MINCIPAL ASSISTANCE CORPORATION FOR THE CITY OF NEW YORK

Minutes of Special Meeting of the Board of Directors

June 23, 1982

A Special Meeting of the Board of Directors of the Municipal Assistance Corporation For The City of New York was held at 9:30 A.M. on Wednesday, June 23, 1982, 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
Eugene J. Keilin
Andrew P. Steffan
Robert C. Weaver

The following Representatives were present:

Jerome Belson
Bradford J. Race
Robert W. Seavey

The following members of the Staff were present:

Heather L. Ruth
John G. Bove
Claire L. Curry
Denise N. Dean
Maxine H. Gillman
Francis N. Higgins
Steven J. Kantor
Terri L. Posner
Stephen J. Weinstein

Also present by invitation of the Board were: Allen L. Thomas of Paul, Weiss, Rifkind, Wharton & Garrison, General Counsel to the Corporation; Stephen E. Berger, Consultant to
the Corporation; Thomas Boast and Patricia C. Fry of the Financial Control Board; Bernard Kabak of the Office of the State Special Deputy Comptroller; Leslie N. Buch of the City of New York; Allen J. Kone of the United States Treasury Department; and Gedale B. Horowitz and Robert Mabon of Salomon Brothers Inc.

Adoption of Minutes

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

RESOLVED, that the Minutes of the Special Meeting of the Board of Directors held on June 3, 1982 be and hereby are adopted.

City Budget Review

Ms. Ruth stated that the staff, together with the City Budget Committee and the Corporation's consultant, Stephen Berger, had prepared a review of the City's 1983 expense budget, which had been circulated to the Board in draft form along with a memorandum regarding the City's capital budget from Dr. Netzer, Chairman of the City Budget Committee.

(At this point, Mr. Brooker joined the meeting.)

Mr. Berger pointed out that there was a greater dependence on unknowns in the City budget for 1983 than in any year since 1976, particularly with regard to State and Federal aid. The first concern, he stated, was that because
of the difference between the fiscal years of the City and the State, the City's budget for its fiscal year beginning July 1, 1982 would be impacted by State aid to be included in the State's budget for its fiscal year beginning April 1, 1983. He explained that while the current Legislature had provided for present program enhancements for local governments throughout the State, including New York City, those programs would have to be funded by a new Legislature for the next State fiscal year. He stressed that the outcome of ongoing discussions regarding appropriate levels of State aid to local governments would have a critical impact on the 1983 City budget.

In response to a question by Mr. Bialkin, Mr. Berger said that substantial new revenues would be needed by the State in its 1983 fiscal year because of the requirement that its budget be balanced in accordance with Generally Accepted Accounting Principles rather than on a cash basis, differences in State budget projections which were of much greater magnitude than in previous years, and the slowing down of the growth in State revenues due to the impact of the economy.

Mr. Kresky observed that the Legislature was now more actively involved in the State budget process than in previous years, and that the leadership of both parties in
both houses recognized the need to address the adequacy of State revenues.

Mr. Rohatyn added that earlier legislative action regarding revenues was preferable to later action.

Mr. Berger stated that a second concern was identifying those costs in the City budget which were controllable, particularly personal service expenditures. He pointed out that both local inflation and City revenue growth were considerably lower than in previous years. Therefore, he stated, future City labor agreements should include mechanisms to reflect periodic economic changes.

Mr. Berger observed that there were also concerns about the City's capital funding and planning, stating that since the onset of the fiscal crisis the expense budget had quite appropriately been the primary focus of monitoring efforts. He said that it was now necessary to look in the same informed way at the City's capital budget, which was the subject of the memorandum from Dr. Netzer.

Mr. Rohatyn emphasized that a meaningful review of the coming year's City budget required a comprehensive examination of the underlying economic and physical conditions of the City and their linkage to prospective budgetary actions. He stressed that current long-term interest rates raised debt service on new borrowings to levels which demanded increased scrutiny of additional
financing, consideration of alternatives and establishment of priorities for City capital programs.

Mr. Kresky stated that City capital spending was an important concern, noting that the Corporation would remain the primary source of capital financing for the City through December 1984. He stressed that the City's capital needs were staggering, with estimates of between $30 and $60 billion over the next ten years. He said that given an ability to finance a more limited expenditure level it was essential to exert a new discipline with regard to capital spending.

