THE CITY OF NEW YORK

RESPONSE TO PROXMIRE COMMITTEE REPORT

MARCH 1, 1978

EDWARD I. ROCH
MAYOR
REPORT
ON
THE NEW YORK CITY LOAN PROGRAM
FROM THE
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

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LETTER OF TRANSMITTAL

U.S. Senate,
Committee on Banking, Housing
and Urban Affairs,

Hon. Walter F. Mondale,
President of the U.S. Senate,
Washington, D.C.

Dear Mr. President: Transmitted herewith is a Report on the New York City Loan Program, pursuant to oversight hearings on the New York City Seasonal Financing Act (Public Law 94-143) held on December 14, 15, and 16, 1977.

Sincerely yours,

William Proxmire, Chairman.
On December 14, 15 and 16, 1977, the Committee on Banking, Housing and Urban Affairs held oversight hearings on the New York City Seasonal Financing Act.

The Act was signed into law just over two years ago, on December 9, 1975. It authorizes Federal loans to New York City of up to $2.3 billion a year to cover seasonal shortfalls in revenues. The loans may be made only if the Secretary of the Treasury determines that there is a reasonable prospect of repayment, and they must be repaid in full at the end of each of the City's fiscal years, with interest at a rate of one percent above the Treasury's cost of borrowing. The legislation expires on June 30, 1978.

The seasonal loan program was part of a financial package put together in late 1975 to avoid a New York City bankruptcy and restore the City's financial condition. Other parts of the package included a pledge by the City employees pension funds to extend $2.5 billion in loans through June 30, 1978 to meet the City's long-term financing needs; an $800 million advance in State aid payments to the City to be provided in each fiscal year; and a State law instituting a three-year moratorium on repayment of $2.4 billion in short-term City notes outstanding and a reduction in the interest rate. (The moratorium law was overturned by the New York State Court of Appeals in late 1975, and various means were used to repay or refinance the City notes outstanding at that time.)

Supporting this financial package was a State law passed in September 1975 requiring New York City to develop a three-year Financial Plan for achieving a balanced budget in its 1978 fiscal year (running from July 1, 1977 through June 30, 1978). The law also established the Emergency Financial Control Board, a State agency controlled by the Governor which has broad powers over the City's fiscal and financial affairs, including the authority to approve or reject contracts and to approve and require changes in the City's Financial Plan.

Previously, in June 1973, after the public credit market had closed to City borrowings, a State law was passed establishing the Municipal Assistance Corporation, a State agency with the authority to borrow on behalf of New York City for the purpose of continuing essential services and creating investor confidence in the soundness of the City's obligations. MAC obligations were given the backing of certain City-related State tax collections, including the sales tax, stock transfer tax, and per capita aid payments due the City. The MAC law set the requirement that the City have a balanced budget in three years (by fiscal year 1975), with the exception that it permitted the operating expenses funded out of the capital budget (then estimated at $650-660 million) to be phased out more gradually over a ten-year period.
When the Seasonal Financing Act was under Congressional consideration, New York State and City officials said that all that was needed, in addition to State, City and local efforts already initiated, was a one-time commitment from the Federal government to provide short-term loans to cover seasonal shortfalls in revenues and maintain the City's cash flow throughout the fiscal year. They stated further that, at the end of the three-year seasonal loan period, or perhaps sooner, New York City would have a balanced budget and be able to meet its financing needs directly from the credit markets. With that understanding, Congress passed the Seasonal Financing Act by a narrow margin and thus took the unprecedented step of providing direct Federal financing to a city for basic operating needs.

1. Response: In 1975, City and State officials believed that the Seasonal Financing Act would be sufficient to enable the City to balance its budget in accordance with the MAC Act and thereby regain access to the credit markets. Although the City expects such a balanced budget for the fiscal year ending June 30, 1973, the market problems were more severe than anyone realized and the City has not been able to sell its securities publicly, as seen in the failure of its Note Offering in November. In addition, the seasonal facility did not enable the City to make the capital improvements necessary to attain long-term vitality. Without that vitality, investors lack assurance that the balance between revenues and expenses can be maintained. While no one can predict the future with certainty, City officials believe that a continuation of the seasonal program combined with a long-term guarantee will give the City time to achieve a record of balanced budgets while reducing past financial pressures so that it can enter the market on its own strength at the expiration of the proposed program four years from now.

In view of the controversial nature of the seasonal loan program, the Committee has undertaken an obligation to conduct regular oversight of New York City's progress under the program and to make sure that all requirements and commitments are met. The recent hearings were the fourth in a series of oversight hearings which the Committee has held at roughly six-month intervals since the seasonal loan program was enacted. Witnesses at the December hearings included the Secretary of the Treasury, the Governor of the State of New York, the Mayor of the City of New York, the Chairman of the Securities and Exchange Commission, representatives of financial institutions which have been underwriters of New York City obligations, and representatives of the municipal bond rating services.

In the course of the hearings, the Committee explored, among other things, New York City's progress toward achieving a balanced budget in fiscal year 1973 and in succeeding fiscal years; and the City's prospects for re-entering the credit markets to meet its short-term and long-term financing needs in the current fiscal year and after June 30, 1973, when the Federal loan program expires.

A number of witnesses expressed the view that an extension of the seasonal loan program beyond June 30, 1973 will be needed, or else New York City will go into bankruptcy. Some also advocated additional Federal loans or guarantees to meet some of the City's long-term financing needs.
Based on information obtained in the hearings and elsewhere, the Committee believes that New York City should be able to meet its financing needs and avoid bankruptcy after June 30, 1978 without further Federal financial aid. Resources available to New York City and New York State appear to be sufficient to enable the City to maintain solvency.

2. Response: While local sources obviously have the ability to meet the City's financing needs, there is a difference between the ability to lend and the willingness to do so. This was vividly seen in the failure of the City's Note Offering in November and the recent decline in the Securities of the Municipal Assistance Corporation ("MAC"). To increase lenders' willingness to provide funds to New York, the guarantee is essential. Without it, required capital improvements cannot be made, financing actions to eliminate the residue of the fiscal crisis and provide budgetary relief cannot be taken, and the City will struggle from year to year with no permanent solution in sight.

While the Committee has received recommendations from New York City and State officials for both extending the seasonal loans and providing new long-term Federal guarantees, no specific legislation is pending at the present time. Since it is by no means clear that the Committee or the Congress would approve any such legislation, it is the strong sense of the Committee that these officials should concentrate their efforts on securing the financing needed from sources within New York City and New York State.

3. Response: Legislation is being proposed for Federal financing assistance to the City. This legislation will be presented to the Congress within the near future.

It is important to note that there are significant differences between the circumstances prevailing now in 1978 and those prevailing in late 1975, when the Federal loan program was enacted. In 1975, New York City's finances were on the verge of chaos, and no resolution of the problem seemed possible absent Federal involvement. In 1973 the size of the financing problem has been considerably reduced, and the City has established a record of significant progress on a number of issues: budget balance, accounting reform, and repayment of seasonal loans and short-term notes outstanding. In 1975, the market was saturated with New York City debt issues. Since 1975, no new New York City securities have been sold in the market, and the City's debt burden has been restructured through the Municipal Assistance Corporation into longer-term obligations with level debt service payments over a number of years.
4. **Response:** While it is true that both market conditions and the City's finances have improved, the fact remains that the City was denied market access when it tried to sell notes in November. And if the City cannot sell $200 million of notes, it certainly will not be able to sell the $1 billion of bonds it needs annually to rebuild the physical plant and to relieve past financial pressures. Nor can the City expect the Municipal Assistance Corporation to meet all its long-term financing needs in view of the difficulties experienced by the recent MAC refunding issue and the subsequent market decline of all MAC issues. In this regard, it might be noted that the points made by the Committee about the City's "significant progress" should be arguments for continuing financing assistance to New York. The City is a much better credit risk today than it was at the time the Seasonal Financing Act was passed and therefore the chances that the Federal Government will not be paid back have been greatly reduced.

For all these reasons, New York City should be in a far better position now to put together on its own a financing package that will ensure access to the municipal securities market and solvency in the coming years. Furthermore, there is now in office a new Mayor who has announced firmly, in a letter produced for the Committee's hearings: "there will be no bankruptcy for the City of New York."

A note of caution should be sounded as well. In 1975, many cities across the country were suffering severe financial problems, as a result of the recession. The municipal securities market was in disarray, and there were fears that a New York City bankruptcy would shut other large, older cities out of the bond market as well. Today, in 1978, the economy is in an upswing, many cities and States are showing surpluses, and the municipal securities market is in excellent shape. New York City stands alone in its lack of access to the market, and the impact of a New York City bankruptcy in 1973 would probably be more circumscribed.

