Letter Report: Certification of the Fiscal Year 2008 Total Non-Dedicated Local Source Revenues in Support of the District’s $333,840,000 General Obligation Bonds (Series 2007C)

January 25, 2008
The Honorable Vincent C. Gray, Chairman
and Members of the Council of the District of Columbia
1350 Pennsylvania Avenue, N.W., Suite 504
Washington, D.C. 20004

Letter Report: Certification of the Fiscal Year 2008 Total Non-Dedicated Local Source Revenues in Support of the District’s $333,840,000 General Obligation Bonds (Series 2007C)\(^1\)

Dear Chairman Gray and Members of the Council of the District of Columbia:

On November 9, 2007, pursuant to section 603(b)(1) of the District of Columbia Home Rule Act ("Home Rule Act"), as amended,\(^2\) Pub. L. No. 93-198, approved December 24, 1973 (87 Stat. 790; D.C. Code, Section 1-206.03 (b)(1)), the Chief Financial Officer ("CFO") of the District of Columbia, through the Office of Finance and Treasury (OFT),\(^3\) requested that the District of Columbia Auditor ("Auditor") certify fiscal year (FY) 2008 estimated non-dedicated local source revenues ("local source revenue estimate") in connection with the District’s issuance of $333,840,000 in General Obligation Bonds (Series 2007C). According to the preliminary official statement, the proceeds from the bonds were to be used to: (1) finance capital project expenditures; and (2) pay the costs and expenses of issuing and delivering the 2007C bonds.

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\(^1\) Concurrently with the $333,840,000 General Obligation Bonds, the District also issued General Obligation Tax Revenue Anticipation Notes (TRANS) (Series 2007B) in the aggregate amount of $300,000,000 to "finance general governmental expenses of the District in anticipation of the collection or receipt of revenues for fiscal year 2008" (see Final Official Statement dated December 18, 2007).

\(^2\) See D.C. Code § 1-206.03 (b)(1).

\(^3\) See the Home Rule Act, as amended by Pub L. No. 104-8, the District of Columbia Financial Responsibility and Management Assistance Act of 1995 ("FRMAA"), approved April 17, 1995, and Public Law 106-522, the District of Columbia Appropriations Act for Fiscal Year 2001, approved November 22, 2000, which indicates that the CFO must prepare annual estimates of all District revenues for use in developing the District’s budget and must prepare quarterly reestimates of revenues during the fiscal year.
Initially, the CFO requested the Auditor’s certification of the $5,188,126,000 local source revenue estimate issued by the CFO in September 2007. In a December 6, 2007 letter, the CFO issued a revised revenue estimate of $5,238,030,000 which increased the September 2007 estimate by $49.9 million. As a consequence, the Auditor used the December 2007 revised estimate of $5,238,030,000 in performing the certification review and analysis.

This report sets forth the results of the Auditor’s analysis of the FY 2008 revised local source revenue estimate of $5,238,030,000.

**OBJECTIVE, SCOPE, AND METHODOLOGY**

The objective of this analysis was to review, analyze and assess the reasonableness and attainability of the CFO’s FY 2008 revised local source revenue estimate of $5,238,030,000. The FY 2008 local source revenue estimate includes tax collections of the Office of Tax and Revenue (OTR) and non-tax revenues generated by other District agencies.

In connection with this certification review, the Auditor: (a) analyzed actual local source revenues for FY 2004 through FY 2006 and projected/estimated local source revenues for FY 2007 and FY 2008; (b) reviewed the District’s FY 2007 and FY 2008 Budget and Financial Plans, statistical and economic data published by various sources,\(^4\) Bond Resolution #17-415,\(^5\) the preliminary official statement supporting the bond issuance, and reports issued by Standard & Poor’s, Fitch Ratings and Moody’s Investor Services regarding the ratings each firm assigned to the Series 2007C general obligation bonds;\(^6\) and (c) interviewed Office of Revenue Analysis (ORA) personnel, the D.C. Treasurer, several local economists,\(^7\) and others external to the District.

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\(^4\) The Auditor reviewed information obtained from the Federal Reserve Board, the U.S. Department of Labor’s Bureau of Labor Statistics, the District’s Department of Employment Services, and reports on the regional economy published by the School of Public Policy’s Center for Regional Analysis, at George Mason University. These reports included the following: “The Washington Region Economy and Residential Real Estate Market in 2007,” dated May 18, 2007, and “The 15th Annual GMU Economic Conference 2007, Forecast and Beyond,” dated January 11, 2007.

