Presentation to the Hon. G. William Miller
Secretary of the Treasury

by

The City of New York

Municipal Assistance Corporation
For The City of New York

September 10, 1980
INTRODUCTION

In the fall of 1978, the City, MAC, State and Federal governments together with various financial institutions and City and State Pension Funds developed and implemented a plan which:

- provided capital financing assistance to the City during a four year period ending June 30, 1982.
- provided for the City's gradual reentry into the public long term credit markets.
- required the City to undertake various budgetary and management reforms designed to produce GAAP balanced operating budgets by no later than fiscal year 1982.

An important component of the plan is the Federal government's issuance of the "standby" guarantees for City debt in the aggregate amount of $900 million during fiscal years 1981 and 1982.

In authorizing the Secretary of the Treasury to guarantee City debt issued to finance its capital program, the Congress recognized that an orderly program of investment in the City's physical infrastructure was essential to its fiscal and economic recovery and to its ultimate reentry into the long term credit markets.

To date, financings have proceeded according to the plan. MAC has issued $938 million of its bonds pursuant to the
financing agreement implemented in the fall of 1978 and sold publicly $847 million of its bonds. The City has issued $750 million of guaranteed bonds to the City and State pension funds to finance its capital program and publicly marketed its own short term debt to meet most of its seasonal requirements. The balance of the proceeds have been used to fund the last vestiges of the City's operating budget deficit, meet MAC capital reserve fund requirements, fund the Guaranty Fund and continue MAC's refunding program.

During the past two years, the City has completed certain basic management reforms and contained the growth in its operating budget. Between 1976 and 1981, the City's total budgetary outlays have increased only 12%. During the same period, the State's budget has increased 33% and the Federal budget has grown 66%. The City has adopted an operating budget balanced in accordance with GAAP for its 1981 fiscal year. This goal has been attained a year earlier than required by the plan despite an economic slump and retrenchment in Federal programs which provide aid to urban areas.

Under the plan implemented in the fall of 1978, the City has resumed the capital planning and construction program after a significant period of near dormancy. The City anticipates
spending a total of $4.7 billion of City funds during the next five years to rehabilitate its capital plant.

Although there has been considerable progress, it appears unlikely that the City will be able to sell publicly its bonds in the amounts originally anticipated. In part, this reflects a general shift in market conditions which has limited the credit available to even the most seasoned issuers. Further, it is generally believed that the City must attain an investment grade rating before achieving full market access.

Notwithstanding the City's present lack of access to the long term credit markets to finance its capital program, its continuation is vital to the City's future. Further, the capital program is a continuous effort which requires a constant flow of projects coming through the design and approval process. Such a program cannot be quickly stopped and started and requires a degree of certainty as to source and timing of funding. Should the City fail to have adequate assurances of financing for its capital program beyond fiscal year 1982, it would have to begin immediately to curtail contract awards. New capital projects would be limited to emergency reconstruction, mandated programs and projects with substantial matching state and federal funds. Major high
priority programs such as the third water tunnel, bridge reconstruction and essential highway, sewer and water supply projects would be delayed indefinitely.

As part of the continuing process of adjusting the City's financial plans, MAC and the City have proposed an extension to the plan of financing implemented in the fall of 1978. The proposed extension would continue MAC's financing assistance for the City's capital program through December 1984 allowing a longer period for the City's gradual reentry into the public credit markets (see Table 1). The proposed plan anticipates that the City will begin public sales of its bonds during fiscal year 1981 and increase the amount it sells each year thereafter. Specifically the proposed plan:

- anticipates that the City will sell at least $1.7 billion of its bonds in the public markets during fiscal years 1981 to 1985.
- requires MAC to sell approximately $1.9 billion of its bonds publicly during the period ending December 31, 1984.
- projects that the remaining $862 million of MAC's private placements to the financial institutions and pension funds will be completed as scheduled and that the City will complete the issuance of the remaining $900 million of its bonds under the New York City Loan Guarantee Act of 1978.

New York State enacted legislation increasing MAC's issuance authority by $1.2 billion, to $10.0 billion (exclusive of
refunding debt and debt issued for seasonal financing), and extending the period during which MAC may issue debt (other than refunding debt) until December 31, 1984. This legislation enables MAC to fulfill its extended role in the proposed plan. For both economic and marketing reasons, however, the $10.0 billion issuance level is the effective limit to MAC's financing capacity under the First and Second General Resolutions.
TABLE 1

Financing Requirements and Sources

Fiscal Years 1981 to 1985

(In $ Millions)

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<tbody>
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<td>Requirements</td>
<td></td>
<td></td>
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<tr>
<td>City Capital</td>
<td>712</td>
<td>975</td>
<td>1,000</td>
<td>1,000</td>
<td>1,000</td>
<td>4,687</td>
</tr>
<tr>
<td>MAC - Capital</td>
<td></td>
<td></td>
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<tr>
<td>- Reserve Fund</td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>and Guaranty Fund</td>
<td>75</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td></td>
<td>375</td>
</tr>
<tr>
<td>- Refunding</td>
<td>100</td>
<td>150</td>
<td></td>
<td></td>
<td></td>
<td>250</td>
</tr>
<tr>
<td>Total</td>
<td>887</td>
<td>1,225</td>
<td>1,100</td>
<td>1,100</td>
<td>1,000</td>
<td>5,312</td>
</tr>
<tr>
<td>Sources</td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>City - Guaranteed</td>
<td>300</td>
<td>600</td>
<td></td>
<td></td>
<td></td>
<td>900</td>
</tr>
<tr>
<td>- Public*</td>
<td>100</td>
<td>200</td>
<td>300</td>
<td>400</td>
<td>700</td>
<td>1,700</td>
</tr>
<tr>
<td>MAC - Private</td>
<td>537</td>
<td>325</td>
<td></td>
<td></td>
<td></td>
<td>862</td>
</tr>
<tr>
<td>- Public</td>
<td>400</td>
<td>400</td>
<td>400</td>
<td>350</td>
<td>300**</td>
<td>1,850</td>
</tr>
<tr>
<td>Sub-Total</td>
<td>1,337</td>
<td>1,525</td>
<td>700</td>
<td>750</td>
<td>1,000</td>
<td>5,312</td>
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<tr>
<td>Reserve for Future Capital Requirements</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Deposits)/Withdrawals</td>
<td>(450)</td>
<td>(300)</td>
<td>400</td>
<td>350</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total for Current Requirements</td>
<td>887</td>
<td>1,225</td>
<td>1,100</td>
<td>1,100</td>
<td>1,000</td>
<td>5,312</td>
</tr>
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</table>

* To the extent City public issues vary from the indicated schedule, MAC issues may be adjusted accordingly.