5. **Response:** The fact that New York "stands alone in its lack of access to the Market", in spite of the improvement in those markets, is *prima facie* evidence of the need for continued financing assistance.

Thus, the Committee believes New York City must rely on its own resources to the maximum extent possible and show that bankruptcy is more than undesirable—it is unnecessary.

6. **Response:** The City also believes that bankruptcy is "undesirable and unnecessary." It will not happen if Federal financing assistance is continued.
FINDINGS AND RECOMMENDATIONS

Based on information obtained in the hearings and subsequently
the Committee finds there are several steps which New York City
should take in order to be in a position to meet its financing needs
after June 30, 1978 with or without reliance on the Federal govern-
ment. These include achieving real budget and taking other actions
necessary to endure investors of the security of the City's obligations.

7. Response: First, under the Four Year Financial Plan sub-
mitted to the Secretary of the Treasury on January 20, the
City showed how it expected to balance its budget in
fiscal 1982 on the basis of generally accepted accounting
principles.

Second, under the Plan, the City indicated that it would
be willing to assure investors as to the security of City
obligations:

- continue outside review of its finances;
- establish a Debt Service Fund;
- submit and adopt balanced budgets;
- establish budgetary controls;
- accept limitations on short-term debt;
- maintain a General Reserve;
- liquidate the State Advance;
- publish monthly, quarterly and annual reports;
- prepare a four-year financial plan; and
- submit to outside audit of its financial statements.

Failure to meet these conditions by April 1, 1978 will result in grave
consequences to New York City whatever the Administration and
the Congress decide to do. Success in meeting them should enable
New York City to meet its basic financing needs, both short-term,
and long-term, from sources available in the City and in New York
State, including the financial community and the City and State pen-
sion funds. The Committee has already expressed the belief that it
would be most desirable for the City to remove itself from dependency
on the Federal government.

8. Response: Local officials agree that "it would be most
desirable for the City to remove itself from depending on
the Federal government." The Four Year Financial Plan
was designed to insure that after fiscal 1982 the removal
will be complete. It asks the Federal Government to help
us help ourselves.
1. Finding—The Committee finds that in order to meet its financing needs after June 30, 1973 without any additional aid from the Federal government, New York City must adopt a Financial Plan to achieve a credibly balanced budget.

On January 20, Edward I. Koch, Mayor of New York City, submitted to the Secretary of the Treasury a revised Four-Year Financial Plan to eliminate an estimated $1.0 billion budget deficit over the next four fiscal years. This deficit is projected to be met through reductions in Federal assistance. The City is currently being assisted by the Treasury Department. Changes may be made in the Financial Plan in the coming weeks. In this report, the current Plan will be referred to as the January 20 Financial Plan.

9. Response: Such a plan, showing how the City expects to balance its budget and re-enter the public capital markets, was submitted to the Treasury on January 20.

This requires that the following conditions be met no later than April 1, 1973:

(a) A schedule for phasing out all of the operating expenses contained in the capital budget (presently about $843 million) over a period of more than three years.


(b) A signed City-wide agreement on the economic terms and budget costs of the City labor contracts over the four-year period covered by the Financial Plan as adopted. Given the fact that the January 20 Plan already projects a $1 billion budget deficit to be eliminated, the City cannot afford to agree to labor contracts which would further increase the deficit, and thus any pay raise would have to be offset by additional budget cuts and/or savings from higher productivity.

11. Response: The City has begun collective bargaining negotiations with a consortium of municipal unions, representing over 200,000 municipal employees. Hopefully, this will enable us to write a City-wide agreement by March 31. The City's position in these negotiations, as publicly stated by the Mayor, is that any settlement must be viewed within the context of the Four Year Financial Plan. The possibility of longer-term contracts is being reviewed.

(c) A commitment from New York State to provide substantial amounts of additional, recurring financial aid to the City over that period, in order to enable the City to bring expenditures into line with available revenues. In view of the large increase in Federal aid to the City over the past three years, it is reasonable to expect that State to provide the additional aid needed to close the budget deficit for fiscal year 1979 to the extent that it cannot be closed by the City itself.
12. **Response:** The Plan requests substantially greater assistance from the State. And the Governor has agreed to increase the State's aid to the City by $200 million in fiscal 1979.

**Recommendation:** The Committee recommends that New York City adopt a Financial Plan to achieve a credibly balanced budget which meets these conditions as soon as possible after April 1, 1978.

13. **Response:** The City has compiled a Financial Plan, submitted to the Treasury on January 20 of this year, that shows how it would achieve "credibly balanced budgets" in the future.

2. **Finding:** The Committee finds that New York City will have to satisfy certain conditions designed to insure investor confidence in order to be able to meet its financing needs in the public credit markets after June 30, 1978. These include the following:
   
   (a) Establishment of an accounting and budgetary control system which will produce reliable City financial statements developed in accordance with generally accepted accounting principles.

14. **Response:** The Integrated Financial and Management System (IFMS) went into effect on July 1, 1977. The new Administration wholly supports this system and Deputy Mayor Toia is working to see that it is successfully implemented.

   (b) Outside audit of the City's financial statements by reputable accounting firm on at least an annual basis, with reports made available to the public.

15. **Response:** A consortium of accounting firms will conduct an audit of the City's finances for fiscal 1978, ending June 30. The new Administration intends for this practice to be continued.

   (c) Establishment of an independent long-term fiscal oversight mechanism, along the lines of the present Emergency Financial Control Board, with authority to require that the budget be balanced and that the City follow reasonable budgeting and borrowing practices.
16. Response: The Mayor has publicly and repeatedly called for a continuation of outside review of the City's finances. As the Plan stated, the fiscal monitor should have the following powers:

- review of the executive budget submitted by the Mayor to determine whether it is balanced and contains reasonable estimates of revenues and expenses (including costs of contracts);

- review of the budget adopted by the Board of Estimate and City Council to determine whether it is balanced and contains reasonable estimates of revenues and expenses (including costs of contracts);

- quarterly review of budget condition to determine that the budget is balanced and contains reasonable estimates of revenues and expenses (including costs of contracts);

- review of all City borrowings to determine whether they are consistent with the budget and the financial plan;

- determination that a financial plan for the year subsequent to the budget year has been submitted and modified as required; and

- determination that the required internal controls are in place.

The Committee finds further that the first two conditions are the City's responsibility and are already in the process of being accomplished, but that the third will require action by the State Legislature.

Recommendation.—The Committee recommends that legislation to establish a long-term fiscal oversight mechanism be proposed as soon as possible, with a view to obtaining passage by the State Legislature no later than April 1, 1978.

17. Response: Informal negotiations are currently underway as to the exact nature of the oversight mechanism. Legislation will be submitted to the State Legislature so that passage can be secured prior to April 1, 1978.
3. Finding—If all of the budget balancing and market access conditions outlined above are met by early April, the Committee believes that New York City should then be in a position to meet all of its basic financing needs, both short-term and long-term, from sources available in New York City and New York State and thus avoid the danger of bankruptcy after June 30, 1978, when the Federal seasonal loan program ends.

13. Response: Advice from the financial community indicates that the City will not be able to gain continuing access to the credit markets in the near future without Federal financing assistance, regardless of steps the City might take. According to these sources, the City cannot expect to regain market access in the near future because investors do not yet have confidence in the City and confidence is the lifeblood of the credit markets.

The following are potential sources of this financing:

(a) Long-term financing: Of the $5.1 billion proposed in the four-year Financial Plan proposed on January 30, only $3.5 billion is needed to meet basic capital needs (including operating expenses until phased out). Of this, the City pension funds could supply $2.25 billion without increasing their fiscal year 1973 level of commitment by agreeing (i) to reinvest $941 million in maturing bonds, and (ii) to invest 50 percent of new investable funds, or $1.3 billion over the four years.

19. Response: Since the managers of the funds have said they want to reduce the proportion of these funds' assets invested in City securities, any concession in this area might result in higher wage settlements, thereby creating added budget pressure. And it should be remembered that genuinely balanced budgets are essential to the City's financial health. For this reason, the Plan asks the Federal government, with State backing, to guarantee additional pension fund purchases of City securities.

The remaining $1.25 billion could come from the Municipal Assistance Corporation, which has the economic capacity to raise $2.5 to $3.0 billion more and should easily be able to raise the $400 million a year needed.

20. Response: On January 10, MAC issued $250 million of bonds to refund outstanding issues. When the issue was released for public trading, it is estimated that as much as $50 million, or 20% of the issue was not sold. As a result, the prices of these securities dropped $2 to $5 per $100 bond in the open market. The difficulties of the January
10 issue raise doubts as to the amounts of capital that can be raised by MAC over the next four years. For that reason, a Federal guarantee is essential because once it is in place MAC should be able to borrow the capital needed to fund capitalized expenses. Without the guarantee, it is doubtful that MAC could fund the capitalized expenses, much less raise the money required for true capital projects.

