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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

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June 10, 1981

The Honorable William V. Roth, ~~DOJ~~ that make available to public reading
Chairman, Committee on
Governmental Affairs
United States Senate

Dear Mr. Chairman:

Your March 31, 1981, letter requested our [views on S.744], a bill to authorize the District of Columbia to issue and sell general obligation bonds for the purpose of paying certain liabilities of the District, and for other purposes. You asked for any recommendations we might have concerning possible Committee action.

Whether the District should be authorized to issue and sell general obligation bonds to pay current liabilities and thus finance part of the accumulated operating deficit is a matter of congressional prerogative, and we make no recommendations in that regard. However, we have some observations for consideration during your deliberations on this issue.

The District estimates that debt service totalling about \$400 million would be required to repay the \$184 million initially borrowed. A significant amount of operating revenue--an estimated \$20 million a year--would have to be dedicated for a substantial future period--20 years. Decisions to commit a city to this type of financing are usually reserved for capital projects with a useful life at least as long as the term of the obligation involved.

Only a portion of the reported accumulated deficit as of September 30, 1980, constitutes a cash need. The proposed legislation recognizes three items that we previously identified as not constituting a cash need, namely; interest, accrued annual leave, and taxes, and eliminates these items from the \$388 million accumulated deficit, to arrive at the \$184 million amount which would be financed from bonds.

If the intent is to restrict the amount of the bonds authorized to the cash shortfall associated with the deficit, there are other current liabilities which are similar to the liabilities excluded by the proposed bill.

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For example, the current liabilities include accrued payroll in the amount of \$47.5 million. This is a recurring item which will always have a year-end balance, although the amount may vary from year to year. The amount outstanding at the end of a fiscal year could vary because of the differences in the number of days between the end of the last full pay period in the year and the end of the fiscal year. For financial analysis purposes, the fact is that, as a general proposition, the District will be meeting 26 payrolls a year--no more, no less. The amount of accrued payroll will also vary, all other things being equal, because of differences in year-end employment levels and average salaries and wages.

Another item impacting on the 1980 deficit may have been overstated, namely the reserve for grant disallowances. In discussing actions taken to avoid a \$60 million deficit in fiscal year 1981 operations the District announced that a \$2 million reserve for grant disallowances for fiscal year 1981 would not be needed and therefore the estimated 1981 deficit would be \$2 million less. District Office of Controller personnel advised us that the \$13 million reserve included in the fiscal year 1980 annual report was considered adequate to cover any grant disallowances through fiscal year 1981. Thus, it appears that the fiscal year 1980 deficit was overstated by about \$2 million for grant disallowances.

If each of the items discussed above are eliminated from the determination of cash needs--\$47.5 million and \$2 million for accrued payroll and reserve for grant disallowances, respectively--cash needs would be \$49.5 million less than the \$184 million in proposed bonding authority.

Even the adjusted amount of \$134.5 million may very well misstate the amount of money that the District needs. For example, the accounts payable item is analogous to the payroll item in that there is certain to be such an item at the end of the year. What is important is what part of the accounts payable total represents past due items that should have been paid during the fiscal year.

In our view, even as adjusted, the September 30, 1980, deficit does not provide the best measure of the District's borrowing needs. A more direct way of arriving at that figure would be to require the District to prepare a cash flow statement covering fiscal years 1981 and 1982. We suggest these years rather than reexamining fiscal year 1980 data, because of the District's dynamic fiscal situation which appears to have deteriorated even further since September 30, 1980. In that statement, cash requirements

would represent all items that will fall due and should be paid within those years. Any differences between available revenues and this amount would seem to represent the amount of additional funds required by the District to get well from the standpoint of being able to meet its obligations as they fall due.

In addition, provision could be made to strengthen the District's working capital position by providing authority for some additional borrowing beyond the baseline need. The District looks upon the bond sale as a means to improve the current asset/current liability ratio in the general fund. Bond sales in excess of cash needs resulting from the deficit would accomplish this objective. Obviously, however, the bond sale will not solve the overall deficit position of the District since it would merely trade short term liabilities for a long term liability.

It is obvious that once the District gets current it must take whatever steps are necessary to stay that way. It must assure that revenues and expenditures are balanced in future years. If this is not done, then it is possible that the District could once again find itself in the same situation as at present--unable to pay its obligations as they become due and facing once again the need for extraordinary measures to maintain solvency.

We have the following comments on the specific provisions of the proposed bill.

Section 3(b) would limit the principal amount of bonds to \$184 million, plus costs incidental to the issuance of the bonds and to amounts needed to provide a debt service reserve fund. The Committee may wish to obtain an estimate from the District of the reasonable and necessary costs of issuance and of maintaining the debt service reserve fund, so that either a specific amount or a limit could be included in section 3(b) to provide assurance that the cost of any bond issue authorized would be limited to reasonable and necessary amounts.

Section 4(a) would allow the Council to adopt one or more acts authorizing issuance of all or any part of the aggregate principal amount of bonds, and would allow such act to take effect immediately and be exempt from the provisions of section 602(c) of the Home Rule Act, which provides for congressional review and approval of District legislation. Section 4(b) provides that any such act set forth a plan for financing the amount required annually for payment of maturing principal and interest on bonds and identifying the source of the funds to be used for the payment. Section 4(a) would remove from congressional oversight the repayment plan for the bond program set forth in any

act adopted by the Council. However, it is not clear whether the exemption in section 4(a) also removes from congressional oversight the implementation of the components of the plan set forth in section 4(b)(1) through (3), such as increasing taxes or reducing expenditures. The Committee may wish to retain oversight by striking the last sentence from section 4(a).

