Auditor Certifies Revenues for Issuance of Income Tax Secured Revenue Bonds

April 9, 2020

A report by Digital Economics Group for the Office of the D.C. Auditor

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Introduction

On February 14, 2020, the Deputy Chief Financial Officer and Treasurer of the District of Columbia requested that the Auditor certify the issuance of Series 2020AB bonds comprised of up to $700 million of Income Tax Secured Revenue (ITS) bonds and $585 million of ITS refunding bonds.[1]

This report sets forth the results of the Auditor's analysis performed by the District Economics Group (DEG) of the OCFO's Fiscal Year 2020 non-dedicated Local Fund Revenue of $8,451,978,000.

The objectives of the analysis were to:

- Assess the reasonableness and attainability of the OCFO's 2020 non-dedicated Local Fund Revenue of $8,451,978,000.
- Determine if the issuance of the proposed ITS Bonds would cause the District to exceed the 17 percent revenue limitation (the "17 percent test"), as outlined in D.C. Official Code § 1-206.03(b)(1).

Changes to the economic forecast

The March 2020 DEG forecast of D.C. Gross Domestic Product (GDP) for 2020 is $152.65 billion compared with DEG's November 2019 forecast of $150.96 billion, or 1.12% larger.[2] This increase is the direct result of stronger U.S. GDP growth, which, in the DEG model, results in stronger D.C. GDP and revenue streams.

1 Notice sent from OCFO's Office of Finance and Treasury to the Office of the D.C. Auditor pursuant to D.C. Official Code, Section 1-206.03(b)(1).

2 The estimates provided in this report were prepared in March of 2020 and are compared with prior estimates prepared in November of 2019 with a report issued December 19, 2019. (http://dcauditor.org/report/auditor-certifies-revenues-for-issuance-of-income-tax-secured-revenue-bonds/). The current estimate was prepared before the severity and impact of the coronavirus. It is likely that the coronavirus will result in a shock to the D.C. economy, but it is too early to model at this point in time. For a detailed explanation of the DEG forecast see "Modeling the D.C. Economy, Revenues, and Debt Service Obligations: A Methodology Report by District Economics Group," Office of the District of Columbia Auditor, November 13, 2019. The estimates provided in that report were based upon DEG estimates prepared in October of 2019.