If MAC is able to raise more than this amount, then the proceeds could be used to do some of the $1.8 billion of financial restructuring actions proposed in the January 20 Plan as well.

(b) Seasonal financing: The City’s present needs are $1.3 billion a year, and they could be met in these ways: (i) through reducing peak seasonal needs by at least $400 million in fiscal year 1979 and more in subsequent years, by such means as accelerating real estate tax collections, delaying contributions to the pension funds, and changing the timing of state and Federal aid payments.

21. Response: The Four Year Plan showed how such a reduction in seasonal borrowing requirements could be accomplished. While a change in the local law to allow accelerated real estate tax collections is being requested, a change in the timing of aid payments depends upon the State and Federal governments. As to delaying pension fund contributions, labor officials have publicly resisted such a change.

and (ii) through obtaining commitments from the New York City financial institutions, the State, and the State pension funds to cover the remaining seasonal needs, to the extent that they cannot be met through sales of City notes in the public credit markets.

22. Response: The Four Year Plan envisions that the Clearing House Banks will provide a $600 million line of credit to help the City meet its seasonal borrowing needs. The City will of course attempt to meet these needs in the public market whenever possible, though the failure of the November offering makes an immediate sale unlikely.

Recommendations.—The Committee recommends that the City work with the State and the Federal government in the period prior to June 30, 1973 to make arrangements for obtaining the financing necessary to cover its basic needs over its next four fiscal years, 1979-82.
23. **Response:** The City agrees wholly with this recommendation.

These arrangements should include the following:

(1) Passage of State legislation to increase MAC's borrowing authority by $3 billion, extend the expiration date of that authority, and permit MAC to do capital financing for the City.

24. **Response:** This legislation is currently being prepared.

(2) An agreement with the City pension funds to provide $2.25 billion in long-term financing for the City over the next four years by maintaining their investments at the fiscal year 1978 level of 35 percent of assets.

25. **Response:** These negotiations are underway though, as previously mentioned, it may have budgetary implications.

(c) Measures to reduce the City's seasonal financing needs to no more than $1.4 billion in fiscal year 1979 and less in subsequent fiscal years.

26. **Response:** These actions are being taken where they are within the City's ability to be effected. Requests for such actions have been made when they are dependent on other parties, including the State and Federal governments.

(d) Commitments by the New York City Clearing House banks to provide at least a $600 million annual line of credit to the City for seasonal purposes and to underwrite and invest in additional amounts of short-term City notes.
27. **Response:** Requests for such commitments are being made.

(e) Stand-by commitments from New York State and/or the State pension funds to provide any additional seasonal financing that may be needed in any of the fiscal years covered by the January 20 Financial Plan.

28. **Response:** The State Comptroller has refused to make such investments, citing his fiduciary responsibilities.

(f) Passage of any legislation needed at the Federal and State levels to permit the City and State pension funds to make the proposed investments in City obligations without infringing on their tax-exempt status or their fiduciary obligations.

29. **Response:** Such legislation is being prepared.

**BALANCING THE BUDGET**

Under a State law passed in September, 1975, New York City was required to develop a three-year Financial Plan to achieve a balanced budget in its 1978 fiscal year (running from July 1, 1977 through June 30, 1978) and to show substantial progress toward this goal in its 1976 and 1977 fiscal years. The only exception was a provision in the law permitting certain operating expenses included in the capital budget (presently about $845 million) to be phased out over a ten-year period.

Based on testimony presented at the oversight hearings, the Committee finds that New York City has complied with the requirements imposed by State law.

According to Mayor Beame, the City "met and exceeded" the targets for each of the first two fiscal years. "In 1976, we reported a deficit of $968 million, $83 million under plan. In fiscal 1977, our deficit was $329 million, $357 million better than anticipated."

Secretary Blumenthal stated that the fiscal year 1978 requirement appears to have been met as well. "This year's operating budget is balanced, as defined by the emergency State legislation of 1975. Operating revenues have materialized as expected and operating expenditures have been consistent with the City's projections." (Emphasis contained in original.)

Unfortunately, there are no assurances at the present time that New York City will operate within a balanced budget in the years to come.
30. **Response:** The lack of such assurances caused the City to request increased State and Federal aid in the Four Year Plan. New York's budgetary gap has State and Federal origins — welfare and Medicaid costs together exceed $1 billion, more than enough to allow the City to achieve balanced budgets over time. For that reason, a State and national solution to the problem has been requested.

First, the budget cannot really be considered to be in balance so long as any operating expenses continued to be funded out of the capital budget.

31. **Response:** As previously stated, the City agreed in the Four Year Plan to phase out these expenses twice as rapidly as permitted by the emergency State legislation of 1976.

Second, there are projections of new operating deficits after the present fiscal year ends, including a $457 million deficit for fiscal year 1979 over and above the amount of capitalized operating expenses to be phased out and certain accrued pension liability.

32. **Response:** The Four Year Plan proposes that this gap be closed by a combination of City, State and Federal actions. The City has begun to take such actions, and it is requesting State and Federal assistance.

Third, these deficit projections are based on the assumption that the City's personnel costs will remain the same. However, all of the City's labor contracts are due to expire by June 30, and union leaders have indicated their intention to seek wage increases. Each one percent increase in pay would cost the City an additional $35-40 million a year.

33. **Response:** The City intends that any increased compensation would be premised upon maintenance of a balanced financial plan.
Testimony at the Committee's hearings revealed a universal and unequivocal view that New York City must achieve a creditably balanced budget and thus allay the fears caused by the magnitude of the deficit projections for fiscal year 1979. In the judgment of the Committee, this means a budget which is balanced in accordance with generally accepted accounting principles and which is likely to remain balanced in succeeding years.

34. Response: The Four Year Plan is designed to achieve budget balance in accordance with generally accepted accounting principles ("GAAP") in fiscal 1982.

City officials told the Committee that the City will present a balanced budget in each fiscal year to come and will take steps to eliminate any projected deficits. Secretary Blumenthal testified that he had asked New York City and State officials to develop "comprehensive budget and financing plans covering the next three or four years" and that the objective of the budget plan "must be to achieve a condition of truly recurring budget balance." These officials responded to the request with the four-year Financial Plan presented to the Secretary on January 20, 1973.

The Committee believes that in order to meet its post-June 30 financing needs, the City must formally adopt a realistic Financial Plan to achieve recurring budget balance over the next four years as soon as possible after April 1, 1978.

35. Response: A multi-year Financial Plan, based on the Four Year Plan, will be submitted with the Mayor's Executive Budget on April 15th, 1978.

This Plan should include, as a minimum, the following elements:

1. A schedule for phasing out all of the operating expense contained in the capital budget (presently about $643 million) over a period of no more than three years;
2. A signed City-wide agreement on the economic terms and budget costs of the City labor contracts over the period of times covered by the plan; and
3. A commitment from New York State to provide substantial amounts of new, permanent financial aid to the City over that period, in order to enable the City to bring expenditures into line with recurring revenues.

36. Response: As previously stated, the City is addressing itself to each of those points in the manner suggested by the Committee.
These points are discussed in more detail below.

**Phaseout of Operating Expenses in Capital Budget**

As noted previously, the State law requiring a balanced City budget in fiscal year 1978 exempts from that requirement the operating expenses funded out of the capital budget and instead provides that these expenses be phased out over a ten-year period, at a rate of at least $50 million a year. Although it appears that the City has complied with the letter of the law, the estimated amount of expense items to be phased out has actually increased, due to changes in accounting methods.

37. **Response:** The amounts of operating expenses in the capital budget rose after an accounting review and legal analysis was made to insure that all such items had been properly identified.

The most recent available figures for fiscal year 1978 indicate that there are $840 million in expense items funded out of the City's capital budget and $428 million in "true" capital expenses.

38. **Response:** These figures are correct in the City's opinion.

Obviously it is not desirable for New York City to continue funding these expense items out of its capital budget. This practice inflates artificially the size of the capital budget and pulls resources away from real and essential capital needs. Moreover, so long as this relic of past accounting gimmickery remains in existence, it will serve as a constant reminder of the City's unfortunate fiscal history.

39. **Response:** For the reasons stated, the new Administration agreed to accelerate the phase out of these items before the Committee report was released. With sufficient Federal and State assistance, the phase out could be accomplished in one rather than three years. A one-year phase out is not now possible in view of the $457 million budget gap projected with a three year phase out and other governments' reluctance to help us close even this gap.
Testimony at the hearings revealed widespread agreement that New York City must accelerate the schedule for removing all operating expenses from the capital budget. Otherwise, there will be continued skepticism about the City's ability to balance its budget and serious questions about its capacity to finance a capital budget which includes such items.

