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## **How Bad Is DC's Budget Shortfall? What Resources Are Available to Address it? Will it Get Worse?**

**By Katie Kerstetter**

The District is facing its first major budget shortfall since FY 2003, joining 46 other states that have budget gaps this fiscal year or projected shortfalls for FY 2010.<sup>1</sup> DC's budget troubles stem from declining revenues, particularly in its business income and property taxes and individual income taxes, which are related to the national economic downturn. DC's expected revenue collections for FY 2009 have fallen by nearly \$400 million in recent months, and the FY 2010 shortfall is \$800 million. The FY 2010 shortfall equals roughly 14 percent of the local budget — making it the largest fiscal crisis since the mid-1990s.

While DC's problems are severe, there are resources that will help the city close the budget gap, including a surplus from 2008 and federal stimulus funds. The current unresolved shortfall for FY 2009 and FY 2010 — the shortfall after actions taken to date to this year — totals more than \$900 million. Stimulus funds and other available resources will cover only about half of what is needed to close these shortfalls. Stimulus funds and other resources to address the gap are roughly \$500 million, but still leave a budget gap of more than \$400 million.

This report describes the extent of DC's budget shortfall, the resources that can be used to address it, and factors that could lead to future budget gaps.

### **How Bad Is the Budget Shortfall?**

Four times a year, the District's Chief Financial Officer (CFO) estimates how much revenue the District will collect in the current year and in the next four years. These estimates are used to develop the DC budget each year and to determine whether the District has enough funds to pay for what has been budgeted. When an estimate indicates that revenues will be lower than expected, the District experiences a budget shortfall.

DC's revenue projections have been downgraded substantially since the current-year budget was adopted. Revenue forecasts from September 2008, December 2008, and February 2009 all revealed worsening revenue conditions:

- **September 2008 forecast:** In the September revenue forecast, the CFO identified a shortfall of

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<sup>1</sup> Elizabeth McNicol and Iris J. Lav, "State Budget Troubles Worsen," Center on Budget and Policy Priorities, Updated February 10, 2009, <http://www.cbpp.org/9-8-08sfp.htm>.

\$131 million for FY 2009 and \$152 million FY 2010 (Table 1). The DC Council closed these gaps in November by eliminating vacant positions in government agencies, finding other agency cost-savings, eliminating proposed new programs, and cutting some ongoing services. The Council also created a \$46 million cash reserve to address future budget shortfalls.

- **December 2008 forecast:** The CFO's December revenue forecast found that the District was facing another \$127 million shortfall in FY 2009 and a \$304 million shortfall for FY 2010.
- **February 2009 forecast:** The most recent revenue forecast again showed declining revenues, with an additional \$136 million gap in FY 2009 and an additional \$346 million gap in FY 2010. The December and February shortfalls have not been addressed yet.

The total revenue shortfall for FY 2009 is \$394 million, which represents a 7 percent decrease in local fund revenues since the FY 2009 budget was passed. For FY 2010, the budget gap totals \$802 million, representing a 14 percent drop in revenues projected for the year.

<b>Table 1: The District's Budget Shortfall</b>			
	FY 2009 (in millions)	FY 2010 (in millions)	Total (in millions)
September 2008 forecast	(\$131)	(\$152)	(\$283)
December 2008 forecast	(\$127)	(\$304)	(\$431)
February 2009 forecast	(\$136)	(\$346)	(\$482)
<b>Total Shortfall</b>	<b>(\$394)</b>	<b>(\$802)</b>	<b>(\$1,196)</b>
Amount of Shortfall Resolved <sup>1</sup>	\$131	\$152	\$283
<b>Total Shortfall Remaining</b>	<b>(\$263)</b>	<b>(\$650)</b>	<b>(\$913)</b>
<sup>1</sup> The September shortfall was resolved through actions taken by the DC Council in November 2008.			

Because the Mayor and Council addressed the budget shortfall identified in the September 2008 revenue forecast, the remaining shortfalls that must be addressed are somewhat smaller. The current gap for FY 2010 is \$263 million, and the unresolved gap for FY 2010 is \$650 million.

As part of its gap-closing measure in November 2008, the Council re-classified \$26.8 million in funds for on-going programs as "one-time" expenses, meaning that funding for them would not automatically be assumed in the FY 2010 budget. One example of this is the District's Home Purchase Assistance Program (HPAP), which provides loans to low- and moderate-income District families to help them purchase a home. Like most ongoing programs, the District's long-term budget planning documents have assumed continued funding for new HPAP loans each year. Because the Council shifted HPAP to a one-time expense, however, no new funds for loans will be included in the FY 2010 budget unless the Council or Mayor restores the funds. Other on-going expenses that were eliminated for FY 2010 include the recent expansion of the Summer Youth Employment Program, housing and supportive services for homeless families, and aging in place services for seniors.

