MUNICIPAL ASSISTANCE CORPORATION FOR THE CITY OF NEW YORK

Minutes of a Special Meeting of the Board of Directors

June 23, 1981

A Special Meeting of the Board of Directors of the Municipal Assistance Corporation For The City of New York was held at 10:30 A.M. on Tuesday, June 23, 1981, at the offices of Paul, Weiss, Rifkind, Wharton & Garrison, General Counsel to the Corporation, 345 Park Avenue, New York City.

The following Directors were present, constituting a quorum of the Board:

Felix G. Rohatyn, Chairman
Edward M. Kresky, Vice Chairman
Francis J. Barry
Kenneth J. Bialkin
George M. Brooker
Dick Netzer
Robert C. Weaver

The following Representatives were present:

Leonard Nadel
Bradford J. Race

The following members of the Staff were present:

Lorenzo F. Bailey
John G. Bove
Maxine H. Gillman
Steven J. Kantor
William J. Lithgow
Terri L. Posner
Stephen J. Weinstein

Also present by invitation of the Board were: Allen L. Thomas, Paul S. Pearlman and Dorothy A. Carey of Paul, Weiss, Rifkind, Wharton & Garrison, General Counsel to the Corporation; John J. Keohane of Hawkins, Delafield & Wood, Bond Counsel to the Corporation; Stephen Berger, Consultant to the Corpor-
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ation; Thomas Boast of the Financial Control Board; Bernard Kabak, Abe Biderman and Brian Perlee of the Office of the State Special Deputy Comptroller; Leslie Buch and David Hack of the City of New York; Allen Kone and Lawrence Kieves of the United States Treasury Department; and Robert Mabon of Salomon Brothers.

Minutes

After discussion, the Board directed that certain changes be made to the draft minutes of the Board meeting of June 2, 1981, to delete references to arrivals and departures of individuals other than those associated with the Corporation, and directed that the revised minutes be circulated for review.

Review of City Budget

Mr. Berger stated that a proposed report prepared by the staff summarized its review of the 1982 City budget. He stated that the City's 1982 budget was balanced in accordance with generally accepted accounting principles for the second consecutive year and that once again the City would show a cash surplus. He explained that the City's impressive performance had been due in large part to an extraordinary growth in local tax revenues, observed that such growth appeared to be slowing down, and noted that the City appeared to have the capacity and commitment to deal with revenue shortfalls. He stressed the importance of effective monitoring by the City of its revenues and expenditures during the 1982 fiscal
year. He said that the Corporation's concern was that the City's remarkable fiscal accomplishments to date be continued.

Mr. Rohatyn stated that the problems with regard to financing transit and medicaid were of great concern to the Corporation. He said that the end of the four year financing plan agreed to in 1978 was approaching, during which period the Corporation had to finance publicly less than half of its total borrowings. As of January 1982, he continued, the Corporation would have to rely totally upon the public credit markets. He also pointed out that the Corporation had the statutory authority to issue no more than $10 billion of debt, and to issue additional debt for new money only until December 31, 1984.

Mr. Rohatyn stated that the City needed an investment grade rating from both rating agencies as soon as possible in order to obtain the necessary access to the credit markets to meet its own financing needs. He observed the dreadful condition of the municipal bond markets and stated that it was unlikely that interest rates would come down significantly in the foreseeable future, which condition would be exacerbated by the proposed Federal tax reduction program making tax-exempt bonds less attractive to investors, and further exacerbated by increasing regional discrimination in the markets against issuers in the Northeast and New York. He stated that for all of those reasons the Corporation was developing a proposed short-term borrowing program with
long-term protection, which he expected to be presented to the Board within the coming month.

Mr. Kresky observed that the City's financing needs required a stronger tax-exempt market, along with State help in resolving transit and medicaid financing problems. He emphasized that it would be critical for the City to obtain investment grade ratings from Moody's as well as Standard & Poor's in order to be self-sustaining as of January 1985.

Mr. Bialkin and Mr. Berger discussed certain changes in the language in the proposed budget report from an earlier draft circulated to the Board. Mr. Netzer stated that the report spoke for itself. Mr. Nadel said he agreed that it was important not to be complacent in analyzing the City's budget position. Dr. Weaver stated that he agreed with the tone and content of the proposed report.