Figure 1: Revised D.C. GDP Forecast CY 2019-2023 as of March 11, 2020

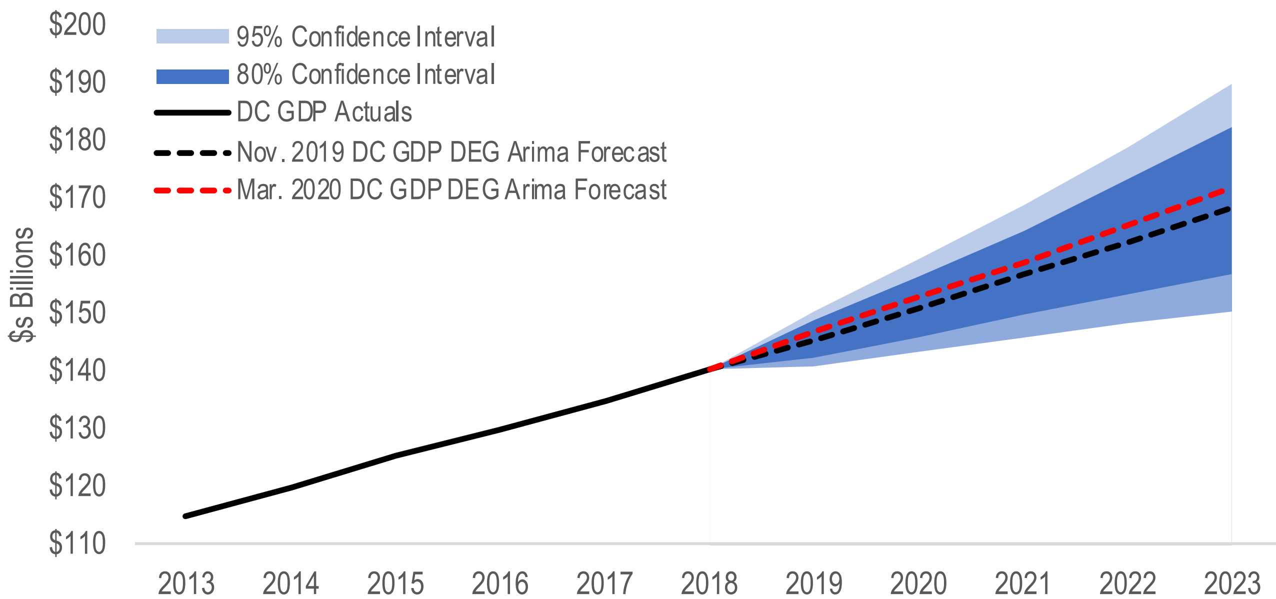

Figure 1 shows how the March DEG 2020 forecast of D.C. GDP is slightly larger than the November DEG 2019 forecast of D.C. GDP.

Changes to the revenue forecast

Figure 2 on the following page shows the larger March 2020 DEG forecasted revenue streams (blue shaded columns) compared to the November 2019 DEG forecasted revenue streams (gray shaded columns). This table shows the forecasted gross revenue streams before the dedicated revenues are netted out. The white columns show the change in DEG's revenue forecasts from November 2019 to March 2020.

Figure 2: Revised Revenue Forecasts as of March 11, 2020 ($ Thousands)

Year	Income tax revenue			Property tax revenue			Sales and excise tax revenue		
	Nov '19	March '20	Difference	Nov '19	March '20	Difference	Nov '19	March '20	Difference
2019	$2,722,548	**$2,941,982***	$219,434	$2,768,180	**$2,827,757***	$59,577	$1,659,857	**$1,707,223***	$47,366
2020	$2,818,761	$3,093,413	$274,653	$2,893,505	$2,974,183	$80,679	$1,725,786	$1,777,686	$51,900
2021	$2,915,832	$3,237,203	$321,372	$3,019,947	$3,120,880	$100,933	$1,792,303	$1,856,318	$64,015
2022	$3,016,122	$3,383,723	$367,601	$3,150,583	$3,270,363	$119,780	$1,861,026	$1,936,443	$75,417
2023	$3,120,874	$3,534,855	$413,981	$3,287,032	$3,424,551	$137,519	$1,932,807	$2,019,091	$86,284
Year	**Other taxes revenue**			**Gross receipts revenue**			**Non-tax, lottery and special purpose revenue**		
	Nov '19	**March '20**	**Difference**	**Nov '19**	**March '20**	**Difference**	**Nov '19**	**March '20**	**Difference**
2019	$522,028	**$583,377***	$61,349	$366,178	**$395,068***	$28,890	$924,433	**$1,028,689***	$104,256
2020	$536,080	$547,420	$11,340	$368,670	$389,643	$20,973	$962,142	$1,037,405	$75,263
2021	$550,132	$562,102	$11,970	$370,258	$404,263	$34,005	$1,000,187	$1,087,178	$86,991
2022	$564,184	$576,784	$12,600	$372,412	$407,508	$35,096	$1,039,494	$1,137,897	$98,403
2023	$578,236	$591,466	$13,230	$374,212	$417,200	$42,988	$1,080,550	$1,190,213	$109,662

Source: Office of the Chief Financial Officer; DEG estimates based upon Office of the Chief Financial Officer data.
Due to rounding, numbers presented in this table may not total to the difference indicated.
(*) Bolded values indicate actual FY 2019 revenues and not forecasted revenues.

Using these revised forecasted revenue streams and netting out any dedicated revenues from the gross revenues, an updated version of the D.C. Auditor Certification Table is shown in Figure 3 on the following page.

Figure 3: FY20 Total Local Source, General Fund Revenue Estimate (Net of Dedicated Taxes), March 11, 2020 ($ Thousands)

Revenue Source	DEG's 2020 Total Local Source, General Fund Revenue Estimate (Net of Dedicated Taxes)	FY2020 Tax Changes Full-Year General Fund Revenue Effect	Total
Property Taxes	$2,917,827	($375)	$2,917,452
Sales Taxes	$1,220,306	($7,725)	$1,212,581
Income Taxes	$3,093,413	$1,630	$3,095,043
Gross Receipts Taxes	$259,080	-	$259,080
Other Taxes	$457,007	$4,978	$461,985
Total Taxes	$7,947,634	($1,492)	$7,946,142
Total Non-Tax and Lottery Revenues	$479,330		$479,330
Total Local Source, General Fund Revenue Estimate	**$8,426,964**	**-$1,492**	**$8,425,472**