Restoring these funds would add \$27 million to current projections of budget needs, which means that the FY 2010 budget shortfall would increase to \$677 million.<sup>2</sup>

## Addressing the Budget Shortfall

The District has several sources of funding it can use to address the FY 2009 and FY 2010 budget shortfalls (Table 2). The annual audit of the District's finances recently confirmed a \$191 million surplus for FY 2008 — of which \$87 million is unrestricted and can be used to address the current budget gap. The \$46 million budget reserve created by the Council in November also remains available.

In addition to the local funds available, DC also will receive substantial funds from the federal stimulus bill. A significant portion of these funds — an estimated \$323 million in FY 2009 and FY 2010 — can be used to help close the District's budget gap. The stimulus package also includes funding for a number of specific program areas, including education, public safety, housing, and social services. In some cases, it may be possible to use those funds to pay for existing DC services, which would further ease the District's budget gap. It is not clear at this point the extent to which this will be possible.

Table 2: Funds Available to Address the District’s Current Budget Shortfall			
	FY 2009 (in millions)	FY 2010 (in millions)	Total (in millions)
Budget Reserve Created by DC Council	\$46	\$46	\$92
FY 2008 Surplus	\$87	N/A	\$87
Federal Stimulus Funds	\$145	\$178	\$323
<b>Total Funds Available</b>	\$278	\$224	\$502
<b>Current Budget Shortfall<sup>1</sup></b>	(\$263)	(\$650)	(\$913)
<b>Shortfall Remaining after Available Funds Used</b>			(\$411)
<b>% of Shortfall Covered by Available Funds</b>			55%
Sources: FY 2008 surplus from FY 2008 Comprehensive Annual Financial Report; federal stimulus funds estimates from DC Office of the Chief Financial Officer, “Revenue Estimates and Economic Outlook,” February 25, 2009.			
<sup>1</sup> Does not include shortfalls identified in the September revenue forecast that the Council addressed in November.			

Overall, the resources available to address DC's FY 2009 and FY 2010 revenue shortfalls total \$502 million. While substantial, these funds will only fill about 55 percent of the District's shortfall for the next two years. The remaining shortfall equals \$411 million.

## What Could Make the Shortfall Worse?

While the District has substantial resources to address its current budget shortfalls, the outlook for the future is uncertain. Further decreases in revenue or unexpected costs could create additional budget gaps for FY 2009 and FY 2010.

<sup>2</sup> This number does not include the \$152 million shortfall identified in September 2008 that the Council addressed in November 2008.

- **Declining Revenues:** The CFO will issue one more revenue estimate (in May) before the FY 2010 budget is passed. Given the current state of the economy, this estimate could predict further declines in revenue, meaning that the District's budget could face further shortfalls.
- **Baseline Budget Increases:** Each year, DC develops a "baseline budget" to determine the level of funding needed for agencies to continue operating at their current level. The baseline budget generally increases a small percentage each year due to inflation. For FY 2010, the District's baseline budget increased by nearly 6 percent, or more than \$311 million. This increase reflects additional spending for schools, police, and debt service, among other items.<sup>3</sup>

Despite these spending increases, most DC agencies were asked to submit a budget request that did not include any increased spending over the FY 2009 budget. Because personnel and other costs typically rise each year due to inflation, negotiated pay raises, and other factors, sticking to such a target requires agencies to find efficiencies and could require scaling back services. To the extent that agencies need additional funds to operate existing programs, as suggested in the baseline budget, this could place pressure on the District's FY 2010 budget.

Moreover, as DC's unemployment rate rises and the recession continues, the demand for social services will likely increase, and place additional pressure on funding for existing programs.

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<sup>3</sup> For more information about baseline budget increases, see: Office of the Chief Financial Officer, "FY 2010 Baseline Budget," February 18, 2009, [http://cfo.dc.gov/cfo/frames.asp?doc=/cfo/lib/cfo/fy\\_2010\\_final\\_baseline\\_budget\\_for\\_the\\_web\\_-\\_part\\_1.pdf](http://cfo.dc.gov/cfo/frames.asp?doc=/cfo/lib/cfo/fy_2010_final_baseline_budget_for_the_web_-_part_1.pdf), p. 2-4.