Upon motion duly made, seconded and unanimously carried, it was:

RESOLVED, that the report of the Municipal Assistance Corporation For The City of New York regarding the 1982 budget of the City of New York be and hereby is adopted, and that the transmittal of that report to the Mayor of the City of New York and the Governor of the State of New York be and hereby is authorized.

The Board directed that a copy of the report be appended to the minutes of the meeting.

Resignation of James R. Brigham, Jr.

Mr. Barry noted that James R. Brigham, Jr., would be resigning as Director of the Office of Management and Budget
of the City of New York, a position in which Mr. Brigham had served ably since February 1978. After discussion, in recognition of Mr. Brigham's dedicated and distinguished service in that position, upon motion duly made, seconded and unanimously carried, it was:

RESOLVED, that the Board of Director of the Municipal Assistance Corporation for the City of New York hereby expresses its sincere appreciation to and commends James R. Brigham, Jr. whose sound judgment and tireless efforts have been indispensable to the remarkable fiscal achievements of the City of New York during the administration of Mayor Edward I. Koch.

Adjournment

There being no further business before the meeting, it was, upon motion duly made, seconded and unanimously carried, adjourned at 11:15 A.M.

[Signature]

Stephen J. Weinstein
Secretary
June 22, 1981

The Honorable Hugh L. Carey
Governor of the State of New York
The Honorable Edward I. Koch
Mayor of the City of New York

Dear Sirs,

You will find attached the Municipal Assistance Corporation's review of New York City's executive budget for FY 1982 which we find to be in balance, according to GAAP. The progress made by the City, both in the budgetary as well as the financing area, more fully described in our report, is quite remarkable. We do introduce, however, a cautionary note with respect to the trend of current expenditure growth which appears to be outstripping expected revenue growth. We fully support the City's decision to invest in service delivery and quality-of-life improvement. However, careful and continuous monitoring will be needed in order to avoid the recurrence of large budget gaps in the future which would require offsetting harsh cutbacks. We may be entering a generally less favorable economic climate for the City together with greater burdens caused by Federal budgetary cutbacks.

In addition, there are two issues of overriding importance to the City which must be singled out: Transit and Medicaid.

The degradation of New York's mass transit system can be just as lethal for the City as bankruptcy once threatened to be. A lingering death is, ultimately, no different from a sudden stroke. There is no rational reason to postpone the adoption of a long-range revenue and capital plan for the MTA; no miracles will occur in the next few months, and a piecemeal solution is no solution. Whether the Transit Advisory Panel's suggested plan is adopted or an alternative that is both long-range and comprehensive, we urge legislative action now.

/...
Equally critical to the City's future is the State's phased and assured takeover of the City's share of Medicaid costs. Much of what has been accomplished over the last few years will be jeopardized if such a takeover does not take place, or if it takes place in such small increments and over such an extended period of time as to make it meaningless from the City's budgetary point of view. It is difficult to see how the City will be able to provide adequate funds for services and economic development in the future, unless its budget, simultaneously, is relieved of the cost of Medicaid.

We urge both Governor Carey and Mayor Koch to make the most of their combined leadership and cooperation to bring both these issues to a swift legislative conclusion. Failure on either one would be a sad way to end what has, up to now, been such an extraordinary achievement.

Very truly yours,

Felix G. Rohatyn
Chairman of the Board
ANNUAL BUDGET REPORT

June 23, 1980
SUMMARY

The proposed New York City Executive Budget for FY 1982 is balanced according to generally accepted accounting principles (GAAP). Modifications made by the City Council and Board of Estimate in adopting the FY 1982 budget appear to be within the framework of a balanced budget.

The Executive Budget for FY 1982 represents the second consecutive budget which is balanced in accordance with GAAP. During FY 1981, the City made noteworthy advances toward self-sufficiency in the public credit markets. The City was able to meet its seasonal financing requirements entirely through the issuance of short-term notes backed by the City's revenues. In addition, the successful sale of $75 million of general obligation bonds in March, for which the City obtained an investment grade rating from Standard and Poor's Corporation, represents an initial step toward establishing full access to the long-term public credit markets.