** To be issued during first six months of fiscal year 1985.
As discussed below, completion of the issuances under the proposed plan will leave MAC only a narrow margin of financing capacity. As shown in Figure 1 and Table 2, MAC's issuance capacity is insufficient to provide for both shortfalls in City issuances and the absence of guaranteed issuances. Shortfalls which exceed this margin will require a reduction in the City's capital program expenditure levels.
FIGURE 1

AGGREGATE MAC ISSUANCE FOR THE PURPOSE OF STATUTORY LIMITATION UNDER PROPOSED PLAN
Fiscal Years 1981 to 1985
Table 2

Aggregate MAC Issuances For Purposes of the Statutory Limitation
Fiscal Years 1981 to 1985
(In $ Millions)

<table>
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<tbody>
<tr>
<td>Proposed Plan</td>
<td>7,646</td>
<td>8,221</td>
<td>8,621</td>
<td>8,971</td>
<td>9,271</td>
</tr>
<tr>
<td>Proposed Plan</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Without Guarantees</td>
<td>7,846</td>
<td>8,646</td>
<td>9,246</td>
<td>9,896</td>
<td>10,000*</td>
</tr>
<tr>
<td>Proposed Plan</td>
<td></td>
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<td></td>
<td></td>
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<tr>
<td>Without Guarantees</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>And Assuming No City Issuances</td>
<td>7,946</td>
<td>8,946</td>
<td>9,846</td>
<td>10,000**</td>
<td>10,000**</td>
</tr>
</tbody>
</table>

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* To provide for all of the financing requirements in 1985 would require MAC to exceed its statutory issuance limitation by $196 million. If alternative financing sources are unavailable, the City's level of capital expenditures must be reduced by that amount.

** To provide for all of the financing requirements in 1984 and 1985 would require MAC to exceed its statutory issuance limitation by $896 million and $1,896 million, respectively. If alternative financing sources are unavailable, the City's level of capital expenditures must be reduced by the aggregate $2,792 million by 1985.
During the ten years from the onset of the crisis to the completion of the proposed plan, the City's management and budgetary procedures will have undergone as thorough and rigorous an overhaul as ever undertaken by a major governmental unit. The reorganization will have been accomplished without recourse to bankruptcy and without severe disruptions in the local delivery of services. During the period, the State, both directly and through MAC, will have borne the bulk of the financing burden by extending its moral obligation to over $9 billion of debt issued to support the City. Indeed, out of the total $14.4 billion of long-term financing which will have been issued upon completion of the proposed plan, the portion borne locally by the State, MAC and the City will be almost 90% -- compared to about 10% contributed by the Federal government. The proposed plan -- which relies principally upon the State, MAC and the City -- can be implemented without requiring Federal assistance beyond that authorized in 1978.

FINANCING REQUIREMENTS

The City and MAC project financing requirements which total approximately $5.3 billion during fiscal years 1981 through 1985 as follows:
(In $ Millions)

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<tr>
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</thead>
<tbody>
<tr>
<td>City Capital</td>
<td>712</td>
<td>975</td>
<td>1,000</td>
<td>1,000</td>
<td>1,000</td>
<td>4,687</td>
</tr>
<tr>
<td>MAC Capital Reserve Fund</td>
<td>64</td>
<td>75</td>
<td>100</td>
<td>100</td>
<td></td>
<td>339</td>
</tr>
<tr>
<td>Guaranty Fund</td>
<td>11</td>
<td>25</td>
<td></td>
<td></td>
<td></td>
<td>36</td>
</tr>
<tr>
<td>MAC Refunding</td>
<td>100</td>
<td>150</td>
<td></td>
<td></td>
<td></td>
<td>250</td>
</tr>
<tr>
<td></td>
<td>887</td>
<td>1,225</td>
<td>1,100</td>
<td>1,100</td>
<td>1,000</td>
<td>5,312</td>
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</tbody>
</table>

**City Capital**

During the early 1970's, as capital financing was increasingly utilized for City operating expenditures, the City experienced a sharp decline in expenditures for actual capital construction from the peak of approximately $1.0 billion. At the onset of the City's fiscal crisis in 1975, even the minimal level of new capital construction was halted. The decline in actual capital investment over a number of years has resulted in a significant accumulation of deferred rehabilitation and reconstruction projects.

The financing plan established in the fall of 1978 has enabled the City to undertake capital projects that had been postponed since the early 1970's. In doing so the City made a major
shift in capital priorities from construction of new facilities such as schools, libraries, and police and fire stations, to restoration of its infrastructure. Since little has been invested in such rehabilitation of the City's physical plant, no pipeline of projects existed which could easily be implemented and construction started. The reordering of its priorities and the need to reestablish a capital planning process caused the capital expenditure during fiscal years 1979 and 1980 to fall below projected levels.