\(^5\) See Resolution # 17-415, Fiscal Year 2008 General Obligation Bond Issuance Approval Resolution of 2007, approved November 6, 2007. The Council of the District of Columbia approved “the Mayor’s request for the authority to borrow funds for capital projects... through the issuance and sale of general obligation bonds not to exceed an aggregate principal amount of $678,254,000...”


\(^7\) Interviews were conducted with Professor Stephen S. Fuller, Dwight Schar Faculty Chair and University Professor, Director, Center for Regional Analysis, School of Public Policy, George Mason University, Professor William Spriggs, Chairman, Department of Economics, Howard University, and Dr. Charles E. Mahone, Jr., Dean of the School of Business and Public Administration, University of the District of Columbia.
government, including representatives of the Washington, D.C. Convention and Tourism Corporation, and BDO Seidman, the District’s independent auditors.

The certification review was conducted in accordance with generally accepted government auditing standards and included such tests of documentation as deemed necessary and appropriate under the circumstances. The Auditor believes this review provides a reasonable basis for certifying the CFO’s $5,238,030,000 FY 2008 revised local source revenue estimate.

Based upon our examination of available information as well as representations made by officials in the CFO’s ORA, the Auditor determined that, barring any significant unforseen events that could adversely impact revenues, the FY 2008 revised local source revenue estimate of $5,238,030,000 should be achieved by the District during FY 2008. Therefore, on December 19, 2007, the Auditor certified the CFO’s December 6, 2007, FY 2008 revised local source revenue estimate of $5,238,030,000.

BACKGROUND

Section 603(b)(1) of the Home Rule Act, as amended, states in relevant part, the following:

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 percent 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 ...
The Auditor’s certification was based upon an evaluation of the $5,238,030,000 local source revenue estimate prepared by officials in the CFO’s ORA. The CFO’s estimates are based upon information that can, and often does, change rapidly thus resulting in revisions to the estimate after the Auditor’s certification. The Auditor does not, and cannot, guarantee the stability of the CFO’s estimate submitted for the Auditor’s certification. Thus, the Auditor only certifies that the revenue estimate, at the time of certification, appeared sufficiently supported and achievable.\(^8\) 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 ORA officials have provided a sound and reasonable FY 2008 local source revenue estimate and have fully disclosed and provided reliable and accurate information to the Auditor regarding the District’s FY 2007 revenue collections.\(^9\)

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\(^8\)Recently, it was discovered that two OTR employees allegedly issued fraudulent real property tax refund checks. While the full depth and scope of the alleged scheme have not yet been identified, information presented in the Preliminary Official Statement, indicates that to date these checks totaled over $16 million (this amount may possibly increase). In response, as reported by OCFO officials, the District’s CFO launched an investigation, conducted an examination of OTR’s internal controls and operations, instituted a policy requiring prior approval by OTR’s upper management for all real property tax refunds greater than or equal to $10,000, and expanded OTR’s staff responsible for reviewing and auditing tax operations. Additionally, according to the Preliminary Official Statement, “District accounting and budget officials have indicated that this matter will not require any changes to already-published prior-year audited financial statements, will not negatively impact the District’s forthcoming fiscal year 2007 audited financial statements, and will not negatively impact its fiscal year 2008 budget.” Lastly, officials of BDO Seidman, LLP indicated to the Auditor that they will show a separate line item for fraud expense in the FY 2007 profit and loss statement and include a financial statement disclosure regarding the tax refund fraud in the Notes to the Financial Statements in the District’s FY 2007 CAFR.

\(^9\)A Management Representations Letter concerning the disclosures and accuracy of the financial data on which the Auditor’s certification is based was signed by the District’s CFO on December 19, 2007.
RESULTS OF ANALYSIS

In reviewing the FY 2008 revised local source revenue estimate of $5,238,030,000, the Auditor relied on preliminary revenue collection results reported for FY 2007, as well as current economic indicators, trends and projections. There was insufficient actual FY 2008 revenue collection data available for this review during the 1st quarter of FY 2008.

Preliminary results for FY 2007\(^{10}\) indicate that the actual revenue collections overall may exceed the estimate, in part, from excess collections projected in property, sales, income, and other taxes. Graph I presents a comparison of the FY 2007 estimate to preliminary actual collections for the District’s largest three tax categories: property taxes, sales and use taxes,\(^{11}\) and income and franchise taxes which collectively generated approximately 72% of the FY 2007 revenue.

