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At the Public Hearing on
B17-0914, the Limitation on Borrowing and Establishment of the Operating Cash
Reserve Act of 2008
District of Columbia Committee of the Whole
September 22, 2008

Chairman Gray and members of the Committee, thank you for the opportunity to speak today. My name is Jenny Reed, and I am a Research Associate with the DC Fiscal Policy Institute. DCFPI engages in research and public education on the fiscal and economic health of the District of Columbia, with a particular emphasis on policies that affect low- and moderate-income residents. I am here today to testify in support of establishing a debt limit and an annual operating cash reserve.

We strongly support the goals of this bill. A debt limit is a fiscally responsible tool for the District to use, as is having an operating reserve in each year's budget.

The District has one of the highest debt ratios of any state or major city — and while that is partly due to the District's need to fund a wide array of state-like infrastructure needs, many of which had been delayed — debt levels that continue to significantly increase could have a negative effect on the District's financial health.

For instance, debt service as a portion of the District's budget is expected to rise and reach nearly 12 percent of general fund expenditures.¹ Having no limit on the amount of debt that the District can accumulate could result in budget constraints that limit our ability to fund various government programs and services. A debt limit is important to ensure that debt services do not become too large a slice of the pie.

Furthermore, the CFO also recommends a debt cap to help ensure the District's ongoing financial health and strong fiscal status.² Sound fiscal policies have helped lead the District to its currently high bond ratings. Bond rating agencies use debt ratios as a key factor when determining a jurisdiction's fiscal status and high ratios can lead to lower or stagnant bond ratings. A debt cap could thus help to maintain or even improve the District's financial position — which could help the District save millions of dollars in annual interest payments.³

While this bill is an important step in the right direction, it can be strengthened by taking a few steps.

- First, the 12 percent debt limit should apply to all tax-supported debt, rather than being limited to general obligation (g.o.) bonds and treasury loans. A large portion of the District's debt is for

¹ Letter to Mayor Fenty and Chairman Gray from Dr. Natwar Ghandi, "Debt Burden & Borrowing Constraints: Background and Analysis," 7-8-08.

² Letter to Mayor Fenty and Chairman Gray from Dr. Natwar Ghandi, "Debt Burden & Borrowing Constraints," 7-8-08.

³ Ibid

economic development — mainly comprised of Tax Increment Financing (TIF) and Payment in lieu of Taxes (PILOT) — almost \$2 billion incurred over the past 10 years.⁴ Since bond rating agencies look at all tax-supported debt when determining their ratings, not including this type of debt in the overall cap could possibly hurt the District's fiscal status.

- Second, the 12 percent cap should be calculated as a ratio of debt services-to-total expenditures rather than debt services-to-total revenues. This measure is important to use since, according to the CFO, it is a direct reflection of how much debt the District is taking on, and how that debt may be limiting or constraining the flexibility of the operating budget.⁵ It is also one of the key ratios rating agencies use to determine the District's bond ratings.

Bill 17-914 would enforce the debt limit by prohibiting bonds to be issued if they would push debt service costs above 12 percent of the budget. We support this but also propose an additional provision to help policymakers manage the city's debt. We believe the bill should require the CFO to issue a report annually that would provide an update on the city's debt trends and an estimate of the amount of new debt that can be afforded within the 12 percent cap. The report also would assess the expected amount of new general obligation debt needed for capital projects in the upcoming year and would then calculate how much debt is available for economic development purposes. This figure would then become a binding limit for the upcoming year. This step is important because g.o. debt for public infrastructure projects should be treated as the top priority. This proposal is in effect an extension of the debt letter that Dr. Gandhi now issues every summer, but we feel it would be useful to make the letter a required report to the Mayor and Council.

The debt affordability analysis and debt cap would help the Mayor and Council plan more strategically for public infrastructure and economic development needs. It would require the District to develop longer-term plans for capital projects and to set economic development priorities, hopefully as part of an overall economic development plan.

Moving to the second part of the bill, the creation of an operating cash reserve is a fiscally responsible step to help ensure the financial health of the District's budget from year to year. It is problematic that the approved FY 2009 budget effectively eliminated the \$50 million budget reserve by appropriating those funds. While it may be difficult to find resources for such a reserve in FY 2009 or FY 2010, we believe it is important to create at least some reserve sooner rather than later. An operating cash reserve can be critical to the health of the District's budget since it can help pay for unforeseen budget problems — and possibly prevent officials from having to take monies away from other funds, agencies or departments.

As currently drafted, the bill would allow for \$25 million of the \$50 million reserve to be appropriated within the first half of the year and as early as October 1. We believe the intent of this provision is to prohibit the full use of the reserve early in the year. We support the goal but believe that the current provision may send a signal that it is okay to start spending the reserve early in the year rather than saving it for unforeseen needs. We suggest that this provision be amended to state that *no more than \$25 million* can be available for expenditure in the first half of the year rather than stating that \$25 million is available for expenditure.

In addition, we do not believe that the reserve's uses need to be restricted to one-time functions. The reserves should be allowed for an on-going purpose as long as it can be supported in future

⁴ This figure includes \$1.382 billion in issued, authorized and proposed economic development debt along with \$589 million in debt from the baseball stadium.

⁵ Letter to Mayor Fenty and Chairman Gray from Dr. Natwar Ghandi, "Debt Burden & Borrowing Constraints," 7-8-08.

years without tapping into the reserves in those years. This would be possible, for example, if funding in future years were tied to a new revenue source or if the financial plan showed a projected surplus in future years.

Lastly, as mentioned earlier, an operating cash reserve is important to the financial health of the District's budget. Bill 17-914 would allow the reserve to be used to fund DC's \$50 million additional WMATA contribution that is contingent on funds being approved by both Maryland and Virginia. If the entire reserve is utilized in one fiscal year for this purpose, it would be good to start the reserve up again for the next fiscal year rather than let it sunset. An operating cash reserve from year to year can help the District preserve its approved budget levels while addressing unforeseen problems.

Thank you for the opportunity to offer testimony. I am happy to answer any questions.