Mr. Keilin stated that consideration of "pay-as-you-go" financing did not mean that the Corporation disagreed with the City's proposal for the creation of a special water and sewer authority to raise money for water and sewer expenditures as a way of diversifying the financing alternatives available to the City.

In response to a question by Mr. Belson, Mr. Rohatyn said that the budget report was not meant to imply that City employees should bear all or most of the cost of balancing the City budget, noting that the Corporation had not been directly involved in City labor negotiations since 1975. Rather, he continued, any labor escalation should be linked to changes in the local economy.
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Mr. Bialkin complimented the staff for preparation of the report. He said that while the section on capital spending was appropriate, he did not read any of the report as a criticism of the City's capital program to date. However, he continued, the "pay-as-you-go" financing alternative might be inappropriate for long-term physical improvements. He said that he understood the report to endorse an examination of financing alternatives but not the entire attached memorandum from Dr. Netzer.

Mr. Rohatyn responded that the point would be clarified in the documents transmitting the budget report.

After discussion, 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 1983 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.

Mr. Mabon observed that the view of the long-term tax-exempt market over the next one to two years appeared pessimistic. He said that the ability of the market to accommodate record levels of tax-exempt financing was of increasing concern.
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Mr. Rohatyn noted that the four-year financing plan developed in 1978 had been completed successfully despite the unprecedented magnitude and complexity of the scheduled private placements and public sales of $1.8 billion of the Corporation's bonds.

Mr. Bialkin commended the Corporation's staff, Board and Chairman for development and implementation of the four-year financing plan.

Adjournment

There being no further business before the meeting, it was, upon motion duly made, seconded and unanimously carried, adjourned at 10:30 A.M.

[Signature]

Stephen J. Weinstein
Secretary
MUNICIPAL ASSISTANCE CORPORATION FOR THE CITY OF NEW YORK

ANNUAL BUDGET REPORT

June 23, 1982
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As required by Section 3040 of the Municipal Assistance Corporation For The City of New York Act, the Corporation has reviewed the City's budget submission for the 1983 fiscal year. In accordance with the Act, we present our initial findings and determinations. Our report reviews the Mayor's Executive Budget for fiscal year 1983 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"). The budget as submitted reflects revenues and expenditures of $15.541 billion and is balanced in accordance with generally accepted accounting principles ("GAAP") for the third consecutive year.

THE BUDGET PROCESS

For the second year in a row (and the third in the last four years), the deadline for the Corporation's statutory report on the City's expense budget will expire before the process leading to an adopted budget and approved Four Year Plan is complete. The uncertainties surrounding the budget and Financial Plan are of particular concern this year because, after seven years of solid accomplishments and significant progress toward recurring budget balance, New York City now faces the most difficult budgetary test since 1975.

In his report dated June 15, 1982, the Special Deputy Comptroller has pointed to a remaining gap totalling $21 to $312 million for the 1983 fiscal year. Included in this estimate of the gap is the possible cost of a labor settlement, not yet concluded, at roughly $55 million per percentage point above the three percent settlement provided in the Mayor's Executive Budget. Contributing to the $21-$312 million estimated gap, OSDC believes that up to $124 million in projected City revenues are at risk. The City's planned expenditure level could be undercut even further during the year by uncertainties which might add to the gap: principally, the possibility of further Federal budget cuts, currently estimated by OSDC at $75 million, and possible shortfalls in State aid, worth up to an additional $193 million.
The budgetary process is made more difficult this year by actions and inaction at the Federal and State levels. Federal budget cuts in social programs have already reduced the resources available to both the State and City budgets and, equally important, the disposable income of the segment of our citizens least able to afford it. The delay in closure over this year's Federal budget raises the level of uncertainty with prospects of additional cuts.

The City is now jeopardized by the lack of an orderly and timely budget process in that it depends upon the Federal and State levels of government and is still in the initial phase of establishing the year-in and year-out fiscal credibility required to sustain and expand its access to the long-term capital markets.

The 1975 crisis taught two important lessons: First, that access to the public credit markets is linked to a predictably recurring balanced budget and, second, that the City and State are interdependent. It is the interdependency of the City and State which makes the issues faced in Albany relevant to the Corporation's examination of the City's 1983 fiscal year budget.