With the submission of the Executive Budget, the City has eliminated a budget gap which, one year ago, was estimated to be $1 billion. The single most important factor in eliminating this gap was an increase in projected revenue of approximately $850 million during the past year, a substantially higher increase than was expected.

Based upon the trend of the local economy thus far during 1981, and the economic forecasts for 1982, revenue from the major economically-sensitive City taxes should grow moderately, at or close to the expected rate of inflation. This is in contrast to the very high growth rates experienced since FY 1979. Should the local economy perform more poorly than expected, it may be necessary to reduce the spending levels prescribed in the budget for FY 1982. This slackening in the anticipated revenue growth rate calls for close monitoring of tax receipts by the City.

As presented in the Executive Budget, the growth of City expenditures during FY 1982 is higher than the growth in preceding years, and exceeds the expected rate of inflation.
The projected expenditures grow at a rate which is significantly higher than the projected revenue growth. Annual City-funded expenditures in FY 1982 (exclusive of debt service) are projected to increase by over 10 percent, as compared with an increase in total annual City-generated revenues of only 6 percent. (See chart.) (It should be noted that debt service costs are excluded from the calculation of expenditure growth for FY 1982 because such costs have been reduced by the amount of prior years' real estate taxes collected in excess of debt service requirements. The growth rates calculated by the City differ in that debt service costs were included for FY 1982.) Nonetheless, budget balance will be achieved in FY 1982 because of the availability of funds from prior years' surpluses, higher real estate tax revenues generated through the use of accelerated debt redemption schedules and the City's ability to control the proposed new expenditure increases by restricting new hiring so as not to fulfill planned personnel levels. If not corrected, however, this imbalance will create ever-increasing budget gaps in the future.

It is appropriate that the City take advantage of the relative prosperity we have experienced recently by allocating funds for service improvements that can help to upgrade the quality of life for the people who live and work here. But it is also essential to maintain the balance between the levels of service it would like to achieve and the levels that can be afforded without adding to the burden of City taxation. If the local economy grows more slowly than it has in the recent past, then increases in City spending will have to be tightly constrained. This constraint has an obvious bearing on the City's labor negotiations next year.

* * *

As required by Section 3040 of the Municipal Assistance Corporation For The City of New York Act, we have reviewed the City's budget submission for the 1982 fiscal year. In accordance with the Act, we present our initial findings and determinations. Our report reviews the Mayor's Executive Budget for FY 1982 based on our own studies, the reports of the Office of the Special Deputy Comptroller ("OSDC") and the staff analysis of the Financial Control Board ("FCB"), as well as discussions with representatives of the City. The budget as submitted reflects revenues and expenditures of $14.690 billion and is balanced in accordance with generally accepted accounting principles ("GAAP") for the second consecutive year.
ANNUAL INCREASES IN CITY REVENUES AND EXPENDITURES FROM FISCAL YEARS 1979 THROUGH 1982

% Change

Locally-generated revenues

Adjusted City-funded expenditures (net of debt service)

Source: Office of the Special Deputy Comptroller. Revenues and expenditures for FYs 1979 and 1980 are actual from the Comptroller's Annual Reports; FY 1981 data from the forecast as of May 12, 1981; FY 1982 data from the Executive Budget.
The expected year-end results for FY 1981 indicate that the City was able to overcome a variety of obstacles throughout the year, including costs associated with the labor contract in excess of the funds originally provided, the potential need for increased City subsidies for certain covered organizations, and an unclear revenue outlook due to the unpredictable local economy.

Based on our analysis of the Executive Budget for FY 1982, we conclude that such budget is balanced, and the City may even achieve a modest surplus in that year. This represents an impressive achievement. However, areas of concern remain which will require careful monitoring.

I. Revenues

City forecasts for FY 1982 tax revenues assume a continued expansion of the national economy into calendar year 1982. Although local prices are still expected to rise more slowly than national prices, the disparity experienced in recent years has narrowed during calendar year 1981. Thus, for the near term, the local price outlook, as a measure of the City's competitive advantage, is less favorable than in the recent past because of the combined effects of higher mortgage rates, higher residential and commercial rents and the impending rise in the transit fare. These assumptions are based upon scenarios developed by the major economic forecasting services.