During these two years, however, the pipeline of capital projects in design has increased dramatically. The current estimate of the value of such projects is approximately $3.0 billion, of which $1.5 billion must be financed by the City or MAC. In addition, over the next five years, outstanding commitments of approximately $938 million must be financed. As shown in Table 3, the total of $2.4 billion of existing commitments and pipeline projects, together with projected commitments in the next five years, will require almost $4.7 billion of financing through fiscal year 1985.
Table 3
Projected Levels of City Capital Liabilities and Cash Flow
Fiscal Years 1981 to 1985
(In $ Millions)

<table>
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</thead>
<tbody>
<tr>
<td>Existing City Liability (6/30/80)</td>
<td>938</td>
<td>1,342</td>
<td>1,330</td>
<td>1,333</td>
<td>1,346</td>
</tr>
<tr>
<td>Plus: Planned Commitments</td>
<td>1,116</td>
<td>963</td>
<td>1,003</td>
<td>1,013</td>
<td>1,000</td>
</tr>
<tr>
<td>Less: Liquidations</td>
<td><em>(712)</em></td>
<td><em>(975)</em></td>
<td><em>(1,000)</em></td>
<td><em>(1,000)</em></td>
<td><em>(1,000)</em></td>
</tr>
<tr>
<td>Total City Commitments</td>
<td>1,342</td>
<td>1,330</td>
<td>1,333</td>
<td>1,346</td>
<td>1,346</td>
</tr>
</tbody>
</table>

Financing Requirements

| Amount to Be Financed by the City | 712 | 975 | 1,000 | 1,000 | 1,000 |

* Includes approximately $43.0 million of unfinanced prior year expenditures.

It is likely that the City will substantially meet its capital expenditure targets for fiscal years 1981 and 1982. Further, it is probable that the City will not only have reversed the trend of capital underspending but will be required to constrain capital commitments in order to limit future expenditures and financing requirements to the amounts
projected in the plan. The limited financing resources must be rationed among major capital priorities including highways, bridges, sewers, water supply, transit and equipment -- all areas in which necessary reconstruction and replacement substantially exceed the available financing resources.

The City's capital budget is at a critical juncture. By 1982 the City will have largely accomplished the $2.3 billion of capital investments it projected in 1978 for the four year period. Continuing the rehabilitation of the City's basic physical plant will necessitate enormous investments in the foreseeable future. The long term program to arrest the deterioration of the City's infrastructure now depends equally on availability of financing and the City's ability to manage the capital spending process.

**MAC Capital Reserve Funds**

Pursuant to State law and MAC's existing resolutions, MAC is required to maintain capital reserve funds. The moneys on deposit in these funds may be used only to meet debt service requirements on MAC's bonds in the event that MAC's revenues are insufficient. Generally, these funds must be maintained at a level equal to 100% of the succeeding calendar year's debt service payment requirements.
At June 30, 1980, MAC had on deposit in the capital reserve funds approximately $682.0 million, $296.9 million relating to First Resolution bonds and $385.1 million relating to Second Resolution bonds. As MAC issues debt under the proposed plan, additional amounts will be required to be deposited. The exact amount which will be required is related to the amount and structure of the debt to be issued and the interest rates. By January 1, 1985, the amount required to be on deposit in connection with Second Resolution bonds will be approximately $800 million. It is estimated that the $339 million to be added from bond proceeds during the next five years under the proposed plan, together with retained investment earnings, will be sufficient to satisfy the requirements without using MAC's revenue streams.

Guaranty Fund

The New York City Loan Guarantee Act of 1978 requires that a fund be established in connection with the issuance of guaranteed debt by the City. MAC has created the Guaranty Fund, which it has funded to the required level with a portion of the proceeds of certain issues of its bonds. Issuance of the guarantees during 1981 and 1982 under the proposed plan will require approximately $36 million to be deposited in the Guaranty Fund.
Refunding

MAC was established by the State to provide in part, long term financing over a twenty year period for approximately $5 billion of City notes which were due or becoming due. Market conditions during the first three years of MAC's existence, however, precluded the issuance of substantial amounts of twenty year debt. To complete MAC's initial task of providing long term financing for the City notes, as well as provide the level debt service structure upon which future issues can be layered, it is necessary to continue the program of converting previously issued debt which has short maturities or high coupons into longer and, market conditions permitting, lower cost debt. MAC began this process with the restructuring of its debt in the fall of 1977. The proposed plan provides a total of $250 million for refunding during the five year period. To the extent market conditions permit, MAC may continue its program beyond levels indicated in the proposed plan.

PROPOSED FINANCING PLAN

To provide for the financing requirements, MAC and the City have proposed an extension of the financing plan. Under this proposal MAC would continue its public sales of bonds through December 31, 1984. Under the plan, the City would
begin public sales of its bonds during the current fiscal year, increasing the amount issued each year through 1985 until it had reached self sufficiency by fiscal year 1986.

The issuances under this proposal are as follows:

(In $ Millions)

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<tr>
<td>City - Guaranteed</td>
<td>300</td>
<td>600</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Public</td>
<td>100</td>
<td>200</td>
<td>300</td>
<td>400</td>
<td>700</td>
</tr>
<tr>
<td>MAC - Private</td>
<td>537</td>
<td>325</td>
<td></td>
<td>350</td>
<td>300</td>
</tr>
<tr>
<td>- Public</td>
<td>400</td>
<td>400</td>
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MAC's public issues are projected at the present level of approximately $100 million per quarter. MAC's issuances can be increased to some extent to provide funds in the event the City is unable to sell its bonds on reasonable terms. MAC's senior managing underwriter has advised that under normal market conditions no more than $600 million of MAC bonds per year, or $150 million per quarter, could be sold publicly on reasonable terms. They have further advised MAC that its ability to market such debt may be adversely affected by the absence of a financing plan. (See the letter from MAC's senior managing underwriter appended as Exhibit A.)

To remain within the limitations of MAC's market access, the plan provides that a portion of the moneys raised during
fiscal years 1981 and 1982 will be retained by MAC to support the City's capital program during fiscal years 1983 and 1984. It is anticipated that by 1985, the City will be able to sell $700 million of its bonds which, together with $300 million of bonds issued by MAC prior to December 31, 1984, will provide for that year's financing requirements. Thereafter, it is assumed that the City will be able to finance its capital requirements.

This proposal anticipates completion of existing financing arrangements which include the issuance of $862 million of MAC bonds to certain financial institutions and City pension funds, and the issuance of $900 million of guaranteed City bonds to certain City and State pension funds pursuant to the existing agreements which would be amended to give effect to the proposed plan.

The issuance of guarantees is an integral part of the proposed financing plan. The failure to obtain the guarantees would disrupt the City's efforts to reenter the public credit markets by creating significant questions as to the availability of financing.