The Committee recognizes that it will not be easy for the City to take this action, in view of the present strains on its operating budget. Nonetheless, such action is crucial to the City's prospects for meeting its financing needs after June 30, 1978. Therefore, the Committee believes that if the City is to regain financial credibility, it must phase out all operating expenses presently included in the capital budget over a period of no more than three years.

40. **Response:** As stated, the City is removing these items from the capital budget over the next three years.

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**Labor Contracts**

The Committee finds that all of New York City's labor contracts are due to expire by June 30, 1978, and that the settlement reached in the negotiations with the City employee unions over renewing these contracts will have a crucial impact on the City's ability to balance its budget. This is because wages and fringe benefits (including pensions) make up 39 percent of budget and, as noted above, each one percent increase in pay would add another $33-40 million to the projected budget deficit. Thus the outcome of the contract negotiations is likely to be an indicator of the City's ability and its determination to bring expenditures into line with revenues on a continuing basis.

41. **Response:** All of the major labor contracts do expire by June 30, 1978, except with the United Federation of Teachers and the Professional Staff Congress at City University. Because of the significance of these contracts, the City has agreed to comprehensive bargaining in the hope that a settlement can be reached by March 31 and that a balanced budget submitted shortly thereafter. The actual cost to the City of a 1% increase in pay when all its agencies and covered organizations are considered is actually closer to $50 million, making the need for a prompt, no-increase settlement all the more urgent.

There is likely to be strong pressure brought to bear on the new City Administration to provide substantial pay raises to its employees. City workers have been subject to a State law permitting a wage freeze since 1975, and also to guidelines limiting the size of cost-of-living adjustments, during a period of inflation in the economy as a whole. On the other hand, the Committee received evidence that the City's personnel costs have declined by only one percent since 1975, despite testimony that the City has cut 61,000 employees off the payroll, or about 20 percent of the work force. This gives stern warning of the difficulties faced by the City in attempting to hold labor costs down and of the need to prevent a settlement that would still further balloon the budget deficit.
42. The City actually did save 5% when the work force dropped by 20%. The comparison of a 61,000 employee decrease and only a 1% personnel cost decrease is misleading because the employee count is based on figures excluding CETA and CD workers while the personnel costs are based on figures including CETA and CD workers. There has been a significant increase in CETA workers, and so in their personnel costs. While this cost is included in the gross personnel budget, this cost is mostly federally funded and not supported by tax levy funds. Roughly 10% of the 20% percent decrease in the work force was offset by increased payments to City employees approved by the Emergency Financial Control Board. The contract provisions allowing these increases were the provisions for COLA, the 6% general wage increase, and increments.

The remaining 5% of the 20% percent was offset by increased pension contributions, FICA costs, and health insurance costs. These are costs that did not result in increased benefits for City employees. As the cost of health insurance rose and the FICA rate and base rose, the City had to contribute more to provide City employees with the same benefits as before. City pension costs did not drop immediately following the 61,000 employee decrease, because under State law, pension contributions by the City are not made until two years after the liability occurs. In addition, the City started to implement the recommendations of the Mayor's Management Advisory Board to put pensions on a sounder financial footing, which increased pension costs to the City. Also, when a permanent civil servant is laid off, the person is placed on a preferred appointment list, and for five years, as a matter of State law, the City must continue making pension contributions for that person.

The Committee believes it is vital that the budget impact of the new labor contracts be known well in advance of the June 30 expiration dates of the present contracts, so that the figures included in the City's Financial Plan will be accurate.

43. Response: City officials agree that the budget impact of new labor contracts should be known as quickly as possible.
For the same reason, the contracts negotiated should extend over the period covered by the plan.

44. Response: The possibility of longer-term contracts is being examined.

The transit workers contract expires on March 31, and it is generally believed that the settlement reached in this contract will provide the model for the other labor contracts. In view of this, it would be reasonable to assume that negotiations on the other contracts can be conducted concurrently with the transit workers negotiations. Governor Carey provided some additional indication that the whole process could be expedited. He told the Committee that he would work with the new Mayor to coordinate the role of the City and the role of the Emergency Financial Control Board in order to bring the contract negotiations "to some conclusion as early as possible."

45. Response: As previously noted, the City has agreed to comprehensive talks to be held concurrently with the Transit talks.

The Committee finds that if New York City is to be able to meet its financing needs after June 30, 1973, regardless of source, there must be concluded a City-wide agreement on the economic terms and budget costs of the labor contracts no later than April 1, 1973. This would insure the inclusion of accurate figures on personnel costs in the City's Financial Plan to be adopted as soon as possible after April 1. In the Committee's view, this outcome would promote investor confidence in the City's budget-balancing plan and allow sufficient time to line up alternative sources in the financial community and elsewhere for meeting the City's financing needs after June 30, 1973, when the Federal involvement ends.

46. Response: While City officials agree that a prompt City-wide agreement would provide increased confidence, such a plan is not in itself sufficient to restore the confidence that has been shattered over the last three years, according to financial sources. For this reason, continuing Federal financing assistance has been requested. However, the City will not weaken its bargaining demands to meet any outside timetable.
Increased State Aid

The Committee finds that New York State can and must provide a substantial increase in its financial aid to New York City if the City is to be able to achieve real budget balance in fiscal year 1976 and in succeeding fiscal years. Given the fact that the State's effort appears to have lagged in the past 3 years, when considered in light of the fact that the Federal government has increased its cut to the City sharply during these years, in addition to providing $2.3 billion annually in seasonal loans. According to figures obtained by the Committee, the dollar amount of State aid to New York City has remained virtually unchanged in fiscal years 1976 through 1978. The increase during that period has been less than 4 percent, not nearly enough even to keep up with inflation. During that same time period, Federal aid to New York City has gone up markedly, by about 28 percent. In fiscal year 1978, State aid to the City ran about 4 percent higher than Federal aid; now, in fiscal year 1979, it runs 4 percent lower.

47. Response: The City substantially agrees with these figures and for that reason we have asked for much greater State aid.

Under our Federal system, States are considered to be responsible for their cities. This includes a responsibility for seeing that their cities follow sound financing practices, balance their budgets, and remain solvent. The Committee recognizes that the situation in New York is unusual in that New York City's budget is actually somewhat larger than New York State's budget (about $12 billion for the City, $11.4 billion for the State). However, this anomaly does not relieve the State of the obligation to do whatever it can to alleviate the City's budget problems.

48. Response: The City agrees with this concept. However, to the extent that the State cannot or will not assist the City, Federal aid is required. It should be noted that the State is legally barred from "lending its credit." Thus, the State is not legally able to provide meaningful long-term financing assistance to the City and therefore, the guarantee was requested.

Some of which are related to traditional patterns of State funding. This is especially true in view of the fact that New York State is now showing a budget surplus, while the City is facing a formidable budget deficit.

49. Response: To the extent that the City cannot get sufficient budgetary relief from planned State aid, it should be made up by reducing the tax cut.
Despite these considerations, the Governor of the State of New York, Hugh L. Carey, placed strong emphasis in his testimony before the Committee on his intention to seek substantial Statewide tax cuts in New York City and to commit to providing more State aid to New York City. Since the hearings took place, the Governor has confirmed this position in his January 4 State of the State Address and his January 17 budget message, which proposed $755 million in State personal income and business tax cuts. The budget message also includes an increase of about $800 million in local assistance, of which some $500-550 million would probably go to New York City. However, it is estimated that no more than $100 million of the aid proposed in the budget message would provide real budget relief to the City; the rest requires new City spending. While this may be a step in the right direction, it falls far short of the $283 million in outside aid which the January 25 Financial Plan says New York City needs to balance its budget in fiscal year 1979 alone.

50. Response: The Governor has indicated that the State can provide $200 million of the $283 million that the City will need from outside sources to balance its budget in fiscal 1979, as previously indicated.

The Committee understands that there are strong arguments for some amount of tax reductions, in view of the high level of taxation in New York State and the economic need to retain and attract businesses and jobs. These arguments were made not only by the Governor but also by members of the New York State Legislature who testified at the hearings: Senator John J. Marchi, Chairman of the Senate Finance Committee, and Assemblyman Arthur J. Kremer, Chairman of the Assembly Ways and Means Committee.