Many forecasters of City economic conditions expect that local tax receipts will exhibit moderate growth during FY 1982. The City's own forecasts reflect a lower growth rate than those experienced in recent years, primarily because of the assumption that local inflation will be somewhat lower than in the past.

Other factors affecting the City's FY 1982 budget will limit available revenues and inhibit surplus accumulation.

- The recently adopted State budget affecting the City's 1982 fiscal year maintains the previously enacted ceiling on State revenue sharing. With the exception of probable annual increases in State education aid, the State has made no commitment to provide new sources of budget balancing aid.

- The proposed State take-over of local medicaid costs is still being negotiated. While it is possible that the take-over, if enacted, will provide smaller incremental
savings than the City had assumed in the budget, the realization of any savings from the program remain uncertain.

- The completion of the phase-out of the stock transfer tax on October 1, 1981 will limit revenues from that source to a specified annual level.

- The retrenchment policies evident in the proposed Federal budget have not only reduced anticipated Federal aid but have also created pressures on the City to provide offsetting funds to lessen the burden on those most affected by the proposed spending cuts.

In the Mayor's Message submitted in conjunction with the FY 1982 budget, it was estimated that Federal aid in FY 1982 will be lower by $297 million as a result of the President's budgetary reductions proposed on March 10, 1981. The major portion of this spending reduction, $178 million, is attributable to the President's proposal to eliminate the CETA public service employment program. CETA employees had formerly represented a major component of the City's workforce - especially in certain municipal agencies such as the Department of Parks and Recreation in which CETA workers comprised 35 percent of the total personnel in FY 1981. Other Federal aid of $88 million which the City had anticipated receiving during FY 1982 was also eliminated from the City's Executive Budget. The City funds (totalling $193 million) provided to partially mitigate the impact of the proposed Federal budget reductions should prove sufficient to maintain the affected programs during FY 1982. However, the City will be hard-pressed to produce additional funds from local revenues in future years to continue these programs.

Recent developments in Albany have also affected the City's expectations of the aid levels to be provided by the State. It should be noted that the City's projections of State aid were developed prior to the adoption of the State budget for the State fiscal year which began April 1, 1981. The adopted State budget contains increases in education aid in line with the City's assumptions, as well as other categorical aid levels assumed in the City's budget. However, a total of $75 million of anticipated State aid, a portion of which is attributable to the proposed State take-over of local Medicaid costs, is not reflected in the State budget. While the savings which would accrue to the City from the proposed State action are not significant for FY 1982, the lack of a positive legislative resolution creates large potential shortfalls in the City's plans to eliminate budget gaps projected in FYs 1983 through 1985.
The City's Executive Budget has assumed a further action by the State legislature with respect to an expansion of the activities of the Off-Track Betting Corporation, which was anticipated to provide $50 million of revenues in FY 1982. This anticipated revenue is not included in the budget as adopted by the City Council and Board of Estimate. The receipt of $100 million from the sale of the right-of-way for the Westway project is assumed in the budget for FY 1982. The receipt of this nonrecurring revenue, included in the revenue budget for each fiscal year since 1978, continues to be subject to uncertainty.

By far the most significant assumption with regard to FY 1982 revenues is the rate of growth of City property values inherent in the estimates of real estate tax collections. Such tax collections in FY 1982 are projected to be $300 million greater than the forecast for FY 1981. This increase results from anticipated growth in assessed values of real property of more than $3 billion, as compared to FY 1981. The City had petitioned the State Board of Equalization and Assessment ("SBEA") to update the survey data then being used to determine the full value of real property within the City, in that City officials believed that such data significantly understated the growth rates of real property values from 1978 to 1980. The City estimated such growth to be approximately 18 percent, and computed real estate tax collections accordingly. Also included in the projected tax collections was the full year impact of a $.20 increase in the tax rate, now $8.95 per $100 of assessed value, which took effect on January 1, 1981.

Officials of the SBEA have indicated recently, however, that their preliminary findings point to an increase in property values of only 16 percent, which is below the City's assumption. Barring an increase in FY 1982 debt service (for which a municipality can levy real estate taxes without limit) or an upward revision of the SBEA's growth rates, OSDC notes that the City may exceed the constitutional tax limitation in FY 1982, indicating a need to reduce the tax rate.

