New York City
Fiscal Update

JULY 1978
With the close of its fiscal 1978 year on June 30, New York City reached a major watershed. Its three-year budget and financing plan, put together in 1975, came to an end, and it was about to embark on a four-year plan, designed to restore by June 1982, not only true budget balance, but also access to the public credit market.

New York's fiscal improvement over the past three years has been quite remarkable. In both fiscal 1975 and fiscal 1976, it had budget deficits (including capitalized expenses) of the order of $1.5-2 billion. Audited financials for fiscal 1978 will not be available for a few months, but it appears that the true deficit for that year will be roughly $600 million, represented essentially by capitalized expenses.

On the financing front, the City survived during the past three years because of a combination of four elements. The municipal employee pension funds purchased over $2 billion of City bonds; the United States Treasury provided up to $2 billion of seasonal financing each year; the Municipal Assistance Corporation (MAC) issued over $5 billion of bonds for the benefit of the City (primarily to fund the City's formerly huge short-term indebtedness); and the State has each spring been advancing some $800 million aid to the City normally due in the fall.
This has been, at best, a holding action. It became clear, as early as last November, that the City would not make it on its own when the Federal seasonal financing program terminated on June 30, 1978. Accordingly, a case was made to the Congress for a Federal guarantee program for City bonds over the course of the next four years, to serve as the centerpiece for a financing program designed to ease the City back into the public credit markets.

Such guarantees, approved by both Houses of Congress, and currently scheduled to go to a House-Senate conference committee for resolution of various differences between the two bills, can be expected to be in place very soon. Meanwhile, MAC Chairman Felix Rohatyn, City officials, union pension trustees, and representatives of the financial community, are in the process of putting together the balance of the four-year financing plan. It is hoped that $750 million of the guarantees will be available "up front" to form an integral part of the plan, with the remainder ($1 billion, more or less, depending on the results of the conference committee) being held in reserve. It is expected that the guarantees will be available only to the State and City employee pension funds.

The balance of the $4.5 billion of long-term financing required over the four years for true capital, as well as bonding out capital expenses, and some refunding and other purposes, will come from a variety of sources. These will involve, on the one hand, a combination of private placements of MAC bonds with the commercial banks,
savings banks, insurance companies, and City pension funds; and, on the other hand, roughly $500 million a year of public sales. Initially these will presumably be second resolution MAC bonds. The State Legislature recently raised MAC's authorization by $3 billion.

As the City makes further progress on both the budgetary and the financial fronts, the City's own bonds might be sold in the market, in the 1980-82 time-frame, for the first time since early 1975. New York City bonds are currently rated at below investment grade. However, if the City can achieve substantial budgetary and financial progress over the next few years, it should be able to move towards an investment grade rating. It should also be kept in mind that, in its recent legislation, the State Legislature also established a special debt service fund for City bonds and other indebtedness. The existence of this fund, together with other safeguards in the legislation, should help somewhat in restoring investor confidence, provided that the City adheres to strict budgetary constraints.

Meanwhile, the City will also require $1 billion or more of short-term financing each year. Sales of short-term notes by the City were suspended in the spring of 1975. Plans were underway to re-open this market, at least to a limited extent, last November, but a public sale was aborted when Moody's Investors Service gave the prospective City notes its lowest rating (MIG-4). It appears clear that there is no public market for meeting all of the City's seasonal needs in this fiscal year, and the financial institutions
and municipal pension funds have been asked to subscribe to substantial amounts of short-term financing. Nevertheless, by the late summer or early fall, if the City's four-year plan appears to be off to a reasonable start, and if audited financials for fiscal 1978 contain no major adverse surprises, an improvement in the rating for New York City notes, and perhaps even a modest amount of market acceptance, could be expected.

In conjunction with the re-opening of the short-term market for the City, it could be beneficial to explore the possibility of instituting a modified version of "Dutch auctions" of City notes. Prospective purchasers would bid for the securities, and various financial institutions could agree in advance to "cover" the auction, perhaps along lines generally similar to arrangements which have prevailed with the Treasury bill auction in Britain.

The receptivity of investors to New York City, in the final analysis, will depend not primarily on the marketing technique, but on the hard progress that the City makes in getting its budget into true balance.

The four-year plan indicates that the improper capitalized expenses should be progressively reduced, over the next three years, to $450 million, $300 million, and $150 million, with true budget balance attained in fiscal 1982. However, factoring in the full costs of the new contract for City employees, and taking into consideration the likelihood of additional costs in the next round of bargaining two years from now, true budget balance in fiscal 1982 cannot be considered as a foregone conclusion. Indeed, the City's
Emergency Financial Control Board (EFCB) has directed the City to develop contingency plans for potential expenditure cuts of $100 million in fiscal 1979 and $200 million in fiscal 1980 in the event that revenues fall short or expenditures run higher than forecast. Moreover, well before the start of fiscal 1981, the City will undoubtedly be required to demonstrate how it intends to close what now looks like a rapidly growing budget gap after fiscal 1980.

Which all goes to prove that the City must run very fast to stand still. In this regard, it is noteworthy that the New York State Legislature extended the life of the City's Emergency Financial Control Board for up to thirty more years. After the City has attained certain budgetary and other targets, the enforcement powers of the EFCB would go into "sunset" (although it would still receive all City fiscal reports, etc.), but there would be a subsequent "sunrise" if various slippages occurred, such as a budget deficit of $100 million or more. It is likely that investors will carefully watch not only the City itself, but also the watch-dog agencies such as the EFCB, to ensure that the City's fiscal integrity will be maintained.

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PROPOSED MODIFIED "DUTCH AUCTION" OF NYC NOTES-FISCAL 1979

1. **Timing:** November and later. Audited financials must be in hand.

2. **Amounts:** Preferably not more than $50 million per auction. Avoid possibility of flooding the market. Better to build up scarcity value.

3. **Offering Circular:** Required for each auction of substance; may be in updated form.

4. **Frequency of Auction:** Every two weeks if feasible.

5. **Number of Auctions in FY 1979:** 6 or 7

6. **Bidding Procedures:** Invite (with great publicity) bids from all types of buyers including individuals, either directly or through an agent (bank). Explore whether NY Fed would handle the bids mechanically, or at least act as consultant to City. Advise prospective bidders of "Dutch" feature, so that all successful bidders will enjoy identical rate. Set minimum denominations.
7. Role of Financial Institutions: Draw up agreement with financial institutions, involving:

a) Determining membership, share for each institution and total commitment

b) Setting the rate at which each auction will be covered (e.g. 3/8% above "best" bids covering 1/3 of notes being auctioned

c) Restrictions, if any, on resale

d) Commitment fee

e) Relationship between auction notes and other notes which may be taken on a private placement basis; types of notes to be used

f) Contingency plans in the event all bids at any auction are rejected

gh) Assurance of adequate disclosure

h) Minimum rating requirement (MIG-3, MIG-4?)

i) Conditions under which MAC notes would be used instead of City notes

j) Appointment of manager of the "back-stop" facility bond counsel and counsel for manager

k) Eliminate profiteering