City Reentry Into the Public Credit Markets

For the City to undertake its capital program and to reenter
the credit markets requires a degree of certainty as to the source and adequacy of financing. The City's capital program is a continuous flow of projects through a pipeline of design, approval, contracting, and construction. Some projects require years to flow through this process. To assure that the City can proceed with developing projects for the future, it is necessary to identify financing for both existing commitments and those projected for the future.

Such certainty of financing is necessary to facilitate the City's reentry into the long term credit markets, for investors -- aware of the nature of the capital process -- will be reluctant to purchase bonds if there is substantial uncertainty regarding the City's future access to adequate financing.

The $300 million of guarantees should be issued on October 2 as an important signal of Federal support to the City's potential underwriters and investors. Any delay in the issuance of guarantees may set back the City's plans for public offerings.

Limitations on MAC Debt Issuances

The recently enacted increase of MAC's debt issuance author-
ization to $10.0 billion represents the effective limit to MAC's issuance capacity under its existing First and Second Resolutions.

- If MAC were to issue up to the $10.0 billion issuance limitation during the next five years, it would have approximately $8.8 billion outstanding. Pursuant to the financing agreements entered into in the fall of 1978, MAC's issuances under its First and Second Resolutions are limited to an outstanding amount of $8.8 billion. Issuances under a third resolution are prohibited by law and notwithstanding the statutory prohibition may be undertaken only if backed by an investment grade City bond.

- The rating agencies have consistently been concerned about the continuing level of MAC's issuances to assist the City. Most recently, Standard & Poor's stated explicitly that

  "in the event that additional future debt authorization should be required by the MAC, we would have to review these ratings."

- Although projected revenues upon the completion of the proposed plan will afford adequate coverage of projected debt service as concluded recently by Standard & Poor's, continued issuances could jeopardize MAC's coverages and market.

To provide some degree of certainty that adequate funds will be available through fiscal year 1985, it is necessary for MAC to preserve its narrow margin of remaining issuance capacity for fiscal years 1983 through 1985. If MAC is required to finance the portion to be financed through issuance of guaranteed City bonds, it would have no capacity
to absorb any shortfall in City issuances as shown previously in Table 2 and Figure 1.

Legal Discussion

The availability of guarantees during fiscal years 1981 and 1982 as a component of the proposed financing plan has been reviewed by the City's Corporation Counsel and MAC's General Counsel. The memoranda prepared by them are included in this submission as Exhibits B and C, respectively. It is their conclusion that under the New York City Loan Guarantee Act of 1978 (the "Act"), the Secretary is authorized in his discretion to issue guarantees during fiscal years 1981 and 1982, and that issuance of the guarantees is consistent with the intent of the Act and is a reasonable exercise of the Secretary's discretion. The Agreement to Guarantee contains limitations not imposed by the Act. Pursuant to Section 7.2 of the Agreement, however, the Secretary is expressly authorized to waive any provision of the Agreement intended for the benefit of the United States and is empowered to amend the Agreement to implement the plan.

In reaching their conclusions, MAC's General Counsel and the City's Corporation Counsel reviewed the legislative history of the Act. Particular attention was paid to the history of the
"credit elsewhere" provision of the Act. Based upon this history it is their conclusion that, in determining whether "the City is effectively unable to obtain credit in the public credit markets or elsewhere in amounts and terms sufficient to meet the City's financing needs", access by MAC to the public credit markets will not preclude the issuance of guarantees if the City's financing requirements cannot be satisfied solely by MAC and the City.

In a memorandum prepared by a staff member of the United States Senate Committee on Banking, Housing and Urban Affairs, a view was expressed which is inconsistent with the language of the Act, its development and prior application. At the time the Act was enacted it was understood that inclusion of MAC's market access within the scope of the "credit elsewhere" test, as had been proposed by the Senate would have prevented the City from meeting its full financing needs during fiscal years 1979 and 1980 by precluding the issuance of all or a portion of the guarantees authorized for those years. For this reason, the House version of the provision was included in the final Act. As a result, guarantees were issued during 1979 and 1980 even though MAC was able to and did publicly market its bonds. As was the case then, the financing proposal anticipates that MAC's access to the public markets will be
required to satisfy a portion of the City's total projected financing requirements. MAC's capacity and access, together with that of the City, are not sufficient to provide the anticipated amounts and meet the portion intended to be met through use of the guarantees. The legislative history of the "credit elsewhere" provision clearly indicates that the final text of the "credit elsewhere" provision was intended to accommodate such situations.
June 2, 1980

Mr. Robert F. Vagt
Executive Director
Municipal Assistance Corporation
for the City of New York
Suite 8901
One World Trade Center
New York, New York 10048

Dear Mr. Vagt:

We have reviewed the financing proposal of the Municipal Assistance Corporation for the City of New York ("MAC"). The proposal is designed to assist the City in financing its capital program through December 1984. The proposal would provide for MAC to sell in the public market approximately (i) an aggregate of $800 million of its bonds during the City's 1981 and 1982 Fiscal Years in eight quarterly installments of approximately $100 million each, in addition to the $862 million of its bonds now scheduled to be sold privately during this period, and (ii) at least an aggregate of $1 billion of its bonds during FY '83 and '84 in quarterly installments of approximately equal amounts. In addition, the proposal calls for the sale to City and State Pension Funds of up to $900 million of federally guaranteed City bonds during FY '81 and '82.

Assuming normal market conditions, in our opinion MAC's bonds could be sold in the public market as described above at reasonable interest rates and terms if no more than approximately $600 million of MAC bonds were sold to the public during any year. We would like to stress, however, that such market access is dependent upon your proposal, or one similar to it, being adopted as the City's Financing Plan. Such a Financing Plan is necessary in order to assure the public market that the City will have access to adequate financing to meet its capital needs in an orderly manner.
If such a Financing Plan is not in place, MAC's access to the public markets could be substantially impaired. Without such a Financing Plan, there can be no assurance that MAC would be able to continue to sell its bonds in the public market in the amounts needed to assist the City in meeting its capital needs.

