NEW YORK CITY FISCAL UPDATE

The series of labor settlements reached between New York City and its municipal unions during the past three weeks, signify the proverbial good news and bad news: The good news is the absence of strikes; the bad news is that no one at this point knows how the City can pay the increased wages over the next two years without service cuts or highly counterproductive tax hikes.

For fiscal 1981, which started on July 1, the effects of the collective bargaining agreements on top of various other uncertainties could leave a gap of about $300 million or more. Depending on how severely the economic recession impacts the City, that gap could be either narrowed or exacerbated. In any event, one could make the case that fiscal 1981 can be balanced, provided that there is a strong measure of belt tightening.

For fiscal 1982, however, the problems compound greatly. Even before the labor settlement, the City had foreseen a gap of about $500 million. Including the extra labor costs, the shortfall grows to in excess of $1 billion. One can conceive of some "quick and dirty" measures to trim this by one fifth or one quarter, but the great bulk of this number will be extremely difficult to eliminate without major surgery the nature of which can not even be determined at this time. Some very intensive rethinking of various Federal and State mandates will have to be undertaken, and some less-than-pleasant other options will have to be explored.

Moreover, the gaps in the next two years would be even greater if about $150 million of labor bonuses in such year were not being funded through a $300 million labor reserve that had been accumulated in fiscal
1980. Thus, once we get to fiscal 1983, when the bonuses will apparently become part of the wage base, and a new round of wage increases could be in the offing, the City's fiscal problems would appear to have grown geometrically. In short, any sanguine feeling about the City on account of good performance in fiscal 1980 must be tempered by the enormity of the very real challenges staring the City in the face.

It is not surprising, therefore, that the Financial Control Board, which was scheduled to approve the City's budget and 4-year Plan on June 26, withheld such approval in the absence of specific measures by the City to fund its labor settlements. Instead, the City will be operating for the next three months under an interim budget involving a high degree of workforce attrition, and will have to come back to the Board with a tangible and realistic Plan by August 15.

All things considered, the City's budgetary outlook is grim indeed. Mere band-aids will not suffice. In a letter to Mayor Koch on June 24, MAC Chairman, Felix Rohatyn, summed up the dire prospects by suggesting that the City will have to look to a combination of lay-offs, new taxes, and service cuts to keep its head above water. He observed that all three such choices are undesirable, and suggested that "only by beginning now" can we hope to contain the deleterious impacts of such actions. The conclusion is inescapable, therefore, that the kind of super-human self-sacrifice that characterized New York's major turn-around in the mid '70s, has to be called upon right now if we are to avoid another problem of major proportions in New York City's finances.
BORROWING OUTLOOK

It is now approximately the mid-point of New York City's four-year financing plan. Fiscal 1979 and fiscal 1980 went according to schedule, with the City establishing increasing -- but still incomplete -- market access for its notes, but having to rely on MAC and U.S. Government guarantees for its long-term financing.

The general situation does not appear likely to change radically in fiscal 1981. Although there can be no doubt that New York City has made significant budgetary progress during the past five years, and in particular in fiscal 1980, the market is still in the very early and inchoate stages of receptivity to New York City paper.

No official specific estimates of the City's seasonal financing needs during the coming year have yet been made available, but a figure of about $600-650 million, roughly in the same range as the last two years, appears to be in the ball park, roughly divided between early fall and January-February, 1981. If the economic slowdown and concurrent downturn in general interest rates continues over the next three quarters, and if the City's budget appears to be staying on track, there is a reasonable prospect that the City can do all its short-term financing in the public markets -- for the first time since fiscal 1974.

Needless to say, the City cannot take any risks, and will undoubtedly feel compelled to negotiate a back-up line of credit with financial institutions, as it did last year.
LONG-TERM FINANCING

Inasmuch as the Mayor's expense budget for fiscal 1981 aims at balance without resort to capitalized expenses, and because the City's capital construction program is still not fully geared up, long-term financing requirements in the coming year are less than $800 million. These could be met quite easily through the pre-arranged $537 million of MAC private sales to financial institutions and City pension funds, and relatively small public MAC issues throughout the year.

However, MAC proposed -- and the New York State Legislature endorsed -- a longer range view, looking beyond the year immediately ahead. Anticipating that the City is not likely to have more than token long-term market access by June 1982, when the current four-year financing plan ends, MAC proposed enlargement and prolongation of its own financing capability, together with the utilization by the City of the remaining $900 million in Federal guarantee authority during the next two fiscal years. Governor Carey signed the new MAC legislation in late June.

This approach involves excess borrowing, through a combination of MAC and guaranteed City bonds, until June 1982; stockpiling the excess; and financing the City in fiscal 1983 and fiscal 1984 through a combination of drawing down the stockpile, moderate new public sales by MAC, and perhaps a gradual beginning of public sales (unguaranteed) by the City. The hope is that, by fiscal 1985, the City will have worked its way up to long-term market access, with some residual MAC capability being in place in the first half of that year in the event that one final bit of help is needed.
New York State Comptroller Edward V. Regan, in endorsing the expansion of MAC's authority from $8.8 billion to $10 billion, and its new issuance extension from June 1982 to December 1984, insisted that the City simultaneously develop a meaningful plan for long-term market re-access. Legislation instituting a new reporting mechanism was subsequently enacted into law.

The goal of full market re-access requires a firm demonstration of continuing true budget balance. It also requires more. Because the City's future is plagued by a plethora of problems, even the attainment of a truly balanced budget will not satisfy investors fully. They will require evidence of continuity. They might also seek additional safeguards for themselves as potential bond holders. Whether such safeguards are best established in the form of a substantive debt service reserve, or strong pledge of dedicated revenues, or some other device, remains to be determined. However, they must always be viewed as supplementing, rather than substituting for, recurring budget balance.

Jac Friedgut
Vice President

July 7, 1980