The City does have a mechanism at its disposal, however, which could be used to increase debt service payments in FY 1982, and therefore maintain the current tax rate. This mechanism involves payments to the Corporation for certain City obligations (called bond anticipation note bonds) held by the Corporation. Accordingly, in addition to the scheduled maturity of some $122 million of such BAN-bonds during FY 1982, the proposed property tax levy had assumed a further call (prepayment) of $255 million (including a total of $137 million originally planned to be prepaid in FY 1981.
that was deferred until FY 1982). Based on the results of the SBEA's survey, the City could call an additional amount of such BAN-bonds in order to support the current tax rate for FY 1982. It should be noted that payments made to the Corporation by the City in this respect are returned to the City via a concomitant reduction in the amount of sales tax which would otherwise be required for payment of debt service on the Corporation's bonds.

In the foregoing, we have identified revenues totalling approximately $225 million which are not likely to be received as planned during FY 1982. Potential offsets for these uncertain receipts include $100 million representing the unallocated portion of the general reserve, and potential revenues in excess of the budget forecast, estimated by OSDC to be approximately $120 million, primarily from general corporation taxes and interest income. Therefore, it is likely that the City will realize the full amount of revenues projected in the budget for FY 1982.

II. Expenditures

The FY 1982 Executive Budget projects an overall expenditure increase of $527 million over the forecast for FY 1981. The vast portion of this increase, $434 million, results from the provision within the budget for the costs of the second year of the collective bargaining agreements negotiated in June 1980.

Not all of the second year costs of the labor settlement will be funded from FY 1982 revenues. A significant portion of such costs representing a nonpensionable cash bonus payment were funded in FY 1980. That year, approximately $200 million was set aside in a reserve in order to make such payments during FYs 1981 and 1982. This prepayment has the effect of both understating the costs of the negotiated labor settlement and overstating the City's ability, as represented in the budgets for FYs 1981 and 1982, to rely upon current revenues to fund current expenditures. The cash bonus payments, which become part of the wage base in FY 1983, will add approximately $165 million to expenditures in that year. The agency budgets for FY 1982 have been increased in the areas of essential services, including fire, police, sanitation, corrections and education. Overall City-funded personnel levels are projected to increase to 178,570 during FY 1982, representing the addition of 7,675 positions to planned personnel levels as of June 30, 1981. Included in this increase are 3,579 formerly CETA-funded positions which the City now anticipates funding. However, for several reasons, the
forecast personnel levels are unlikely to be achieved. First, headcounts of City-funded personnel are currently below planned levels for June 30, 1981. As a result, the actual City-funded workforce will be several thousand positions lower than planned at the beginning of FY 1982. Second, positions vacated through normal attrition during the year (about 13,500) are assumed to be replaced, so that the actual number of persons to be hired during FY 1982, according to OSDC's analysis, would have to be approximately 23,700 to meet the planned headcount figure at year-end. Hirings of this magnitude greatly exceed the City's past practices, and may in fact strain the City's hiring capacity.

Other significant expenditure increases over the forecast for FY 1981 contained in the Executive Budget include $83 million to fund City-wide energy costs, and $127 million for medical assistance payments. Projected public assistance costs only increase by $12 million. This slight increase assumes that the public assistance caseload will rise by 2,100 during the year. Though this assumption may prove optimistic in light of the potential impact of CETA employee terminations through October 1981, the City has provided an additional $45 million in its budgeted general reserve for FY 1982 to absorb any unanticipated effects of the proposed Federal budget reductions.

The Executive Budget for FY 1982 projects debt service costs which are $223 million lower than such costs forecast for FY 1981. The major portion of this net reduction - $178 million - comes from real estate tax revenue collections in excess of debt service requirements in prior fiscal years. (The State Constitution provides that such excess collections must be segregated for the payment of the succeeding year's debt service.) Of the $178 million, $137 million represents the deferral of the payment of the MAC-held City BANs from FY 1981 to FY 1982. As previously noted, the amount of sales tax revenue required by the Corporation for the payment of debt service in FY 1982 is reduced by the amount of the City payments on the BANs.