The central debate is over the extent to which the State's revenues will continue to grow at previous rates. The Legislature has enacted a series of programs, some for this fiscal year and others which will cost substantially more in the subsequent fiscal year, without adding new revenue streams to support these programs, thereby creating a new and much higher spending base for the State. One of these major programs, designed to provide relief from Medicaid cost increases for local governments around the State, including New York City, has been adopted but not funded in the State's current fiscal year. Rather, it is proposed to be funded sometime during the first quarter (April-June 1983) of the next (1983-84) State fiscal year, permitting those funds to flow into the City's fiscal 1983 budget.

It is the overlapping calendars of the State and City fiscal years which allow actions pertinent to a future State budget to fund the City's budget at hand. This use of the "Magic Window," which provides the promise but not the presence of State dollars, complicates our ability to judge the City's true fiscal position for 1983.
Beyond this manipulation of the funding cycle, the fundamental disagreement voiced by the Governor relates to the true condition of the State's finances. The Governor's position is that the programs enacted through the legislative process will produce a deficit this year, followed by a far larger deficit next year. If the Governor is correct, substantial new levels of taxation will be required next year to sustain the presently enacted programs, together with their built-in growth. This would reverse the seven year policy of reducing State personal income and certain business taxes. The alternative is to cut back expenditures, thereby jeopardizing the budgets of the City and of other localities throughout the State.

Resolution of these and related issues cannot be deferred too long. The sooner they are resolved, the better for all concerned: not only for the City's 1983 fiscal year expense budget, but also for the perceived creditworthiness of New York City and every tax-exempt borrower in the State, including the Municipal Assistance Corporation For The City of New York.

THE CITY'S 1983 EXPENSE BUDGET

City officials are committed to a GAAP-balanced budget, and we believe they will take such actions as are required to achieve that end. The PCE is in the process of reviewing the City's Plan submission and is expected to take action on June 29. Recent State actions, including the Legislature's approval of authority to enact $171 million in local taxes, promise revenues approximating those required to support the Executive Budget as proposed by the Mayor in May, assuming a 3 percent labor settlement.

As was pointed out in the OASDC report, there remains a series of uncertainties underlying the City's 1983 budget. It seems likely that the outstanding gap will be in a range which can be closed by the methods of expenditure control successfully employed by the City in recent years, that is, without resort to drastic cutbacks. There is no guarantee, however, that such controls will permit sustaining or improving the current level of services as planned. Nor will the accommodations yielding a balanced budget for fiscal 1983 represent any structural progress toward recurring budget balance. At best, as with the State
budget, many of the important issues will have been deferred until further events unfold.

In an environment made uncertain not only by the decisions of higher levels of government but also by the fragile state of the national as well as local economies, many actions affecting the budget are beyond the City's control. It is imperative that the City grasp the one variable which is clearly within its purview—the cost of labor.

Total revenue growth for fiscal 1983 is projected to be a mere 3.5 percent: one-half the growth experienced in fiscal 1981 and less than one-third the growth during 1979. The rate of increase in the cost of living has also slowed substantially. While the CPI increased for the region last month, the cost of living actually decreased by 1.1 percent between September 1981 and March 1982.

In the face of these budgetary and economic uncertainties, the labor settlement should be negotiated in a manner which takes into account actual changes in the cost of living and the final determination must take into account the City's ability to pay. Use of these criteria suggests that increases provided in the wage settlement should not be fixed for the entire length of the contract. Rather, the contract should provide a mechanism for periodically looking back at actual revenue growth and changes in the cost of living as a way of determining changes in compensation. The parties should agree to the development of a procedure which provides for the means of adjustment during the life of the contract.

The Corporation also supports the City's effort to continue the current Tier Three pension system. The establishment of Tier Three was a fundamental pension reform negotiated at the height of the fiscal crisis, and we believe the legislature should resist union efforts to undo this agreement.

CAPITAL NEEDS VERSUS MARKET ACCESS

The same external circumstances which call for continued austerity and caution with respect to the City expense budget demand more rigorous scrutiny of the City's capital spending priorities. Despite efforts in that direction, the City has yet to develop a comprehensive infrastructure
maintenance and rehabilitation program capable of identifying and accomplishing the highest priority capital projects, of spending available capital funds on such projects at projected rates, and of insuring construction is accomplished at the lowest unit cost.

It is perhaps understandable that, beginning earnestly in 1978, the City's initial efforts to re-start its capital program should have focussed on the priority of gearing up the spending process using plans in hand. Indeed, the Corporation remains concerned that City capital spending and commitment rates, despite a large surge this month, will again become "stuck" at a plateau which falls short of the targets against which the Corporation and City jointly formulate the Four-Year Debt Issuance Plan.