Nonetheless, it is highly unlikely that State tax cuts alone will enable New York City to increase revenues enough to balance its budget in the next few years, which is the immediate concern. The Committee feels, therefore, that it is of the utmost importance that the State respond to this concern by providing now and recurring financial aid to New York City in amounts which will achieve substantial reductions in the projected budget deficits over the next four years. This could be done in a number of ways, including changes in local aid formulas, increased amounts of local aid, and State assumption of some or all of the local share of certain on-going programs, such as public assistance and medical assistance. Given the increases in Federal aid to the City over the past three years, including the doubling of community development block grant funding approved by this Committee, it is reasonable to expect the State to provide most or all of the $283 million in outside aid which New York City says it needs to eliminate the adjusted budget deficit in fiscal year 1979.

51. Response: The Four Year Plan requested State actions that will allow recurring budget balances to be achieved. Negotiations are underway to insure that these actions continue beyond fiscal 1979, in increasing amounts.
SECURING MARKET ACCESS

The Committee finds that New York City will have to satisfy certain conditions designed to insure investor confidence in order to be able to meet its financing needs in the public credit markets after June 30, 1973. Testimony at the hearings indicated that there is basic agreement on the nature of these conditions within the financial community, and basic acceptance of the need for them by other parties concerned with the City's financing. The conditions can be summarized as follows:

1. Establishment of an accounting and budgetary control system which will produce reliable City financial statements developed in accordance with generally accepted accounting principles;
2. Outside audit of the City's financial statements by a reputable accounting firm on at least an annual basis, with reports made available to the public; and
3. Establishment of an independent long-term fiscal oversight mechanism, along the lines of the present Emergency Financial Control Board, with authority to require that the budget be balanced and that the City follow reasonable budgeting and borrowing practices.

The last of these, the long-term fiscal oversight mechanism, will require action by the State Legislature. The first two conditions are the City's responsibility and appear to be already in the process of being accomplished. The Committee believes the City and State need to satisfy all of these conditions by April 1, 1973 in order to regain investor acceptance and further the success of the post June 30 financing effort.

52. **Response:** See Responses #14, 15, 16, and 17 in this rebuttal.

**Accounting System**

The Committee finds that New York City now has in operation the "new system of financial and accounting practices, records and controls" (Integrated Financial Management System) required by section 6.7 of the Credit Agreement with the Treasury pursuant to the Seasonal Financing Act. However, doubts continue to be expressed about the adequacy and accuracy of the system and of the financial statements issued by the City. Jackson Phillips, executive vice president of Moody's Investors Service, testified that the disclaimers contained in the prospectus issued by the City in connection with its proposed November 1977 note offering were a major factor in Moody's decision to assign those notes a low MIG-4 rating, which led to subsequent cancellation of the offering. In reference to the statements made in the City's prospectus, Mr. Phillips said in his testimony:

One overriding risk, it seemed to us, was the startling fact relating to all the city financial statements that "the City can give no assurance that the statements are free of material errors or omissions" (p. 3). The Cash Flow Statements for 1977 and 1978 were introduced with the comment: "all actual amounts are unaudited and subject to potential material revision or adjustment" (p. 3). The same point was emphasized in the Preliminary Official Statement where it advised that "it is possible that material errors or omissions may exist in the City Financial Statements and in other financial data set forth herein" (p. 17).

Such statements were found to be unusual in the context of a municipal securities offering, and therefore they may raise serious questions for potential investors.
53. **Response:** It is not surprising that a system as complex as IFMS has had start-up problems. The responsible officials are constantly examining the system to eliminate flaws and it is believed that they will have been substantially removed by the end of the current fiscal year.

Responding to these concerns, the City's then Deputy Mayor for Finance, John C. Burton, pointed out that the disclaimers in the prospectus referred to financial statements from previous fiscal years, 1976 and 1977, and that these were prepared before the new accounting system was put into operation at the start of the 1978 fiscal year, on July 1, 1977. Thus they indicate possible uncertainties and omissions in connection with the earlier statements. Burton contended, but not any basic shortcomings in the present accounting system.

The existence of these disclaimers and of the detailed information on financial condition and risk factors contained in the City's Preliminary Official Statement may be positive factors in certain respects. They appear to be, in part, the result of the findings of the Staff Report on Transactions in Securities of the City of New York during the period from October 1, 1974 through April 30, 1975, which was issued by the Securities and Exchange Commission in August 1977. That report describes at length the alleged failure of various parties to disclose pertinent information about the City's financial condition in connection with securities offerings which took place during that time period. Thus the volume of information contained in the Official Statement, although disturbing in some respects, can also be viewed as a constructive development which offers assurances to investors that the City is not concealing any material, adverse information.

54. **Response:** The new Administration has publicly stated that it is committed to prompt, full disclosure of all material facts about its accounting system and all the other aspects of government.

Mr. Phillips also questioned the reliability of the data base underlying the City's new accounting system, in view of "the variety of estimates currently reported respecting the prospective operating deficit for 1978-79." Deputy Mayor Burton responded that these were forecasts of future budgets, not actual figures, and that the differing estimates were "not a function of the data system" but "a function of the economic assumptions as to what will happen," which does not imply any defects in the underlying data base. Information submitted by the Treasury Department, based on work done by Arthur Andersen & Co., indicated that the IFMS system is functioning reasonably well and is likely to provide "credible" financial statements for fiscal year 1973.

In view of the concerns expressed in the hearings, the Committee recommends that the Secretary of the Treasury conduct a continuing review of the performance of the IFMS system to determine whether the system is in fact producing complete and accurate data, in order to insure investor confidence in the City's budgetary control and accounting systems for the period after June 30, 1973.
55. Response: The City welcomes continuing review of the IFMS system by the Treasury and conducts regular meetings with its consultants, Arthur Andersen and Co., in this regard.

The Committee recommends that legislation to establish a long-term fiscal oversight mechanism be proposed as soon as possible, with a view to obtaining passage by the State Legislature no later than April 1. Otherwise, the absence of a monitor will continue to be a subject of controversy and a deterrent to the City's meeting its financing needs on its own after June 30, 1973.

56. Response: As previously noted, the City expects that such legislation will be enacted before April 1, 1973.

Independent Audits

Witnesses at the Committee's hearings, particularly those from the financial community, stated that independent outside audits will be the crucial test of New York City's new accounting system and a major condition of the City's re-entry into the credit markets. The Chairman of Bankers Trust Company, Alfred Brittain III, stated this condition clearly in his prepared testimony: "the City's financial statements and supplemental data must be accurate and must be audited by certified public accountants of national standing according to generally accepted accounting principles . . . the results of the financial audits and reviews should be made public."

Section 8.7 of the Credit Agreement requires that "an audit may be made as at June 30, 1973, by the State Comptroller, or at his election by an independent certified public accountant." In accordance with this requirement, the City in mid-1977 engaged the accounting firm of Peat Marwick & Mitchell to conduct such an audit, which now appears to be underway. Deputy Mayor Burton told the Committee:

We met yesterday with our auditors, Peat Marwick & Mitchell, who are giving us the first report on their progress toward the audit of the 1973 fiscal statements, and they indicated to us that they had done some preliminary work with IFMS and they saw no reason to revise any of their judgments, which they have already given to the Treasury, that the financial statements for the year will be auditable.

57. Response: Peat, Marwick and Mitchell continues to advise the City that its account will be auditable.
The Committee recommends that the Secretary monitor the City's progress in the course of the audit to make certain that the requirements contained in the Credit Agreement are met.

58. *Response:* The City will also welcome the Treasury's review, through Arthur Andersen, of the Peat Marwick audit.

**Fiscal Oversight Mechanism**

The Committee finds that there is now general agreement on the need to establish a long-term fiscal oversight mechanism for New York City, with authority to insure that the budget stays balanced and that the City follows reasonable budgeting and accounting practices. Creation of such a fiscal monitor is necessary to regain access to market and promote investor confidence in the City's ability to maintain fiscal responsibility and meet its debt obligations over the long term.

59. *Response:* The City agrees on the need for a fiscal monitor.

Governor Carey assured the Committee that he would seek to "create some version of a long-term fiscal monitor for the City, through State legislation that is agreeable to all parties." As yet, there has been no agreement on the details of such legislation and on the basic question of how to achieve market confidence while retaining the City's right to make basic spending and program decisions.

60. *Response:* As previously noted, informed negotiations are underway on the exact nature of the monitor.

**Meeting the City's Financing Needs**

With all of the budget balancing and market access conditions met, as discussed above, the Committee believes that New York City should then be in a position to meet its financing needs on its own and thus avoid the danger of bankruptcy after June 30, 1973. City and State officials have continued to argue, on the contrary, that such an outcome is not possible in the absence of a long-term Federal financing commitment.
61. **Response:** As mentioned, while local sources obviously have the ability to meet the City's financing needs, there is a difference between the ability to lend and the willingness to do so. This was vividly seen in the failure of the City's Note Offering in November and the recent decline in MAC securities. To increase lenders' willingness to provide funds to New York, the guarantee is essential. Without it, required capital improvements cannot be made, funding actions to eliminate the residue of the fiscal crisis and provide budgetary relief cannot be taken, and the City will struggle from year to year with no permanent solution in sight.