Similarly, section 4(d) would exempt the bonds from provisions of Charter Amendment Numbered 1 entitled "Initiative and Referendum." Since District residents may be called upon to pay additional taxes or forgo services to provide funds to retire bonds authorized under this proposed legislation, the Committee may want to consider whether citizens should have an opportunity to vote approval or disapproval of the terms and conditions of any bonds issued under this legislation.

Section 5(a) requires the Mayor to publish once in at least one newspaper any act authorizing issuance of bonds and a notice of the enactment in a form specified in the proposed legislation. However, section 5(b) provides that failure to publish the notice or any error in any publication thereof will not impair the effectiveness of the act or the validity of bonds issued pursuant thereto. The Home Rule Act, in section 463 contains language substantially identical to the language in section 5(a) of the proposed legislation. The Home Rule Act contains no provision similar to section 5(b). Since the notice provided for in section 5(a), in effect, signals the start of the limitation period provided for in section 6, we are not sure of the effect on the limitation period should the provisions of section 5(b) remain in the bill and notice is either omitted or improperly rendered. The Committee may wish to clarify this matter.

Section 8(a) would require that proceeds from the sale of bonds be deposited in a special account in a federally insured financial institution in the District. Section 8(a) provides that these proceeds can be expended only for the purpose for which the bonds were authorized, and that any funds not so expended shall be applied only to the payment of annual debt service on the bonds. Section 8(b) provides that moneys realized on any investment of the proceeds of bonds shall be used for the same purposes as section 8(a), as well as to pay for the expenses of maintaining the special account. The payment of debt service is itself a purpose for which the District is authorized to issue bonds under section 3(a)(4). Furthermore, it is not clear whether the payment authorized in section 3(a)(3) of costs incidental to the issuance of the bonds encompasses the payment authorized in section 8(b)(3) of expenses of maintaining the special account.

To eliminate redundancy and to provide additional clarity, the Committee may wish to amend section 3(a)(3) to specifically include the payment of expenses of maintaining the special account and then provide that the proceeds in section 8(a) and the moneys realized from investments in section 8(b) may be used only for the purposes stated in section 3(a). These changes also would ensure that there are funds available to pay the expenses of maintaining the special account in the event that at some point the moneys realized on investments are not sufficient to pay such expenses.

Section 8(b) raises an issue by referring to moneys realized on any investment of the proceeds of bonds. The bill does not specify the type of investment the District may make. It is not clear whether section 8(b) is an authorization to use the proceeds for reasons not specified in section 8(a), namely, to make investments, or whether "moneys realized on any investment" refers to interest realized as a result of a deposit under section 8(a). It would be useful if the Committee specified what type of investments are authorized. It may be appropriate for the District to be authorized to invest the proceeds, but such investments should be limited to interest-bearing, guaranteed investments in order to ensure that such investments do not result in a loss.

Section 10(a) authorizes the Council to provide in its act authorizing the issuance of general obligation bonds a pledge of District revenues as additional security for the payment of the bonds. Section 10(a)(1) through (7) lists requirements which the Council may include in its act authorizing the bond issue. These requirements also may be included in the contract with bond holders.

These provisions provide some additional guarantees as to how the bonds will be handled and the bond holders protected. The Committee should consider whether the protection provided in subsection (a)(1) through (7) should be required, rather than permissive, in situations when District revenues are pledged as security and whether particular parts of the subsection should be applicable even when District revenues are not pledged as security.

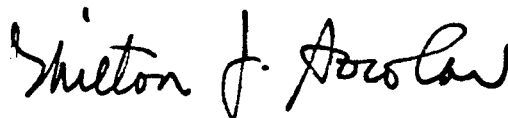
Subsection (a)(5) contains a provision which causes us some concern. It provides, in part, that the Mayor may enter into agreements concerning "the doing of any act (including refraining from doing any act) which the District would have the right to do in the absence of such agreement." It is not clear whether this provision allows the Mayor to incorporate in the agreement acts authorized by other laws, but not specifically authorized

in this legislation. We believe that subsection (a)(5) should be clarified to indicate whether the agreement is limited to acts which the District would have the right to do under this legislation.

Section 12 would exempt from congressional oversight and control amounts obligated or expended from bond proceeds, amounts approved, obligated or expended for payment of any bonds and the pledge, transfer or assignment of any District revenues to secure or otherwise to provide for the payment of any bonds. The Committee may wish to retain and exercise its oversight and control responsibilities with respect to these items and accordingly may wish to revise the proposed legislation by deleting or amending section 12. In this connection, it may help in your deliberations to point out that section 13 proposes to make bonds issued under the proposed legislation tax-exempt and authorizes investments in District bonds by certain regulated financial institutions in conformity with the general District bond authority contained in sections 485 and 486 of the Home Rule Act.

We would be pleased to discuss this matter further with you or your staff.

Sincerely yours,

A handwritten signature in cursive script that reads "Shelton J. Arosow".

Acting Comptroller General
of the United States,