Actual total expenditures for FY 1982 may be less than the budget assumes if the pattern of underspending experienced in previous years continues in FY 1982. This potential underspending, which occurs primarily in the estimated expenditures for other than personal services ("OTPS"), has been estimated by OSDC to be $85 million, with perhaps another $15 million of underspending in personal services, based upon an analysis of FY 1981 spending.
Fiscal Years 1983-1985

While a surplus is expected for both FYs 1981 and 1982, the proposed financial plan for FYs 1983 through 1985 continues to include large budget gaps.

The City's financial plan for FYs 1982 through 1985 projects budget gaps of $739 million, $935 million and $963 million for FYs 1983, 1984, and 1985, respectively. The City has acknowledged that pressures from Federal budget reductions and increased agency expenditures have increased budget gaps in the later years of the plan. Compared with the gaps projected in the plan approved in February, the proposed plan now projects gaps which are greater by $167 million in FY 1984 and $157 million in FY 1985. The projected gaps are understated in that (i) the provision for a labor settlement of 3 percent annually will be inadequate, (ii) levels of State aid assumed in the gap projections are by no means assured, and (iii) shortfalls in other planned revenues may occur. It has been estimated by OSDC that the potential gap for FY 1983 could grow to $1.3 billion, assuming a labor settlement in line with the projected rate of inflation (8.7 percent) and shortfalls that are likely in certain revenues and State aid. Such assumptions for FYs 1984 and 1985 would result in budget gaps approximating $1.7 billion and $2.2 billion, respectively.

Closing the budget gap for FY 1983 appears to be more difficult now than six months ago because of certain changes which have occurred since the submission of the January financial plan. These changes include (i) the expectation that local economic activity will level off, (ii) the possibility of further reductions in Federal aid levels, (iii) the tentative nature of the proposed State Medicaid take-over, and (iv) the impact of proposed spending increases in FY 1982.

In the aggregate, these factors not only increase projected budget gaps during the plan period but also reduce the gap-closing options available to the City. For FYs 1983 through 1985 the City has proposed gap-closing programs consisting of various City, State and Federal actions which, if fully achieved, are sufficient to close the projected gaps in each of those years. In their report on the financial plan submission, OSDC raised serious questions regarding the proposed gap-closing actions.

Proposed City actions include expenditure reductions of $244 million, $313 million and $411 million in FYs 1983 through 1985, respectively. Of these actions, savings of $93 million in FY 1983, $117 million in FY 1982 and $153 million
in FY 1985 appear to be realizable. The proposed elimination of the budgeted general reserve, to be replaced by a cash reserve, may be precluded by the reference to such reserve within the covenants provided to holders of the Corporation's bonds. In addition, elimination of the reserve may negatively affect the marketability of the City's long-term bonds. Another $69 million of "other City actions" in FY 1983 have not been supported by sufficient detail.

The City has also proposed a revenue enhancement program anticipated to provide $143 million annually. In a recent report, OSDC has determined that only $58 million per year, from increases for water and sewer charges, CUNY tuition and other user charges, can be implemented by the City. The other proposals require legislation or other enabling determinations not within the City's control.

Intergovernmental aid levels assumed in the gap-closing program are also uncertain. These include undefined Federal aid of $50 million in each year, and savings from the proposed State take-over of Medicaid of $88 million, $256 million and $510 million in FYs 1983 through 1985, respectively.

Since the City's gap-closing program does not provide any assurance that the proposed actions will be sufficient to close the gaps projected for FYs 1983 through 1985, and even those projections may be significantly understated, we will look for more a definitive gap-closing program in the City's January modification of the financial plan. Access to the public credit markets, in the magnitude required to address the City's enormous capital needs, depends upon the City's ability to provide a plan to close the projected gaps through actions within the City's control to implement, combined with assured levels of intergovernmental aid. In the face of the withdrawal of Federal aid - especially for mass transit operating subsidies and for human services programs - it is essential that the City and the State come together to resolve two discrete problems affecting City life. The deterioration of the transit facilities poses a serious threat to the City's economic viability. Equally critical is the enactment of the proposed State take-over of local Medicaid costs, which will provide much needed budgetary relief. The swift resolution of these two issues through comprehensive, long-range programs will do much to insure that the City can continue its fiscal progress.