In his testimony at the Committee's hearings, Felix Rohatyn, Chairman of the Municipal Assistance Corporation, outlined his estimates of New York City's financing needs, both short-term seasonal and long-term capital needs, over the next three years. He also described his plan for meeting those needs, which involved a phase-out of the $2.3 billion in Federal seasonal loans and a phase-in of $2.25 billion in Federal long-term lending over that three-year period.

Since the date of the hearings, the Rohatyn plan has undergone a number of modifications and has emerged as part of the Four-Year Financial Plan presented to the Treasury in New York City on January 20. However, the basic outlines of the plan are still the same, and it still envisions both an extension of the seasonal loans and $2.25 billion in Federal long-term lending in the form of guarantees of MAC bonds backed by City bonds. Using this plan as a basis for discussion, the Committee believes it can be clearly demonstrated that non-Federal sources are available for meeting New York City's essential financing needs, both short-term and long-term, over the four-year period.

**Long-term Financing**

Of the $5.1 billion in estimated long-term financing needs contained in New York City's Four-Year Financial Plan submitted on January 20, only $3.5 billion is allocated for basic capital financing ($2.5 billion "true" capital, $900 million to cover capitalized expense items until they are fully phased out), and this is all that is needed to accomplish the basic goal—preventing bankruptcy. The other $1.6 billion would be used for certain financial restructuring actions.

The Committee finds that the Municipal Assistance Corporation should be a major source of this capital financing. As Mr. Rohatyn stated in his testimony, "we have the economic horsepower, within MAC's ratios and bond covenants, to raise another $2.5 to $3.0 billion on the City's behalf," assuming State authorizing legislation and favorable markets. This means that in the best case, MAC might be able to cover almost all of the City's capital financing needs; and even should it fall short of this, it could contribute a substantial portion.

62. **Response:** See Response #20 of this rebuttal.
Unlike New York City, MAC has been able to borrow in the credit markets over the past three years. In 1977 alone, the Corporation raised $700 million from new bond issues, along with carrying out a substantial restructuring of existing City and MAC obligations. MAC should be assured of continuing access to the market by reason of the fact that it can offer strong security to investors. Pursuant to State law, MAC is authorized to issue obligations backed by certain City-related State tax collections, and payment of debt service is assured by the fact that these revenues are channeled directly to MAC for that purpose. MAC First Resolution bonds are backed by collections of State sales taxes within the City and by stock transfer tax revenues. MAC Second Resolution bonds are backed by per capita State aid due the City and by a subordinated claim on the State sales and stock transfer tax revenues, to the extent that they were not needed for First Resolution bonds. In the Restructuring Agreement executed last August, the Corporation acted to increase the protections afforded to bondholders, by reducing the maximum allowable annual debt service on both First and Second Resolution bonds and insuring that the coverage provided by the earmarked revenues would be about two times the amount needed to pay debt service in any given year.

63. Response: In view of the difficulties experienced by the recent MAC issue, it is not certain that MAC can meet a substantial portion of the City's long-term needs. In fact, MAC has publicly stated that it will not attempt to come to the market before May or June of this year. This is further evidenced by the narrow spread in yields between City and MAC securities having the same maturity in spite of MAC's "strong security".

Mr. Robatyn informed the Committee that the revenue stream backing MAC's debt service would support an increase of $3 billion in the Corporation's borrowing authority, in accordance with the terms of the Restructuring Agreement. However, there will have to be State legislation passed to increase MAC's borrowing authority by $3 billion to $8.8 billion, to extend that authority beyond the present expiration date of June 10, 1980, and to permit MAC to do capital financing on behalf of the City. The Committee recommends that the necessary legislation be proposed as soon as possible with the intent to obtain passage by the State Legislature no later than April 1, 1978.

64. Response: See Response #24 in this rebuttal.
In addition to the MAC borrowings, the City should also be able to count on a substantial amount of additional financing from its employee pension funds. The Committee recognizes the major contribution that the City employee pension funds have already made in shoudering the burden of New York City's long-term financing needs in the past three years, since the credit markets closed to the City. By June 30, 1973, the pension funds will have a total of $3.34 billion invested in New York City and MAC securities, which amounts to 39 percent of their total assets. This include $2.25 billion invested pursuant to the November 26, 1975 Amended and Restated Agreement, which formed the basis of the financial rescue package. It may not be reasonable to expect the pension funds to increase substantially the proportion of their resources invested in long-term City bonds over the next four years, but neither would it be wise to encourage a significant decrease in their holdings at the very time when the City may be most in need of a financing bridge to the long-term capital markets. Moreover, the financial fate of the pension funds will still be closely linked to that of the City. So whatever may be the expressed desires of the union leadership, the Committee believes it would be reasonable to expect the City employee pension funds at least to maintain their existing level of commitment to the City's long-term financing, which would involve the following actions:

1. Reinvestment of the amounts of their holdings which will be maturing in the next four years. According to information obtained by the Committee, this amounts to a total of $941 million: $237 million in fiscal year 1979, $272 million in 1980, $227 million in 1981, and $155 million in 1982.

2. Investment of 35 percent of new investable funds accruing to the pension funds over the next four years, thus holding constant the overall level of investment in long-term City bonds. Figures obtained by the Committee indicate that this would amount to a total of about $1.311 billion: $309 million in fiscal year 1979, $319 million in 1980, $335 million in 1981, and about $343 million in 1982.

65. Response: The City substantially agrees with these figures. However, the managers of the funds have said they want to reduce the proportion of these funds invested in City securities. While it might be possible to negotiate further pension fund investments in City securities, any concession in this area might result in higher wage settlements, thereby adding budgetary pressure. And it should be remembered that genuinely balanced budgets are essential to the City's financial health. For this reason, the Plan asks the Federal government, with State backing, to guarantee additional pension fund purchases of City securities.

It is likely that an extension of Public Law 94-236 with some amendments would be needed to permit these additional City pension fund investments. The law was passed in early 1976 pursuant to the Amended and Restated Agreement on the New York City financing package. It permits the pension funds to make the investments in City obligations set forth in the Agreement in order to maintain the City's ability to make future contributions to the funds and to meet future obligations to pay benefits to retirees. To the extent that City obligations are acquired and held pursuant to the Agreement, Public Law 94-236 exempts the City pension funds from (1) the requirement
of the Internal Revenue Code that a qualified trust be for the exclusive benefit of the employees or their beneficiaries, and (2) the self-dealing prohibitions of the Code applicable to tax-exempt governmental trusts. Should an extension be needed, then the Committee recommends that the Administration request the necessary legislation in a timely fashion.

66. **Response:** We agree that an extension of this legislation would be needed to permit additional pension fund investments in City securities, guaranteed or not.

If an extension of the State indemnification law is also needed, then the Committee assumes that prompt action will be taken at the State level.

67. **Response:** The City is pursuing this matter.

In all, then, the Committee believes that sufficient long-term financing should be available to New York City over the next four years from sources other than the Federal government to more than meet the $3.5 billion in basic capital financing needs. At least $2.25 billion of this amount could be supplied by the City employee pension funds, at the rate of $500 to $600 million a year, without increasing the percentage of their assets currently invested in City obligations. On the basis of recent experience, it would seem entirely feasible to obtain the remaining $1.25 billion, or roughly $400 million a year, through the sale of MAC bonds to private investors. This annual amount is well below the $700 million in new bond sales that MAC was able to realize in 1977.

68. **Response:** While the calculations in this paragraph are accurate, they do not take into account the stated intention of the City pension fund advisors to reduce the proportion of the funds' holdings of City and MAC securities; nor do they consider the recent market difficulties experienced by MAC securities. In view of these realities, the City does not believe it can meet all its long term financing needs without Federal assistance.
In addition to the $3.5 billion in basic capital needs, the City's financial plan calls for an additional $1.5 billion in long-term financing to be used for financial restructuring purposes. While this restructuring may be desirable, it is not absolutely necessary in order to prevent bankruptcy. The financial restructuring contemplated in the City's plan should therefore be considered as actions to be taken only if resources obtainable from the public credit markets permit. It is entirely possible that some, if not all, of these needs could be met through sales of MAC bonds or new City bonds if the City continues to show progress toward bringing its expenditures in line with its current revenues.

