Council of the District of Columbia

Office of Councilmember David A. Catania
1350 Pennsylvania Avenue, NW, Suite 110, Washington, D.C. 20004

Memorandum

To: Interested Persons

From: Ben Young, Chief of Staff

Date: October 30, 2008

Subject: The Looming Budget Crisis

In recent days, Councilmember Catania has warned of a looming budget crisis and has challenged the Chief Financial Officer's (CFO) September 2008 revenue projections for the District of Columbia. These projections show a $131 million revenue shortfall for the current fiscal year. Catania believes that this figure is likely to be significantly higher and that budget pressures may be long-lasting. He has asked the CFO to re-estimate District revenues so that the Council and Mayor can revise the fiscal year 2009 (FY 09) budget to address further declines early in the fiscal year. The CFO has maintained that the revenue projections "reflect a conservative view of the economic outlook," and has refused to consider performing additional projections for the District's elected policymakers. Our office has prepared the following analysis to help you better understand the assumptions underlying the CFO's revenue projections and some context in which to consider our current budget shortfall.

Key Economic Indicators Used in the Chief Financial Officer's September 2008 Revenue Projection

Economic Indicator	CFO Assumption 2008	CFO Assumption 2009	Analysis
Unemployment	6.1%	6.8%	D.C.'s unemployment jumped to 7.0 percent in September 2008, up from 5.7 percent in December 2007. The current unemployment rate is already higher than the CFO's assumption for 2009. It is unrealistic to rely on a revenue forecast that projects a decrease in unemployment. According to the Wall Street Journal, unemployment has remained relatively low through October 2008 but is beginning to spread beyond the construction and financial industries. [Wall Street Journal, 10/27/2008]
Change in S&P 500	-5.5%	-7.7%	Through October 28, 2008, the S&P 500 Index is down 36.38 percent for the 2008. Moreover, the index is down 22.2 percent since the release of the CFO's September Revenue Projection. The CFO's estimate under these circumstances seems ridiculous. [www.wsj.com]

CFO Assumption

	2008	2009	
Change in Personal Income	5.5%	2.6%	Data from the U.S. Department of Commerce show that personal income experienced a dramatic 0.6 percent drop in July 2008. The year to date gain in personal income is 2.9 percent, but there has been no growth in this common economic indicator since June. [www.bea.gov]

	CFO Assumption		
	2008	2009	
Change in Home Sales	-20.0%	-10.0%	Through September 2008, the number of residential units sold in the District is down 28.8 percent compared to 2007. The total dollar volume of sales is down 26.1 percent over the same period. [www.mris.com]

Using these and other economic indicators, the CFO projected District revenues by type for FY 2008 through FY 2012. Two of the city's largest revenue categories are income (including franchise taxes) and real property tax collections. Together they account for 38 percent of all local revenues. Fluctuations in these two revenue sources can dramatically affect the District's overall budget. In his September 2008 revenue projection, the CFO projected the following annual changes to total income tax collections.

2008: 1.1%
2009: -8.0%
2010: 4.7%

He also projects annual increases in real property tax collections of:

2008: 18.2%
2009: 17.4%
2010: 7.9%

To understand these projections in the context of our current economic situation, it is important to consider changes to income and real property tax collections during previous economic downturns, including 1990-93 and 2002-03 and real estate market slumps, which included much of the 1990s. The current decline is likely to be (or already is) much worse than any previous economic crisis in decades. Thus, it is reasonable to assume that income and property tax collections will decline more over the next 1-2 years than during these previous periods. The table below lists collections from these taxes beginning in 1990 and ending in 2007.

While the CFO projects an increase in total income tax collections of 3.2 percent in 2008 and a decline of 8 percent in 2009, history suggests the decline(s) will be much larger. In 2002, in the aftermath of the September 11th attacks, income tax collections plummeted -17.1% and remained down through 2003. **Actual collections in 2003 remained below their level in 1999 – 4 years earlier – and had barely reached their pre-September 11th level by 2005.** A drop of this magnitude will have a devastating effect on the District's local funds budget. Fortunately, during that period, real estate values and home sales were skyrocketing, easing the budgetary pain of declining wages and a floundering stock market. The District will not be so fortunate this time around.

It is simply inconceivable that the District will see increases in real property tax collections of 17 and 18 percent over the next two years. As previously discussed, data on home sales show major reductions in the number and dollar volume of transactions in 2008. In addition, average sale prices have remained stagnant this year and declined 4.29 percent in September 2008 compared with September 2007. From 1994 through 1999, during the city's last real estate decline, real property tax revenues declined for 6 consecutive years. **The decline was so profound that even with spiking real estate values in the early 2000's, the District collected 11.4 percent <u>less</u> real property tax revenue in 2003 than it did in 1993!** Again, a decline of this nature would devastate local revenues.

D.C. Revenues from Total Income and Real Property Taxes: 1990 - 2007
(in $1,000s)

Year	Total Income Tax Collections	Percent Change vs. Previous Year	Real Property Tax Collections	Percent Change vs. Previous Year
1990	777,651	---	664,591	---
1991	749,025	-3.7	801,876	20.7
1992	708,085	-5.5	820,892	2.4
1993	730,519	3.2	928,322	13.1
1994	800,868	9.6	730,641	-21.3
1995	804,355	0.4	654,284	-10.5
1996	843,553	4.9	624,382	-4.6
1997	936,980	11.1	617,694	-1.1
1998	1,083,102	15.6	616,935	-0.1
1999	1,169,751	8.0	597,566	-3.1
2000	1,338,564	14.4	610,896	2.2
2001	1,400,237	4.6	633,172	3.6
2002	1,160,424	-17.1	726,014	14.7
2003	1,167,452	0.6	822,845	13.3
2004	1,299,009	11.3	947,689	15.2
2005	1,472,432	13.4	1,058,100	11.7
2006	1,591,483	8.1	1,152,143	8.9
2007	1,736,361	9.1	1,443,601	25.3

Note: "Total Income" is comprised of revenues from individual income, corporate franchise, and U.B. Franchise taxes.

For these reasons, Councilmember Catania has argued that it would be detrimental to the District and its residents to rely on and to act upon the CFO's September 2008 revenue projection. It is a virtual certainty that the deficit will be much larger than $131 million in FY 09. In addition, the District is likely to see increased demand for city services over the coming months. To budget for the increased use of the District's Medicaid and D.C. Healthcare Alliance programs, yesterday Catania revealed that he will propose nearly $20 million in additional cuts to budgets of the Departments of Health and Mental Health. These funds would be held in a separate account for use later in the fiscal year.