Graph I


\(^{11}\)Includes General and Selective Sales and Use Taxes.
FY 2007 collections of property taxes, sales and use taxes, and income taxes are discussed briefly below:

- **Property Taxes.** Preliminary results reported for FY 2007 indicate that collections of property tax revenue exceeded the estimate by $70 million. According to several local economists, after several years of significant housing appreciation in the double digits, the real estate market continued to undergo a market correction (cooling off) in 2007. Based on reported information, the median price of single family homes increased by roughly 4.8%, and sales declined by nearly 9.4% in FY 2007. Sales of condominium homes, however, increased by 4.9%, in FY 2007, but prices of these units dropped by approximately 4.2%. On the commercial side, the real estate market continued to do well. According to a report issued by the Staubach company, “In the 3rd quarter 2007 Washington, DC continued its strong performance and maintained its status as one of the world’s top office markets.” The report also noted that Washington continues to post one of the lowest vacancy rates of 7% versus the national rate of 11.1%.\(^{12}\)

- **Sales and Use Taxes.** Collections of sales tax revenue in FY 2007 were $4.3 million, or 1%, above the estimate in FY 2007. As a result, ORA made no changes to the revised FY 2008 estimate issued in December 2007. Overall, sales tax revenue grew approximately 6% above the FY 2006 level strengthened by a slight increase in tourism-related sales. In addition, the National Retail Federation’s (NRF) preliminary assessments of Black Friday sales statistics indicated that while the number of shoppers over the whole Thanksgiving weekend increased 4.8% from the prior year, consumers spent 3.5% less overall.\(^{13}\) However, NRF predicted 4% growth in 2007 holiday sales over last year amid consumers’ fears about lower home values, higher fuel and food costs, and a volatile stock market.

- **Income Taxes.** According to information reviewed by the Auditor, income tax collections were strong in FY 2007, in part, from stronger wage growth and increases in estimated payments. Estimated income tax payments were higher due to higher stock market returns in 2006. Also, through June 2007, wage and salary jobs were

\(^{12}\) See The Staubach Company Market Research Department 3rd Quarter 2007 report.

up 1.5% above the level for the same period in the previous year. Unemployment levels in FY 2007 in the District averaged 5.8% which was slightly below FY 2006 levels which averaged 6.1%. Collections of corporate and unincorporated franchise taxes increased in FY 2007 above the previous year’s level for the same period, by 14.8% and 17.7%, respectively.

The Auditor’s analysis of the FY 2008 revised local source revenue estimate for tax and non-tax revenues, as well as FY 2007 preliminary actual collections as reported through December 10, 2007, indicated that the District should achieve the $5,238,030,000 estimate. Therefore, on December 19, 2007, the Auditor certified the $5,238,030,000 total local source revenue estimate for FY 2008. Table I presents the FY 2008 revised local source revenue estimate prepared by the CFO and certified by the Auditor.

**TABLE I**  
FY 2008 Revised Local Source Revenue Estimate  
Prepared by the CFO and Certified by the Auditor  
(000s)

<table>
<thead>
<tr>
<th>Revenue Category</th>
<th>CFO’s December 2007, FY 2008 Revised Local Source Revenue Estimate as Certified by the Auditor on December 19, 2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property Taxes</td>
<td>$1,668,255</td>
</tr>
<tr>
<td>General Sales and Use Taxes</td>
<td>741,459</td>
</tr>
<tr>
<td>Selected Sales and Use Taxes</td>
<td>74,228</td>
</tr>
<tr>
<td>Income Taxes</td>
<td>1,785,243</td>
</tr>
<tr>
<td>Gross Receipts</td>
<td>254,444</td>
</tr>
<tr>
<td>Other Taxes</td>
<td>309,995</td>
</tr>
<tr>
<td>Total Taxes</td>
<td>4,833,624</td>
</tr>
<tr>
<td>Total Non-Tax Revenues</td>
<td>334,406</td>
</tr>
<tr>
<td>Lottery</td>
<td>70,000</td>
</tr>
<tr>
<td><strong>Revised Local Source Revenue Estimate</strong></td>
<td><strong>$5,238,030</strong></td>
</tr>
</tbody>
</table>

Source: Transmittal letter from the Chief Financial Officer to the Mayor and Council Chairman, dated December 6, 2007
CONCLUSION

Based on the analysis of information provided by the District's CFO through ORA and OTR, including the actual collections for FY 2007, as of December 10, 2007, the assumptions supporting the revenue estimate, and other relevant data, the Auditor found that the December 2007, FY 2008 revised local source revenue estimate of $5,238,030,000 appeared to be reasonable and achievable.

Therefore, on December 19, 2007, the Auditor certified the $5,238,030,000 FY 2008 revised local source revenue estimate as prepared by the CFO.

Respectfully submitted,

[Signature]

Deborah K. Nichols
District of Columbia Auditor