

Fitch Affirms District of Columbia's Deed Tax Revs at 'A'; Outlook Stable

Written by Australian Business

NEW YORK--([BUSINESS WIRE](#))--Fitch Ratings has affirmed the 'A' rating on \$120.5 million in outstanding District of Columbia (Washington, D.C.; the District) deed tax revenue bonds.

The Rating Outlook is Stable.

SECURITY

The bonds are special obligations of the District, secured by pledged revenues consisting primarily of 15% allocations of real property transfer taxes and deed recordation taxes levied by the District.

KEY RATING DRIVERS

VOLATILE PLEDGED REVENUE STREAM: Pledged revenues, which are derived from the economically sensitive housing market, have exhibited significant volatility, both recently and historically.

SOUND LEGAL PROVISIONS: Under terms of the indenture, debt service is funded one year in advance of when due from required monthly transfers by the District to the trustee. The additional bonds test (ABT) coverage minimum is a satisfactory 1.5x and bondholders benefit from the ABT's three-year look-back to address inherent pledged revenues volatility. Fitch notes the District recently enacted legislation preventing issuance of future new money deed tax revenue bonds.

SOLID DEBT SERVICE COVERAGE: Pledged revenues provide ample coverage of debt service, which is declining to flat beginning next fiscal year.

CREDIT PROFILE

The pledged revenue stream is narrow and dependent on the value and volume of real property transfers and deed recordation activity in the District. The 'A' rating further reflects solid legal protections and strong debt service coverage provided by the pledged revenues. The 1.5x ABT incorporates a three-year historical element to offset the risk of over-leveraging after a rapid increase in District real estate values. The District's city council recently enacted legislation preventing issuance of additional new money deed tax revenue bonds, though Fitch notes future legislation could reauthorize issuance in the future.

PLEGGED REVENUES TIED TO REAL ESTATE MARKET

Bond security is derived from a 15% pro rata share of the District's real property transfer and deed recordation taxes dedicated to the Housing Production Trust Fund (HPTF). The District's independent Chief Financial Officer (CFO) can reduce the percentage allocation if needed to balance its budget but the District covenants not to reduce the 15% unless aggregate debt service for the current and ensuing fiscal year and any amounts necessary to replenish the reserve fund to its required level have been provided for. Under the indenture, violation of this covenant represents an event of default, providing strong incentive for the District to remain in compliance.

The District levies its real property transfer tax upon the conveyance of real property or interests therein at 1.45%, except on transactions involving residential property being conveyed for consideration of less than \$400,000, in which case the transfer tax rate is 1.1%. The deed recordation tax is a tax of 1.45% imposed upon recordation of deeds, including those concerning a lease or ground rent for a term (with renewals) of at least 30 years. Exceptions are also made in the case of recordation surrounding residential property with consideration of less than \$400,000, for which the tax rate is 1.1%.

The pledged revenue stream has been very volatile, characterized by sharp gains and losses. Driven by the weakening housing market, total deed recordation and transfer tax collections deposited in the HPTF for transfer to the trustee in fiscal 2008 declined by 30.9% and fiscal 2009 deposits declined an additional 30.4%. Revenue performance improved considerably for fiscal years 2010 and 2011 with growth in HPTF deposits of 6.8% and 49.7%, respectively, as the District's housing market rebounded strongly. Results

over the last two fiscal years continued to reflect the inherent volatility of pledged revenues: in fiscal 2012 HPTF deposits from the deed recordation and transfer taxes declined 5.4%, and then grew 24.5% in fiscal 2013. The District's CFO estimates HPTF deposits will decline 14.4% in fiscal 2014 before resuming a slow, steady rate of growth and essentially return to fiscal 2013 levels by fiscal 2018.

ROBUST DEBT SERVICE COVERAGE

Despite the revenue volatility, debt service coverage remains strong. Projected fiscal 2014 pledged revenues provide 5.8x coverage of MADS, occurring in fiscal 2015, despite the forecasted sharp decline. Fitch's breakeven analysis indicates that deposits would need to sustain 7.7% annual declines every year before reaching sum sufficient coverage in fiscal 2037 (or 6.1% declines every year to reach the ABT that same year). Fitch views these scenarios as very unlikely. Between fiscal 2004 (the first full year of HPTF deposits) and fiscal 2013, average annual growth has been essentially flat at 0.58%, despite the volatility caused by the last recession which particularly affected the housing market.

SOLID BONDHOLDER PROTECTIONS

Given the demonstrated volatility in pledged revenues, Fitch's rating incorporates important legal protections for bondholders. The District allocates 15% of the real property transfer and deed recordation taxes to the HPTF (subject to the potential budgetary limit noted earlier), and on a monthly basis, transfers those amounts to the trustee to pre-fund debt service for the following year, and make any debt service reserve fund replenishments. The act creating the HPTF allows the District to issue deed tax debt with aggregate annual debt service up to \$16 million (currently, MADS of \$7.8 million). The ABT requires 1.5x coverage of MADS by the lesser of pledged revenues for the prior fiscal year or the average amount of pledged revenues for the past three fiscal years. The three-year look-back is an important offset to the risk that a single year of strong performance would lead to over-leveraging.

While program needs continue, the District does not anticipate issuing future deed tax revenue bonds. Under the statutory authorization, bond proceeds were dedicated to finance the District's New Communities Initiative for housing infrastructure, particularly in areas of public housing. In 2014, the city council passed legislation effectively ending new money issuance of deed tax revenue bonds, and instead shifting support for the New

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Communities initiative to the District's income tax bond program (currently rated 'AA+' / Stable Outlook by Fitch). Both the deed tax and income tax bonds are managed by the District's independent CFO and are subject to the District's debt ceiling act.

Additional information is available at 'www.fitchratings.com'.

Applicable Criteria and Related Research:

--'U.S. State Government Tax-Supported Rating Criteria' (Aug. 14, 2012);

--'U.S. Local Government Tax-Supported Rating Criteria' (Aug. 14, 2012).

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U.S. Local Government Tax-Supported Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685314

Additional Disclosure

Solicitation Status

http://www.fitchratings.com/gws/en/disclosure/solicitation?pr_id=837697

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