69. **Response:** The Four Year Plan called for a refunding of $560 million of MAC securities, funding $250 million of the MAC capital reserve and bonding the $300 million State advance. The refunding is expected to reduce debt service expenses* by approximately $3 million in fiscal 1979, $47 million in 1980, $59 million in 1981 and $61 million in 1982; funding the capital reserve will save almost $200 million in fiscal 1979 and $50 million in 1980. Since these actions relieve fiscal pressure, they should be pursued.

As for the State Advance, it represents accumulated budget deficits. It also increases the City's seasonal borrowing needs. To the extent it can be bonded, the City can reduce its reliance on the Treasury for short term borrowing.

*At the current time, about two-thirds, or $1 billion of debt service on the City obligations is for principal repayment. About 50% of the $2 billion of combined City and MAC debt service is for principal repayments.

However, the Committee does not believe there has been sufficient justification to provide long-term Federal guarantees for the purpose of facilitating financial restructuring actions which are not absolutely necessary to maintain the City's solvency.

70. **Response:** The Four Year Plan does not request long-term Federal guarantees of securities to be sold for restructuring the City's finances, only for issues to provide funds for true capital projects.
The City’s Financial Plan, as submitted to the Secretary on January 20, describes three components of the proposed $1.6 billion restructuring plan: $250 million for financing a MAC capital reserve fund; $500 million for refunding certain MAC bonds; and $500 million for bonding out the State advance.

The most important of these items appears to be the $250 million for funding a MAC capital reserve fund. Under the State law establishing the corporation, MAC is required to establish a reserve fund equal to one year’s debt service. This is a common practice for bond issuances generally, to provide a margin of security. Because of the magnitude of the borrowings MAC had to undertake, it was given four years, until fiscal year 1979, to build up that reserve through borrowings. In the meantime, the reserve has been funded out of the City’s budget. Thus the funding of this reserve through $250 million in MAC borrowing would not only meet the requirement in State law but also provide some budgetary relief to the City.

[Response: See Response #69 of this rebuttal.

Next would come the refunding of some $500 million in high-interest MAC bonds, which is intended to provide some savings in debt service to aid in balancing the City’s budget. These savings would help offset the cost of phasing out the expense items in the capital budget; otherwise, the City will simply have to make deeper cuts in the operating budget. So although this refunding may be desirable from the City’s standpoint, it does not appear to be essential and should only be done if resources permit. This component of the financing plan may be easier to achieve through sources in the financial community, since it involves a refunding of outstanding obligations rather than the issuance of new securities.

[Response: See Response #69 of this rebuttal.

Finally, there is the bonding out of the $500 million State advance, which appears to be of more dubious benefit. On the one hand, it would have the salutary effect of reducing the City’s seasonal borrowing needs. With this and some other adjustments, the January 20 Financial Plan estimates that the City’s present seasonal borrowing needs of about $1.3 billion a year could be reduced to as low as $400 million. This would lower the City’s debt service costs, and quite possibly facilitate its re-entry into the credit markets for short-term borrowing purposes.

On the other hand, the $500 million seasonal financing is basically guaranteed the City, whereas the equivalent amount of long-term financing is not. Moreover, New York State would be the principal beneficiary of the bonding out of the advance; this would relieve the State of its present need to provide backdoor seasonal financing to the City and thus improve the State’s own borrowing picture considerably. All this runs counter to the Committee’s view that the State should be more, not less, involved in the City’s financing. While not opposing the bonding out of the State advance if it can be done with available resources, the Committee would certainly not assign it top priority and would definitely not favor the use of Federal long-term financing to accomplish this purpose.
73. **Response:** The State Advance represents accumulated budget deficits. For that reason, bonding the advance would, like the phase-out of capitalized expenses recommended by the Committee, remove a symbol of the City's past fiscal gimmicks and thereby facilitate market re-entry, in addition to lowering the City's interest cost and improving the State's "borrowing posture." In this regard, the City would, because the Advance assists the State, request a "quid pro quo" in the form of higher recurring State aid. As noted, the City has not asked for a Federal guarantee of securities to be sold to bond the Advance, only for securities whose proceeds will be used to rebuild the City's physical plant.

In conclusion, then, the Committee finds there is ample reason to believe that New York City could cover its long-term financing needs over the next four years from resources immediately available to it, even in the absence of any financial aid from the Federal Government beyond June 30, 1973. Furthermore, it is important not to prejudice the possibility of the City's doing some long-term capital financing on its own through offerings of new City bonds, at least in the latter part of the four-year period. In fact, the January 20 Financial Plan includes sales of at least a modest $340 million in City bonds in the last two years of the Plan. However, the figures cited above indicate that the City's basic long-term financing needs could be met even without any sales of City bonds.

74. **Response:** As previously stated, there is a difference between the ability of local sources to lend and their willingness to do so. The realities of the market place, in fact, make this a truism. That is why the City needs long term Federal financing assistance.

**Seasonal Financing**

The Four-Year Financial Plan submitted on January 20 estimates that the City's short-term seasonal financing needs will amount to $1.8 billion in fiscal year 1979 and will decline in later years. The Plan proposes that these needs be met (a) by an extension of the Federal seasonal loans on a declining basis ($1.2 billion in fiscal year 1979, $800 million in fiscal year 1980, $400 million in fiscal year 1981, and $0 thereafter); and (b) by obtaining a $600 million line of credit from the New York City Clearing House banks.

The Committee finds that New York City should be able to cover all of its seasonal financing needs on its own, through a combination of measures to reduce seasonal revenue shortfalls and financing obtained from local sources, including the banks and the State pension funds.

75. **Response:** As mentioned, the Four Year Plan calls for $600 million line of credit from the Clearing House banks.
In a previous report, the Committee recommended that the City and State take steps toward revising the City's revenue collection schedule and smoothing out some of the seasonal shortfalls, in order to reduce the City's large annual short-term borrowing needs and the attendant interest costs. Thus it is encouraging to find that the City's January 29 Financial Plan contains proposals to do this. These include accelerated collection of real estate taxes within the fiscal year and changes in the timing of State and Federal aid payments. The Special Deputy State Comptroller made similar suggestions in a report issued January 12, which included proposals to delay repayment of the State advance until later in the fiscal year and to defer payment of the City's contribution to the pension until the end of the year, rather than paying it in regular monthly installments (which is not legally required.)

The Committee recommends that the City and the State, with the aid of the Secretary of the Treasury, take immediate action on a program to reduce the City's $1.3-billion seasonal financing needs by at least $400 million in fiscal year 1979 and by additional amounts in succeeding fiscal years. The Committee understands that a $400 million reduction could be achieved relatively quickly by such measures as accelerating collection of real estate taxes and delaying repayment of the State advance.

76. **Response:** See point #26 of this rebuttal

In addition, further reductions in peak annual needs could be achieved if agreement were reached on delaying the City's contribution to the pension funds.

77. **Response:** As previously stated, labor officials have publicly objected to delaying pension payments. Therefore, any concession in this area might result in higher way settlements, thereby adding budget pressure.

With such a program in place, the Committee believes that the remaining amounts of seasonal financing needed—a maximum of $1.4 billion in fiscal year 1979 and less thereafter—should be forthcoming from sources other than the Federal government. This is especially true in light of the following considerations:

1. The security for those seasonal borrowings is strong, since they are all geared to anticipated revenues from the State. The State's credit is strong, and there are statutory or other express commitments to providing these revenues over at least the next three years.

2. The City has an impeccable record of repaying its seasonal loans from the Federal Government in full and on time or ahead of schedule. There is little reason to believe that other investors could not feel assured of a similar repayment record. Furthermore, with the Federal Government out of the picture, there would be no impediment to repayment arising out of any express or implied prior lien on revenues by the Federal Government.

3. Although the recently attempted City note offering was cancelled on account of the MIG-4 investment rating, both the Comptroller of the Currency and the Federal Reserve Board declared that the notes would be eligible investments for the banks they regulate and would not be classified. This was an important vote of confidence in New York City's financial condition from the influential Federal bank regulatory agencies.
79. Response: This point is an argument for continued financing assistance to the City since its credit is much stronger today than it was in 1975.

Given these considerations, and assuming accomplishment of the budget balancing and other actions recommended above, the Committee finds that New York City should be able to meet all of its seasonal financing needs in the public credit markets after June 30, 1978.

79. Response: The Committee may find what the City "should be able to do...in the public credit markets" but these markets tells us what we can do, as evidenced by the failure of the City's Note Offering in November. The market, not the Committee's finding, is the test of reality.

This will require a major effort by the New York City banks, as both underwriters of and investors in New York City obligations. As noted above, the City's January 20 Financial Plan suggests that the large Clearing House banks could provide a $600 million annual line of credit for seasonal financing purposes, which would amount to almost half of the adjusted total needs. The Committee finds that this would be a good start but believes that these banks and other New York financial institutions could do a lot more to aid the City without jeopardizing their financial condition.