Principal and Interest From	2020 Principal and Interest Payments Including Series 2020AB	Principal and Interest Payments Including Series 2020AB as Percent of General Fund Revenue Estimate
General Obligation, ITS, QZAB, Housing Production Trust, and 225 Virginia Ave, LLC	$807,857	9.59%
+ PILOT	$847,147	10.05%
+ TIF	$859,035	10.20%

Source: DEG estimates of revenues and CFO estimates of principal and interest payments.
Notes: General Obligation and ITS Bond Outstanding Debt Service updated through March 11, 2020. The 17% test statistics reflect the inclusion of the maximum ITS 2020AB bond issuances rather than the actual amount certified, which was, on aggregate, $252,455,000 less. Outstanding Debt Service for QZAB, Housing Production Trust, 225 Virginal Ave, LLC, PILOT, and TIF from 2019 Comprehensive Annual Financial Report, released February 2020.

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Issues with forecast revision

DEG sourced revenue collections data from the OCFO's February 2020 Quarterly Revenue Report. There was little change between the OCFO's December 2019 estimate of FY 2019 local fund revenue and the February 2020 actual, as detailed in the February report.

To forecast the District's FY 2020 local fund revenue, DEG adjusted its model's underlying revenue data to account for non-recurring revenues that occurred in the final months of FY 2019. These one-time revenues not expected to recur in FY 2020-2023 are detailed in the OCFO's December 2019 Quarterly Revenue Report. Of note, approximately $140 million of actual FY 2019 revenue was one-time, mainly attributable to an acceleration in real property deed recordation and transfer revenue as well as higher than expected corporate and individual income tax collections. DEG's adjustments for these non-recurring revenues are reflected in Figure 2's forecasted revenues.

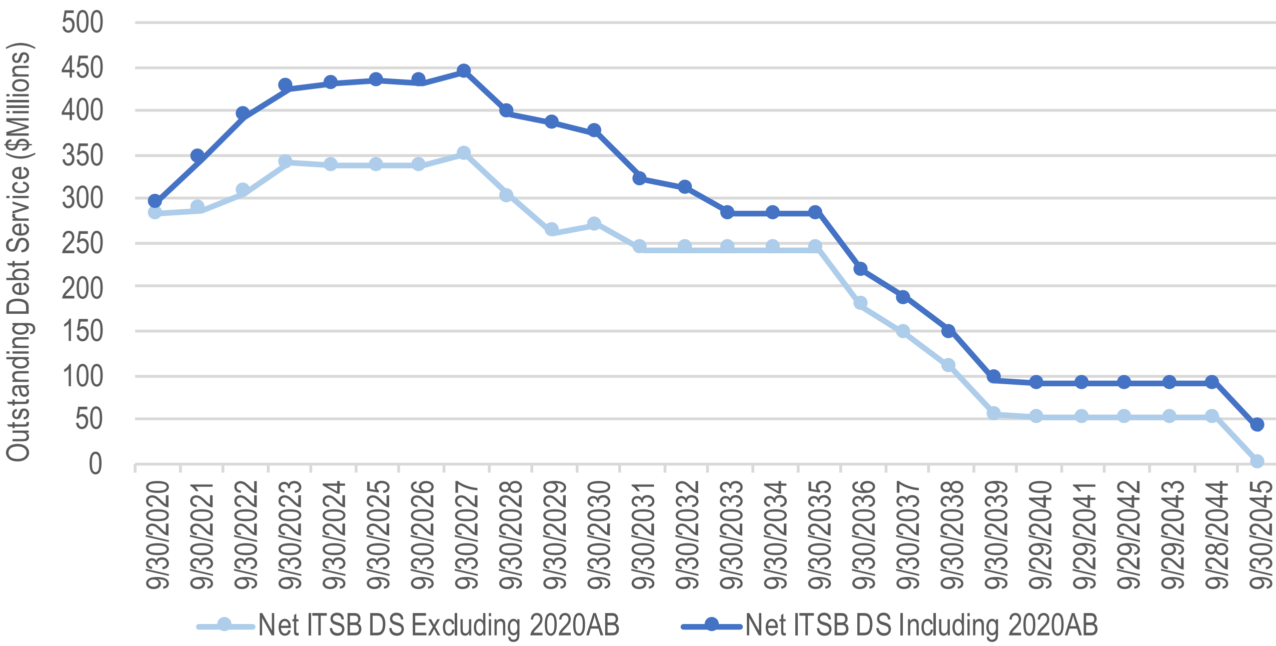
DEG's estimates were prepared before awareness of the coronavirus, and before its impacts could be observed in the District's economic data. While it is likely that the spread of the coronavirus will result in a shock to the D.C. economy, it is too early to model at this point in time. As the OCFO notes in its February 2020 Quarterly Revenue Report, corporate profits and individual capital gains may be adversely impacted, travel and tourism likely will be disrupted, which would be felt immediately in sales tax receipts from restaurants and hotels, and the outlook for the District's labor market could weaken. When economic data become available, we will update our model to reflect the coronavirus' impacts.