Very truly yours,

GBH/lab
MEMORANDUM

TO: Edward I. Koch
MAYOR

FROM: Allen G. Schwartz
Corporation Counsel

RE: Federal "Standby Guarantees"

DATE: August 11, 1980

You have asked me to determine whether there is any legal impediment under the New York City Loan Guarantee Act of 1978 (the "Act")\(^1\) or the Agreement to Guarantee dated as of November 15, 1978 among the United States, The City of New York (the "City") and others (the "Agreement to Guarantee") to the issuance by the Secretary of Treasury (the "Secretary") of Standby Guarantees during the City's 1981 and 1982 fiscal years. For the reasons discussed below, I have concluded that (i) no condition exists at this time which precludes the Secretary from issuing such guarantees and (ii) a number of factors suggest the desirability of the Secretary's issuing such guarantees under the loan guarantee program.

As you know, Standby Guarantees are defined in the Agreement to Guarantee as "Guarantees issued or to be issued pursuant to this Agreement during the 1981 Fiscal
Year or the 1982 Fiscal Year." Pursuant to the Agreement to Guarantee, Standby Guarantees covering up to $900 million of long-term City indebtedness may be issued.

A. "Credit Elsewhere" Test

Section 103 of the Act lists several conditions of eligibility which must be satisfied prior to the issuance of Standby Guarantees. Among these conditions, the most significant potential obstacle is the "credit elsewhere" test contained in Section 103(2) of the Act, pursuant to which the Secretary may issue Standby Guarantees only if:

"...the Secretary determines that the city is effectively unable to obtain credit in the public credit markets or elsewhere in amounts and terms sufficient to meet the city's financing needs."

Since the Municipal Assistance Corporation For The City of New York ("MAC") can apparently sell an aggregate of $800 million of its bonds in FY 1981 and 1982, it may be contended that the City has credit elsewhere and is therefore ineligible for Standby Guarantees. Indeed, Senators William Proxmire and Jake Garn of the Senate Committee on Banking, Housing, and Urban Affairs wrote to the Secretary on June 2, 1980 that "it is clear from the statutory language that so long as MAC has the capacity to meet the city's financing needs in 1981 and 1982, no further Federal guarantees can be issued". Although MAC is a State agency established as a financing agent for the City, a careful reading of the legislative history and the Agreement to Guarantee (executed
pursuant to the Act) reveals that the "credit elsewhere" test applies solely to the ability of the City to obtain credit (which it currently cannot do except in inadequate amounts) and that MAC's capacity to raise funds need not be considered.

The key reference on this subject may be found in the Conference Report which reconciled the Senate and House versions of the legislation. In the section discussing the "credit elsewhere" test, the following language appears:

Credit Availability

"The House bill required, as a condition to the making of guarantees, that the Secretary determine that the city is effectively unable to obtain credit through traditional sources in amounts and terms sufficient to meet its financing needs. The Senate amendment required the determination by the Secretary that credit was not otherwise available to the city or a financing agent on reasonable terms.

The conference report contains the House provision."6

Since the Conference Report specifically rejected the Senate version of the legislation, which would have included MAC, the City's "financing agent", in applying the "credit elsewhere" test, the Secretary is directed to consider only the City's ability to obtain credit in making the determination required by this provision. Accordingly, the final wording of the "credit elsewhere" test, contained in Section 103(2) of the Act and Section 3.1.2 of the Agreement to Guarantee, refers only to the credit of the City and contains no reference
to MAC whatsoever.

Section 3.3.3 of the Agreement to Guarantee, dealing
with Standby Guarantees, supports this interpretation of the
"credit elsewhere" test:

"Section 3.3.3 Standby Guarantees. The issuance
of the Standby Guarantees shall be subject to
compliance by the City, the State and MAC with
such other terms and conditions as the Secretary
shall reasonably deem appropriate pursuant to the
Guarantee Act, including the inability of MAC to
sell MAC Indebtedness in the public or private
credit markets on reasonable terms and conditions."

Although the Secretary may refuse to issue guarantees based
on this provision, it is significant that MAC's market
access or lack thereof is merely deemed an additional term
or condition for the Secretary to consider in issuing
Standby Guarantees, rather than a required component of the
"credit elsewhere" test contained in Section 3.1.2 of the
Agreement to Guarantee, which provides as follows:

"Section 3.1.2 Credit Elsewhere. The City is
effectively unable to obtain credit in the public
credit markets or elsewhere in amounts and on
terms sufficient to meet the City's financing
needs as set forth in the Financial Plan and the
Secretary shall have received a certificate of the
Financial Advisor and the City to such effect."

Accordingly, the conclusion is inescapable that the omission
of MAC in the "credit elsewhere" provision was not an oversight,
but rather a deliberate action consistent with the Committee's
intentions.

Further, it should be understood that MAC proposes to
use its $800 million of public debt issuances during FY 1981-
1982 to fund an escrow that will help meet the City's capital needs during the three fiscal years after the end of the original four year Financing Plan. To enable MAC to finance these needs during FY 1983-1985, the State legislature has increased MAC's borrowing authority by $1.2 billion. This additional borrowing capacity, in combination with the escrow to be funded by MAC during FY 1981-1982, is designed to ensure that the City has a reasonably certain source of capital after the expiration of the Federal guarantee program. The guarantees are essential to this effort, since MAC could not borrow enough to fund $900 million of FY 1981-1982 City capital expenses (which is the role proposed for the guarantees) in addition to the escrow necessary to provide for the post-FY 1982 period.

Of course, under the original four year Financing Plan, it was assumed that MAC financing would be available to the City to meet all capital expenses in FY 1981-1982 on the theory that full market access would be regained for City bonds immediately after completing one City fiscal year with a budget balanced in accordance with generally accepted accounting principles. Two developments have made it unwise to continue to proceed on the basis of this assumption. First, it now appears unlikely that the City's bonds will receive an investment grade rating from both of the major credit rating agencies until a series of balanced budgets
has been reported. Second, the condition of the credit markets has been and may continue to be extraordinarily unfavorable to issuers whose credit is perceived as unproven.