The Corporation currently holds in escrow $812 million and is scheduled to borrow $1.25 billion more by December 31, 1984, when our statutory authority to issue new debt for the City's capital program expires. In this relatively short period, the so desperately needed renewal of the infrastructure is constrained by the City's capability to spend and not by the access of the Corporation or the City to capital.

To end there, however, is to take a fatally short-sighted view. Beginning January 1, 1985, the Municipal Assistance Corporation For The City of New York will be authorized to sell bonds and notes only for refunding outstanding debt. Otherwise, our task will be limited to payment of our bonds through 2008. The City will stand alone for raising capital under current plans at an average rate of $1.7 billion per year. Few are prepared to argue that even this projected capital spending level is "adequate" when compared with the true needs of the City's antiquated infrastructure.

The issue is two-fold: first, whether the City is putting its capital resources to the best possible use and, second, whether the City is prepared to make the kinds of difficult choices required if and when market access proves to fall short of current plans. As indicated in the attached memorandum from the Chairman of the Corporation's City Budget Committee, Dick Netzer, there are several areas in which we believe the City should assume a more aggressive posture: among them, in the establishment of capital priorities, the management of project costs, and wider
consideration of alternatives to borrowing for capital spending.

The Corporation and the City--whether separately or together--have yet to raise so much as $1 billion in long-term capital in the public markets since 1975. Moreover, we sell bonds today, in modern history's most adverse capital markets, at almost twice the cost per dollar borrowed, that the Corporation did in the depths of the crisis.

When tax-exempt rates were seven percent and we borrowed $1 billion, we paid back $1 billion in principal plus $1 billion in interest over the fifteen-year average life of the bonds. At tax-exempt rates approaching fourteen percent for the same bonds, we pay back $1 billion in principal plus $2 billion in interest. Notwithstanding legitimate arguments concerning the City's projected level debt service for this decade and the capacity of the real property base to sustain the level of debt service indicated, there is a point beyond which debt service at 14 cents or more per dollar borrowed is no longer affordable and "pay as you go" is the only alternative.

The City's accomplishments to date in reentering the public markets on its own account are impressive and heartening. Barring utter collapse of the markets, further significant progress will doubtless be made each year. But nothing in the immediate prospects for the national economy or the bond market, in the uncertainties underlying the City budget or the State's, suggests that the City can afford to be less hard-headed about its rock bottom capital priorities and standards of productivity than it has been forced to be on the expense budget since 1975.

Attachment: Memorandum from Dick Netzer to the Board of Directors (June 18, 1982).
18 June 1982

To: Board of Directors

From: Dick Netzer, Chairman, City Budget Committee

Re: Reflections on the Problem of Financing the City's Capital Program

Intermediate and long-term economic and financial forecasts tend to be as highly colored by the short-term outlook as are short-term forecasts. That is, even the longer-term outlook, at any given moment, is heavily affected by the prevailing tenor of pessimism or optimism. This being a time of fairly deep pessimism, it may be that all of us are unduly gloomy about the ability to finance the capital program needed over the next decade to preserve and restore New York City's public infrastructure and other basic components of the public stock.

It would take a remarkable act of imagination, however, to contemplate seriously a scenario in which the local and national economies are in such good shape and the markets for long-term debt securities in general and tax-exempt bonds in particular are so buoyant that the financing of the City's capital program poses only technical, not substantive, problems. The more likely scenario is one in which economic and financial conditions external to the City government itself severely constrain the financing of the capital program.

The Office of Management and Budget's ten-year capital program, for the fiscal years 1983-1992, contained in the Mayor's 1983 Executive Budget contemplates capital expenditures averaging almost $3.5 billion annually, of which $1.7 billion is to come from City (including MAC) sources. Even this huge program is considered inadequate by some observers. For example, David Grossman (in a draft chapter for Setting Municipal Priorities 1983) concludes that the $750 million or so in City funds programmed for infrastructure (narrowly defined to include only water, sewer, roads and bridges) may be no more than is sufficient to match the current rate of deterioration, with an additional 50 percent required to make much of a dent in the huge backlog created by past undermaintenance. Grossman suggests that an overall $6 billion annual rate of capital spending could be justified easily. But, of course, there is nothing like an assured capacity to finance the much smaller program planned.

Are there ways to mitigate the probable severity of the financing problem? At least two come to mind.