Existing and potential outstanding ITS bond debt service

ITS bonds are a pledge of the District's individual income and business franchise taxes. However, *unlike* other types of debt issuance, the tax revenue pledged as coverage for ITS bonds is *not* netted out of general fund revenue estimates. The 17 percent test does not require netting out of tax revenue pledged in bond covenants for ITS bonds.

Figure 4 on the following page shows the maxmium increase in ITS bond debt that the District planned to issue with the series 2020AB ITS bonds. The amount certified on March 11, 2020 was $252,455,000 less than the maximum proposed. Under the District's issuance, there will be an additional $1.35 billion in debt service throughout the life of these bonds.

Figure 4: Existing Aggregate ITS Bond Debt Service (Light Blue) and Projected Aggregate ITS Bond Debt Service After Inclusion of 2020AB Series Bonds (Dark Blue) as of March 11, 2020 [3]



Revisions to revenue forecasts

Since ODCA's December certification done by DEG, the 17 percent test statistic decreased from 10.10% to 9.59%. This is after the inclusion of the Series 2020AB ITS bonds and is largely due to both an increase in revenues and a reduction in debt service.[4] After the inclusion of PILOT and TIF Bonds, the certification test statistic increases to 10.20%. DEG's Total Local Source, General Fund Revenue Estimate increased by approximately $82 million from $8.343 billion to $8.425 billion. Debt service obligation subject to the 17 percent test for FY 2020 decreased by approximately $35 million from $843 million to $808 million, taking into account payments on general obligation and income tax secured revenue bonds through March 11, 2020.[5]

3 Figure 4 shows the maximum ITS Series 2020AB bond debt for possible issuance. The actual amount certified in ITS bond debt was $252,455,000 less than the maximum.

4 Amount included in the calculation is the maximum 2020AB ITS bond debt issuance rather than the actual amount certified which was, on aggregate, $252,455,000 less.

5 Ibid.

Conclusion

DEG's estimate for the District's FY 2020 non-dedicated Local Fund Revenue is $8,425,472,000, or 99.7% of the OCFO's estimate of $8,451,978,000. Given the similarity, DEG finds the OCFO's estimate to be both reasonable and attainable.

Additionally, based on the analysis performed by DEG, including adjustments for increased revenues, the Auditor can certify that after issuance of the Series 2020AB bonds, the District will comply with statutory debt limitations.

The Auditor certified the FY 2020 non-dedicated Local Fund Revenue estimate of $8,451,978,000 submitted by the OCFO for the issuance of $578,110,000 million of ITS bonds and $454,435,000 million of ITS refunding bonds, on March 11, 2020.

The Auditor only certifies that the revenue estimate, *at the time of certification*, March 11, 2020, appears sufficiently supported and achievable. As the OCFO frequently revises projections throughout the fiscal year after gathering additional information, we stress that our report is based on the information available at the time of our review.

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About ODCA

The mission of the Office of the District of Columbia Auditor (ODCA) is to support the Council of the District of Columbia by making sound recommendations that improve the effectiveness, efficiency, and accountability of the District government.

To fulfill our mission, we conduct performance audits, non-audit reviews, and revenue certifications. The residents of the District of Columbia are one of our primary customers and we strive to keep the residents of the District of Columbia informed on how their government is operating and how their tax money is being spent.

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