In terms of the "credit elsewhere" test, the role proposed for MAC financing in FY 1981 and 1982 is thus seen to be similar to its role during the past two years: despite the issuance of approximately $847 million of MAC bonds to the public and $938 million in private placements for purposes other than financing the City's immediate capital needs, the "credit elsewhere" test was deemed to be satisfied because these other needs were recognized as valid and essential to the success of the four year plan. Financing the MAC escrow is no less valid and essential since there now appears to be no other method available to ensure that the City's capital needs can be met after FY 1982 through the public credit markets—which is a paramount objective of the Act. To the extent MAC financing is needed to satisfy this objective, it is clearly not available for other purposes and cannot be considered a source of credit to meet the City's current capital needs.

Based on the foregoing, the Secretary clearly has the authority to issue Standby Guarantees notwithstanding MAC's ability to issue bonds during FY 1981 and 1982.
B. Other Applicable Provisions

Before considering the advisability of the Secretary's issuing Standby Guarantees in FY 1981 and FY 1982, a brief discussion of two other provisions of the Act and the Agreement to Guarantee is necessary. First, Section 2.1 of the Agreement to Guarantee provides that the amount of available Standby Guarantees must be reduced by any City or MAC public sales made after June 30, 1980. Once again, however, action by the Secretary in this respect is discretionary, not mandatory. Pursuant to Sections 2.1 and 7.2 of the Agreement to Guarantee, the Secretary has the right to waive this requirement, thereby enabling Standby Guarantees to be issued notwithstanding any City or MAC public bond sales during this period. 8

Second, Section 103(4) of the Act and Section 3.1.4 of the Agreement to Guarantee direct the Secretary to determine as a condition to the issuance of Standby Guarantees that the City will be able to meet all of its long-term and seasonal borrowing needs through the public credit markets after June 30, 1982. At this time, there is doubt as to whether the City alone will be able to achieve this objective by the original target date. As discussed above, however, with assistance from MAC, this goal will be met, and further Federal assistance will not be required provided the remaining guarantees are made available. A review of the legislative history on this point reveals that assistance from MAC is not precluded and will not affect the City's compliance with
C. Advisability of Issuing Standby Guarantees

As the preceding discussion demonstrates, each of the potentially troublesome conditions to the issuance of Standby Guarantees can be satisfied. Assuming that all of the remaining conditions set forth in the Act are met, which we are advised is presently projected, the only relevant issue then is whether it is desirable for the Secretary to proceed.

It is clearly within the spirit and objectives of the Act for the Secretary to issue Standby Guarantees under the circumstances now prevailing. The objectives of the Act were (i) to enable the City to effect needed reforms so that it could satisfy all of its financing needs after June 30, 1982 without Federal financing assistance and (ii) to assist the City with its financing needs during the interim period.

Despite the fact that the City has effected all the fiscal reforms envisioned by the Guarantee Act well within the schedule set forth, unforeseen conditions have made it advisable to give MAC the means to finance the bulk of the City's capital needs until three years of truly balanced City budgets have been completed and audited. As discussed above, use of the remaining Federal guarantees will achieve this. If the Federal guarantees are withheld, there will be a substantial risk that MAC and the City will be unable to finance the City's capital needs after the end of the guarantee program, thus inviting the risk that continued Federal
financing assistance will have to be sought for the period after FY 1982. Since the use of the remaining guarantees will provide reasonable assurance that MAC can furnish the City with financing for the necessary period, it would appear to be in the interest of the Federal government to choose this option rather than the risk associated with refusing further guarantees. In this connection, Senators Proxmire and Garn indicated in their recent letter that "it is clearly preferable to return the responsibility for meeting all of New York City's financing needs to the State and local level as soon as possible."

Although Standby Guarantees were considered an alternative under the Financing Plan to be used only if both the City and MAC could not sell long-term bonds to the public in sufficient amounts on reasonable terms and conditions in FY 1981 and 1982, it is clear that the Financing Plan can be modified from time to time with the consent of the Secretary. An adjustment of the Plan, at this time, would be legally permissible and appropriate to complete the recovery program approved by Congress in 1978.
FOOTNOTES


2 Section 1.1 of the Agreement to Guarantee (definition of "Standby Guarantees")

3 Section 2.1 of the Agreement to Guarantee

4 Oral statement by Felix G. Rohatyn, Chairman of the Board of Directors of MAC, at the MAC Board of Directors meeting held on June 3, 1980.

5 The general view is that the City would be able to sell publicly approximately $100 million of its bonds as a speculative investment. Although the City is obligated by Section 103(10) of the Act to offer to sell its long-term bonds to the public in FY 1981 and FY 1982, the Secretary has the authority to waive all such required City bond sales. The City plans to issue $100 million of bonds in the last quarter of the current fiscal year.


7 Testimony of Freda Stern Ackerman, Senior Vice President of Moody's Investors Service, before the Senate Committee on Banking, Housing and Urban Affairs on January 28, 1980, in which she stated the following:

"The general rule in financial analysis is that three years of sound, realistically balanced operations can be defined as a trend. We expect the end of fiscal 1981 or 1982, whichever the City chooses, to mark the beginning of that trend"
which, in the case of an issuer so previously unmindful of the principles of sound administration, would require much longer than the generally accepted rules for it to be adequately characterized."

Section 2.1 of the Agreement to Guarantee provides in pertinent part:

"Unless the Secretary shall otherwise agree, the amount of Standby Guarantees which may be used during any Fiscal Year shall be reduced by the amount of Long-Term City Indebtedness and MAC Indebtedness issued after June 30, 1980 other than under the Financing Agreements or to MAC and other than to holders of Long-Term City Indebtedness or MAC Indebtedness to refund such Indebtedness held by such holders."

The Senate report indicates that Congress' intent in this matter was only that the City be able to meet its financing needs in the credit markets without further Federal assistance. S. Rep. No. 95-932, 95th Cong., 2d Sess. 15, reprinted in [1978] U.S. Code Cong. & Ad. News 1227-28.