First, there is serious question as to whether the City's capital program has been subjected to the kind of painful paring the operating expense budget has been subjected to
since mid-1975. The monitors quite correctly assert, at frequent intervals, that there are numerous opportunities for further economies and better management in the everyday operations of City government. But the fact is that there have been enormous economies in the operating expense budget, effected by lay-offs, attrition, declines in compensation in real terms and reductions in "expenditures for other than personal services." In some areas, services have been fairly well maintained in the face of expenditure restraint by dint of better management practices, resulting in lower unit costs in real terms. In other areas, services have been reduced but selectively--in other words, priorities were changed and services deemed "essential" before July 1975 became no longer essential. In still others, services were reduced more or less across-the-board.

In contrast, the capital program has gone through much more limited scrutiny. Capital spending was turned off almost completely, and pretty indiscriminately. The spigot was turned on again in 1978: rather abruptly, long lists of capital spending projects were at hand and included in the ten-year capital program.

Many of the departmental lists of capital projects that suddenly surfaced in 1978 were rather similar to the departmental lists that had evolved during the 1960s and early 1970s (and, in some cases, very likely had elements dating back before World War II) but were put into the file drawers in 1974, 1975 and 1976. Now, most of those old lists of capital projects did not reflect anything like a careful ordering of priorities, but instead a blend of narrow-gauge planning by old hands in the departments, passing fancies and fads of commissioners and community groups, and changing short-term policies of successive mayors. In some cases, there is considerable question about even the narrow technical competence underlying the old lists: it's hard not to question the capital program of a department that (a) has no inventory of the infrastructure for which it is supposedly responsible and (b) has a history of being unable to program everyday repairs in any rational manner.

So, it is most unlikely that the ten-year capital program is an up-to-date list of projects ranked by priority, with one department's list dovetailed with that of others, for example, in connection with work in the same streets. The operating expense budget has been subjected to a triage-type of scrutiny, imperfect and rough and ready though it may
have been. Surely, such a scrutiny is appropriate for the capital program; surely, it will result in a significant scaling-down of the lists.

Moreover, there is little evidence that there has been much attention paid to the unit costs of the projects on these lists, comparable to the management improvement efforts on the operating expense side. To be sure, the City lets contracts for construction work and the unit costs are set by the low bidders. But the bids are very much influenced by the conditions set by the City—the specifications for the projects (and in the good old days of ample capital budget funds, there was no great incentive to minimize capital costs by careful setting of realistic specifications), the required scheduling of the work (e.g., doing the work at off-hours) and similar conditions. In addition, the City must become an aggressive fighter against the bid-rigging, collusion and pay-offs that are said to be worse in the construction industry in New York than elsewhere. Here, too, it is likely that hard-boiled management can scale down the costs of the capital program significantly.

It would also be wise for the City to expand its consideration of alternatives to issuance of general obligation debt to support the capital programs. The City hopes to obtain—through the creation of a new State authority or otherwise—the capacity to issue revenue bonds for water and sewer commitments, supported by dedicated revenues. The expansion of the City's flexibility to do so in this area makes sense.

In addition, a second approach to mitigation of the financing problem could lie in greater reliance on current revenue, i.e. "pay as you go" financing of capital outlays, particularly in connection with activities amenable to user-charge support. If the City is going to be spending approximately $250 million a year for the next two decades on water and sewer lines, consideration should be given to funding all or a portion of this program directly through increased sewer and water charges.

By eliminating or reducing the need of a new water and sewer authority to issue $280 million of revenue bonds annually, other city needs might be more easily financed. The City could increase the water and sewer charges (FY 1982 revenues were about $270 million, so doubling them would produce roughly $250 million more annually) and appropriate that
additional revenue to the water and sewer capital program as an expense item.

Either approach—water and sewer revenue bonding or "pay as you go"—will result in higher water and sewer charges in the early years of the program. In the case of "pay as you go," however, overall project costs would be reduced. Moreover, increases in user charges which are unmistakably dedicated to capital improvements that directly benefit users are extremely unlikely to have the kind of negative impact on the local economy that increases in general taxes have.

If the external economic and financial conditions are indeed dreadful, then these approaches will be far from adequate to solve the financing problem. Even so, they will help. And if the external conditions are only moderately bad, these approaches may make it possible, by reducing significantly the amount of debt financing required each year, to create a reasonable adequate long-term City capital program.

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