 2016) revenue collections.

Results of the Auditor’s Examination

In reviewing the fiscal year (FY) 2017 local source revenue estimate of \$7,170,180,000, the Auditor relied on revenue collection results for FYs 2012 through 2016, preliminary year-to-date FY 2017 revenue collections (as of October 31, 2016), as well as economic indicators and projections provided by the Office of Revenue Analysis, external local economic data, and an interview held with a local economist.

Figure 1: FY 2017 Local Source Revenue (net of Dedicated Taxes) Estimate Submitted by the CFO on September 30, 2016, and Certified by the Auditor.

Revenue Source	CFO’s September 2016, FY 2017 Local Source Revenue Estimate (net of Dedicated Taxes)
Property Taxes	\$2,515,160,000
Sales Taxes	\$1,201,217,000
Income Taxes	\$2,381,571,000
Gross Receipts Taxes	\$236,369,000
Other Taxes	\$351,984,000
Total Taxes	\$6,686,302,000
Total Non-Tax Revenues	\$428,378,000
Lottery Revenues	\$55,500,000
Estimated Total Local Source Revenue	\$7,170,180,000

Source: Revenue certification letter from the CFO to the Mayor and Council Chairman dated September 30, 2016. Available at: <http://cfo.dc.gov/sites/default/files/dc/sites/ocfo/publication/attachments/September%2030%20Revenue%20Estimate%20letter.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.

Property Tax

Property tax, the bulk or 96 percent of which is real property, has generally seen an increase in revenues from FY 2012 through FY 2016, averaging \$126 million or 6.5 percent year over year for the last five years. OCFO’s FY 2017 projection of property tax collection of \$ 2.515 billion reflects an increase of 5.5 percent or \$130 million when compared to the same period in FY 2016. According to the Delta Associates Second Quarter 2016 Washington Area Housing Outlook, healthy economic and job growth are expected to support the overall housing market over the next two years. While the housing market improved during the second quarter of 2016 with the sales volume continuing its upward trend at 8.6 percent, and with a 1.2 percent sales price increase from a year earlier, several factors will keep the

price appreciation at a modest 1 percent to 3 percent in the year ahead. OCFO's estimate is in line with the projected modest growth in the area's housing market, rendering the FY 2017 property tax estimate both reasonable and achievable.

Sales Tax

For the period of FY 2012 through FY 2016, actual sales tax collections showed an average increase of 3.6 percent or approximately \$38 million per year. Based on OCFO's FY 2017 revenue estimate, issued on September 30, 2016, the District expects to collect approximately \$ 1.2 billion in sales taxes during FY 2017. The increase in sales tax collections estimated for FY 2017 represents a 3.9 percent increase over FY 2016 actual sales tax collections, which is consistent with the average increase calculated for the period FY 2012-FY 2016, at 3.6 percent. In reviewing data for recent sales tax collections and forecasts, OCFO's sales tax estimate for FY 2017 appears reasonable and achievable.

Income Tax

OCFO projects that total income tax revenue will remain essentially flat in FY 2017, increasing just 0.3 percent from FY 2016, from \$2,373,368,000 to \$2,381,571,000. The Auditor has determined that this revenue estimate for income taxes for FY 2017, representing an increase of \$8,203,000, is both reasonable and achievable.

In the four most recently completed fiscal years, total actual income tax revenue has come in both above and below revenue estimates. In FY 2013 and FY 2014 revenue came in 1.7 percent and 4.6 percent below expectations, respectively, while in FY 2015 and FY 2016 collections exceeded projections by 1.1 percent and 3.3 percent. Overall for the four years, total income tax revenues have differed by less than one-half of one percent from estimates, on average. This indicates that in recent years OCFO has accurately estimated this revenue source, lending credibility to their current estimate for FY 2017. The first month of FY 2017's collections bears out OCFO's estimate as well, as revenue from income taxes has topped the first month's total from FY 2016 by about \$3.7 million. And while it is difficult to extrapolate a year's worth of collections from just one month, October's collections show that revenue is on pace to meet OCFO's projection.

Estimates of a small increase in total income tax revenue are also consistent with observed economic conditions within the District. According to the OCFO's analysis of U.S. Bureau of Economic Analysis (BEA), real per capita personal income in the District (in 2005 dollars) is projected to rise by 1.1 percent between 2016 and 2017 from \$56,315 to \$56,912. In addition, OCFO, using BEA and Census data, also estimates that the District's unemployment rate will decrease from 6.5 percent to 6.4 percent over the same time period. Individually and combined, these economic forces suggest that the District is likely to bring in more revenue from income taxes collected on District residents, as more residents will be employed and those that are already employed will take home higher pay.

Additional Observations

The Auditor also considered the following data on other tax and non-tax revenue sources in analyzing the FY 2017 local source revenue estimate of \$7,170,180,000:

- For the period of FY 2012 through 2015 the category of gross receipts taxes (which includes utility, telecommunications, and insurance premium taxes) has seen general growth, increasing from about \$240.6 million in FY 2012 to \$250.4 million in FY 2015. As of September 2016 however, OCFO projects that this revenue source will decline 3.1 percent in FY 2016 and a further 2.6 percent in FY 2017.
- Between FY 2012 and FY 2015 other tax revenue (consisting of deed recordation, deed transfer, estate, and economic interest taxes) fluctuated substantially year over year, but generally increased over the period, from \$404.1 million to \$428.3 million. OCFO projects these revenue sources to decline somewhat in the just completed FY 2016 to \$419.3 million. OCFO further projects a significant decline in FY 2017 of 16.3 percent to \$351.1 million.
- Non-tax revenue (composed of licenses and permits, fines and forfeits, charges for services, and miscellaneous revenue) has declined significantly for the period of FY 2012 through FY 2015, falling from \$456.1 million to \$416.6 million. OCFO attributes this drop to decreased collections from the city's red light cameras, among other things. OCFO does project that this trend has reversed itself in FY 2016 however, and as of September 2016 estimated that the District would bring in an additional \$18.1 million in non-tax revenue, an increase of 4.3 percent. For FY 2017, OCFO projects a small decline of 1.4 percent from these sources.
- In the Auditor's discussions with ORA, we learned that the agency tends to estimate gross receipts, other tax, and non-tax revenue sources conservatively, since they can significantly vary from year to year based on unpredictable events. For instance, estate tax collections are completely dependent on collections from the estates of individuals subject to the tax, while fines and forfeits are dependent on agencies that impose them actively collecting the required fines.

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 principle 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 (principle and interest) for all bonds outstanding is projected to be 8.38 percent of the District's FY 2017 estimated revenue of \$7,170,180,000. During the period in which the District has outstanding debt from both this issuance and other previous debt issuances (2017-2041), the percentage of revenue necessary to pay debt service ranges from 10.10 percent (2026) to 0.42 percent (2041). 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 2016D) and the general obligation refunding bonds (Series 2016E).

Conclusion

Based on an analysis of information provided by the Office of the Chief Financial Officer of the District of Columbia, as of December 19, 2016, the assumptions supporting the fiscal year (FY) 2017 revenue estimate, and other relevant economic data, the Auditor concludes that the September 30, 2016, FY 2017 local source revenue (net of Dedicated Taxes) estimate of \$7,170,180 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, on December 19, 2016, the Auditor certifies the \$7,170,180,000 FY 2017 local source revenue (net of dedicated taxes) estimate submitted by the CFO.

Sincerely,



Kathleen Patterson
District of Columbia Auditor

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