Section 1.1 of the Agreement to Guarantee-definition of Financing Plan:

"The financing plan for the City providing for the issuance and sale of MAC Indebtedness and City Indebtedness pursuant to the Financing Agreements and in the public credit markets as described on Exhibit A, as such plan may be modified from time to time with the consent of the Secretary."
MEMORANDUM

To: Municipal Assistance Corporation For The City of New York
From: Paul, Weiss, Rifkind, Wharton & Garrison
Subject: Issuance of "Standby Guarantees" by the Secretary of the United States Department of the Treasury

You have informed us that the Municipal Assistance Corporation For The City of New York (the "Corporation") and The City of New York (the "City") are currently developing methods of financing the City's capital projects during the fiscal years immediately following expiration of the four-year financing plan of the City adopted in November 1978 (the "Financing Plan"). In connection with this study, you have asked us to determine whether, under the circumstances described below, the Secretary of the United States Department of the Treasury (the "Secretary") may permissibly issue "Standby Guarantees"* pursuant to the New York City Loan Guarantee Act of 1978 (the "Guarantee Act") and the Agreement to Guarantee (the "Agreement to Guarantee"), dated as of November 15, 1978, by and among the United States of America (the "United States"), acting by and through the Secretary, the State of New York (the "State"), the City, the New York

* As used herein the term "Standby Guarantees" refers to Guarantees to be issued by the Secretary pursuant to the Agreement to Guarantee during the City's 1981 and 1982 fiscal years.
State Financial Control Board and the Corporation.

As discussed in detail below, we have concluded that the Secretary is empowered by the Guarantee Act to issue the Standby Guarantees under the circumstances described. In addition, we have concluded that the Secretary has the contractual authority under the Agreement to Guarantee to issue such Standby Guarantees in such circumstances if he were to waive -- as he has the legal right, but not the obligation to do -- the contractual requirement contained in the Agreement to Guarantee that the amount of such Standby Guarantees be reduced in any fiscal year of the City by the amount of bonds of the Corporation issued to the public during such fiscal year. (These conclusions assume, of course, that all other required conditions precedent to the issuance of such Standby Guarantees have been fulfilled.)

Statement of Facts

The Financing Plan was adopted to provide approximately $4.5 billion of long-term financing for the City during its 1979 through 1982 fiscal years. As outlined in Exhibit A to the Agreement to Guarantee, the Financing Plan includes four long-term financing components: (i) the sale of up to $1.8 billion of the Corporation's bonds to various commercial banks, savings banks and insurance companies and
four City employee pension funds (the "City Pension Funds"); (ii) the sale of up to $750 million of federally guaranteed City bonds to the City Pension Funds and two State employee pension funds (the "State Pension Funds"); (iii) sales to the public of up to $1 billion of the Corporation's bonds; and (iv) sales to the public during the City's 1981 and 1982 fiscal years of up to $950 million of City bonds that are not federally guaranteed, or, to the extent neither the City nor the Corporation is able to sell its bonds to the public in sufficient amounts on reasonable terms and conditions to fulfill this element of the Financing Plan, the United States has agreed to guarantee up to $900 million of City bonds and the City and State Pension Funds have agreed to purchase such bonds (see footnote 6 of such Exhibit A).

The major portion of the funds to be generated by the Financing Plan are to be used to finance the City's capital programs during the four years of the Plan. As stated in the report of the United States Senate Banking, Housing and Urban Affairs Committee, the primary objective of the Plan is to enable the City to regain full reentry into the long-term public credit markets, thereby permitting the City to finance its capital needs on its own after the expiration of the Plan. (S. Rep. No. 95-952, 95th Cong. 2d Sess. 8, 14.) To that end, Section 103(10) of the Guarantee Act and Section 6.16 of the Agreement to Guarantee require that the City
attempt to sell through public offerings some amount of long-term bonds during its 1981 and 1982 fiscal years, unless the Secretary "determines that such offer would be inconsistent with the financial interests of the City." (Section 6.16 of the Agreement to Guarantee.) To the extent the City is unable to sell such bonds, the Financing Plan (as outlined in Exhibit A to the Agreement to Guarantee) provides that the City's capital needs would be met during those years, in the first instance, by sales of the Corporation's bonds to the public or, if the Corporation is unable to market publicly such bonds on reasonable terms, by the sale of federally guaranteed City bonds to the City and State Pension Funds.*

You have advised us that despite the successful operation of the Financing Plan to date and the significant budgetary progress the City has made during the past few years, it has become increasingly apparent that the City will be unable to market publicly the amount of bonds required to finance its capital needs during its 1981 and 1982 fiscal years. In addition, it appears unlikely that the City will be able to sell publicly such required amount of bonds during

* It should be noted that a large portion of the City's capital needs during its 1981 and 1982 fiscal years will be met pursuant to the Financing Plan by private placements of the Corporation's bonds to various commercial banks, savings banks and insurance companies (collectively the "Financial Institutions") and the City Pension Funds pursuant to the Bond Purchase Agreement, dated as of November 15, 1978, by and among, such Financial Institutions, City Pension Funds and the Corporation.
its 1983 and 1984 fiscal years. Accordingly, alternative sources of financing will have to be arranged to enable the City to finance its capital needs during those years. You have informed us that the City's bondable capital requirements are expected to range from approximately $700 million to $1.2 billion during each of its 1981 through 1984 fiscal years.

In this regard, the Corporation has stated its intention to ask the State legislature for increased borrowing authority and an extension of its authorization to issue debt through the 1984 calendar year in order to be prepared to help the City meet its financing needs to the extent necessary during the City's 1983 and 1984 fiscal years. The Corporation has recently been advised by its managing underwriters, however, that, assuming no unforeseen dramatic changes in the economy or market conditions for municipal bonds, it is their expectation that the Corporation's ability to market publicly bonds on reasonable terms will be limited to approximately $600 million annually through the City's 1984 fiscal year. Consequently, if the Corporation were to issue such amount of bonds during the 1983 and 1984 fiscal years of the City, the proceeds of such sales, together with the limited amount of bonds that the City is expected to be able to market publicly in those years, would be insufficient to finance all of the City's projected capital needs for such years.
You are therefore considering a proposal (the "Proposed Plan") pursuant to which the Corporation would issue to the public during the City's 1981 and 1982 fiscal years the amount of bonds it is capable of issuing on reasonable terms, and set aside the proceeds of such sales to, in effect, prefund a portion of the City's capital needs for its 1983 and 1984 fiscal years. The funds derived from these sales would be available to the City to the extent required to finance the City's projected capital programs in the City's 1983 and 1984 fiscal years. Thus, the Proposed Plan would permit the City to meet all of its 1983 and 1984 capital requirements without the necessity of Federal assistance in the form of guarantees or otherwise. Thereafter, assuming the City is able to continue the budgetary progress it has made to date, it is expected that the City will regain sufficient access to the public credit markets to finance its capital projects entirely through the public sale of its bonds.