30. Response: In addition to requesting a $600 million line of credit from the Clearing House banks, the Four Year Plan asks the banks, along with other New York financial institutions, to purchase $1 billion of City and MAC bonds during the period.

Information supplied to the Committee shows that the total domestic assets of New York State commercial banks, savings and loan associations, and savings institutions were approximately $305 billion as of June 30, 1977, and approximately $247 billion of those were assets of financial institutions with headquarters in New York City. From these figures, it is evident that it is well within the means of the New York financial institutions to cover much or all of New York City's seasonal financing needs, which equal less than one-half of one percent of their assets. The question then is whether the condition of these institutions and of the City would permit such a level of investment.
There is every reason to believe that financial institutions located in New York City and in New York State are in a far better position now to take on more New York City-related obligations than they were in 1973, for several reasons. First, the economy is in better shape now, and the financial strength of the banking industry has improved. Second, the banks hold no short-term City notes at all at the present time, nor are there any such obligations still outstanding or in default. Third, in most cases, total bank holdings of long-term City and MAC bonds have remained constant or declined since 1973, while assets as a whole have increased. Fourth, the City has made tremendous strides toward putting its financial house in order in the past three years and is likely to do still more in the next few months. Fifth, the banks can look to the record of repayment of the Federal loan in the past several years as an indication that the City will live up to its commitments and repay its borrowings. Sixth, there is the fact that the Comptroller of the Currency and the Federal Reserve Board both declared the proposed City notes to be eligible investments for the banks they regulate. For all these reasons, the Committee finds it is reasonable to expect the banks and other financial institutions in New York City and New York State to pick up a substantial volume of short-term City notes over the next four years, and significant amounts of long-term MAC and new City bonds as well.

31. Response: The City agrees that all these points make it "reasonable to expect the banks and other financial institutions in New York City and New York State to pick up a substantial volume of City notes...and bonds" in the next four years. They are also excellent reasons why the Federal government should help the City in the event its financial institutions do not.

The Committee heard testimony at the hearings from the heads of six of the largest banks in New York City—Citibank, Chase Manhattan, Morgan Guaranty, Bankers Trust, Manufacturers Hanover, and Chemical Bank. These banks alone represent total capital of $10 billion and total assets of $123 billion. Among them, Chemical Bank had by far the largest holdings of New York City and MAC bonds—about $342 million, or 1.9 percent of assets, in 1976. The other banks had a much smaller proportion of their holdings in these obligations, and information submitted to the Committee indicated that most had reduced their holdings since September 30, 1975. Thus there is every reason to assume that these banks and other New York City financial institutions could invest in far larger amounts of MAC and New York City obligations, including new short-term notes, without in any way damaging their financial. Given the large volume of their loans to foreign countries, the Committee believes it is reasonable to expect the New York City banks to increase their investments in City-related obligations. And although the bankers who testified were reluctant to make firm commitments, they did indicate that they would do their share in any future efforts to meet New York City's financing needs.

32. Response: The City is actively trying to convince New York's financial institutions to "do their share" in meeting its financing needs.
Should New York City fall short of meeting all of its seasonal financing needs in fiscal year 1979 or subsequently from sales of notes to New York financial institutions and other investors, then it should be able to obtain the additional amounts needed from New York State directly or from the State pension funds. In fact, if these parties were to make a commitment to do a certain amount of seasonal financing on a stand-by basis, then this might facilitate New York City's access to the public credit markets.

83. Response: As mentioned, the State is legally prohibited from "lending its credit." As for the State pension funds, the State Comptroller, who is the sole trustee of these funds, has refused to buy substantial amounts of City or MAC securities, citing his fiduciary responsibilities.

The Committee believes that New York State must play the main role here, both in reducing the City's peak seasonal needs and in providing back-up seasonal financing to the extent needed. Governor Carey has told the Committee repeatedly that the State Constitution prohibits lending to a municipality. However, a memorandum from State Comptroller Levitt which the Governor submitted to the Committee a year ago gives some indication that the Constitution may not bar lending for short-term seasonal purposes. The memorandum stated, in part, that "the present Constitutional ban on gifts or loans of the State's credit precludes borrowing to assist the City except by notes payable within a year out of current revenue." (Emphasis added.) The latter phrase would appear to describe rather clearly the nature of seasonal borrowings and would suggest that the State might be able to assist the City directly in meeting some of those short-term needs.

84. Response: City officials are investigating this possibility, though substantial legal barriers are thought to exist to an actual loan.

Even if there might be some problems involved in direct State financing, there is no legal barrier to the State pension funds' picking up substantial amounts of the City's short-term notes. These State pension funds hold very considerable assets, and the Committee was informed in the oversight hearings that they have made no real commitments to the City's financing, either short-term or long-term. Given the importance to the State and its public employees of New York City's avoiding bankruptcy—an eventuality which could imperil the State's finances as well—there is every reason to request that the State pension funds backstop the City's seasonal borrowing needs, to the extent that they cannot be met in the public credit markets.

85. Response: See point #83 of this rebuttal.
There are two State pension funds: the general State employees retirement fund, which has total assets of $9.2 billion, and the teachers retirement fund, with total assets of $5.5 billion. Neither has any significant holdings of either New York City bonds or MAC bonds. Even if the pension funds were asked to pick up as much as $300 million in seasonal financing in fiscal year 1979 (the amount remaining over and above the $600 million line of credit from the banks), it would amount to only 3.3 percent of their assets. This would be far smaller than the commitment made by the City pension funds, and it would be on obligations whose quick repayment is assured, and at attractive rates of interest.

Questions have been raised about the ability of the State pension funds to make such investments and still meet their fiduciary obligations. In view of the security underlying these investments, and the likelihood that the amounts involved would be rather small—probably less than $300 million at peak, the Committee believes that the State pension funds should be able to do this seasonal financing for the City without encountering any fiduciary problems. Should Federal legislation along the lines of Public Law 94-328 be considered necessary to clarify the status of these State pension fund investments, the Committee recommends that the Administration request such legislation in a timely fashion. State legislation similar to that provided the City pension funds should also be proposed if necessary.

86. Response: The City supports this legislation.

In conclusion, the Committee is skeptical about the need for continued Federal financial assistance to New York City either for short-term or long-term purposes. A renewal of the New York City seasonal loan program would not necessarily serve the best interests of the Federal government or of the nation.

87. Response: The City believes Federal assistance that would enable New York to regain long-term vitality is in the best interests of the nation.

It would raise the risk of encouraging other cities to look to the Federal government for similar financial aid in times of economic stress.

88. Response: Because New York's fiscal crisis has national origins, the City Administration will propose a suggested national solution—federal guarantees of pension fund purchases of municipal obligations. All distressed communities will be able to utilize the guarantee program so long as they meet the following criteria:

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The community must have an unemployment rate at least 1% greater than the national unemployment rate each of the past twelve months;
--The community's pension funds must be willing to purchase the community's bonds;

--The community must accept outside review of its finances;

--The community must have failed to sell its long-term obligations in the public market within the past twelve months; and

--The State in which the community is located must provide a back-up to the guarantee.

While there is obviously a federal commitment to assisting cities through various existing grant-in-aid programs, a dangerous precedent would be set if the federal government became viewed as the ultimate guarantor of the fiscal solvency of municipalities. Such a precedent would certainly weaken the incentive for fiscal discipline at the local level and erode the foundations of our federal system.

89. Response: To date, Federal assistance has proved an incentive rather than a disincentive to fiscal discipline in the City of New York.

If the Federal government were to provide long-term financing for New York City, as the City and State are requesting, then the precedent would be far more dangerous. It would greatly increase the Federal government's financial exposure, while severely limiting its ability to safeguard its investment through the types of controls that are presently available.

90. Response: See points #4, 73 and 81 as to why the federal exposure is minimized in the Committee's own words. In addition, as pointed out in The Four Year Plan, the Federal Government's exposure under the plan would at no time equal or exceed the current $2.3 billion exposure under the Seasonal Financing Act.

Under the seasonal loan program, the Secretary of the Treasury can require that certain conditions be met before he extends a loan or before he makes new loans at the start of a fiscal year. A commitment to long-term Federal financing would remove the basis for such constraints.

For all these reasons, the Committee believes it would be far preferable for New York City to obtain the financing it needs after June 30, 1973 from sources available to it in New York City and New York State, rather than rely on further financial aid from the Federal government.

91. Response: While the City also prefers to obtain its financing from local sources, it does not believe it can do so in the view of market reality.