In connection with the Proposed Plan, we have reviewed the New York State Municipal Assistance Corporation Act, as amended by the Municipal Assistance Corporation For The City of New York Act (the "Act"), other laws which we considered relevant and the agreements implementing the Financing Plan and are aware of no prohibitions against the issuance of bonds by the Corporation in one year to
prefund a portion of the City's capital programs for subsequent years.* In addition, we believe such issuance of bonds would be within the Corporation's authorized purposes. We assume, of course, that you will be consulting with Hawkins, Delafield & Wood for their views with respect to any arbitrage problems which may result from the Proposed Plan.

As discussed above, the Financing Plan contemplates that the City's capital projects for its 1981 and 1982 fiscal years will be partially financed by public sales of City bonds during such years, and in the event the City is unable to sell such bonds on reasonable terms, such capital projects would be partially financed, in the first instance, by public sales of the Corporation's bonds during those years, none of which sales are currently scheduled. Because, however, the Proposed Plan contemplates that the proceeds of any public sales of the Corporation's bonds during the City's 1981 and

* As you know, Section 3037 of the Act provides that any amounts paid to the City by the Corporation to finance the City's capital projects are to be evidenced by bonds of the City delivered to the Corporation. Although restrictions may exist with respect to the issuance of bonds by the City in one year to prefund its capital programs for subsequent years, such restrictions should not affect the Proposed Plan, because bonds of the City are to be delivered to the Corporation pursuant to Section 3037 only at the time the Corporation pays moneys to the City, which, as we interpret the Proposed Plan, will not occur until the year in which the moneys are actually required for the City's capital program.
1982 fiscal years would be used to prefund a portion of the City's 1983 and 1984 capital requirements, other funds will be required to finance the City's 1981 and 1982 capital projects. Under the Proposed Plan, such funds would be provided from sales of federally guaranteed City bonds to the City and State Pension Funds provided the Secretary is willing to issue the Standby Guarantees. Thus, you have asked us to determine whether the Secretary may permissibly issue such Standby Guarantees under the factual situation described.

Legal Discussion

The Guarantee Act and the Agreement to Guarantee authorize the Secretary to guarantee the payment of principal of and interest on up to $1.65 billion in aggregate principal amount of outstanding City indebtedness issued to any City or State employee pension fund during the 1979 through 1982 fiscal years of the City. Pursuant to the Guarantee Act and the Agreement to Guarantee, the Secretary has guaranteed the payment of $750 million of City bonds during the City's past two fiscal years, and is authorized pursuant to Section 2.1 of the Agreement to Guarantee to guarantee, on a standby basis, the payment of $900 million of such bonds during the City's 1981 and 1982 fiscal years if certain specified conditions are met. After reviewing the Guarantee Act and the
Agreement to Guarantee, we believe that there are three such conditions which could clearly affect the Secretary's ability to issue the "Standby Guarantees" under the Proposed Plan.

One such condition is contained in Section 103(2) of the Guarantee Act which provides that prior to the issuance of any Guarantee the Secretary must determine that:

"the city is effectively unable to obtain credit in the public credit markets or elsewhere in amounts and terms sufficient to meet the city's financing needs."

Because the Proposed Plan calls for the Corporation to raise money in the public credit markets during the same period the Standby Guarantees are to be issued, two questions may be raised with respect to the "credit elsewhere" test contained in Section 103(2). First, should the test be interpreted to require that both the City and the Corporation be unable to obtain credit in the public credit markets or elsewhere prior to the issuance of any Guarantees? Second, even if the answer to that question is No, if the Corporation has raised money does it become an "elsewhere" where the City might obtain credit?

Section 103(2) of the Guarantee Act was adopted, virtually without change, from the House version of the Guarantee Act. The Senate version of such Act had provided, however, that "the Secretary determine that credit is not otherwise available to the city or a financing agent [the
Corporation] on reasonable terms before he agrees to guarantee . . . any city indebtedness." (S. Rep. No. 95-952, 95th Cong. 2d Sess. 13). The adoption of the House version of the bill, and the concomitant rejection of the Senate version, we believe, evinces a Congressional intent that only the City's ability to obtain credit in the public credit markets or elsewhere be considered by the Secretary prior to the issuance of any Guarantees.*

As to the second question, although the Corporation is expected to have certain market access during the City's 1981 and 1982 fiscal years, the Corporation intends to use that access under the Proposed Plan not to finance the City's capital needs for those years but for the purpose of raising funds to enable the City to finance its capital needs, without Federal assistance, in the years following the expiration of the Financing Plan. As discussed above, this purpose is consistent with the primary objective of the Financing Plan.

* The House Report, in discussing Section 103(2), states in pertinent part that such Section:

" . . . requires the Secretary to determine that the city's financing needs cannot be met effectively through borrowings in the private credit market. The use of the word "effectively" is intended to create a test of the practical unavailability of credit, including maturity and rate, through the private market. The Secretary has discretion to determine when that test has been met."

Accordingly, because the Corporation will use its full available market access for this purpose, it will be unable to issue indebtedness in the public markets on reasonable terms to provide funds for the City's capital needs for the City's 1981 and 1982 fiscal years. Similarly, during the City's 1979 and 1980 fiscal years, the Corporation had certain access to the public credit markets but used that access not to finance the City's capital needs for those years but for other purposes consistent with the Financing Plan without causing the City to fail to meet the "credit elsewhere" test.

For the reasons discussed above, therefore, we believe that it would be appropriate and consistent with the Guarantee Act for the Secretary to determine that the requirements of Section 103(2) of the Guarantee Act have been satisfied in connection with the issuance of Standby Guarantees under the Proposed Plan.

Sections 2.1 and 3.3.3 of the Agreement to Guarantee provide in pertinent part that the amount of Standby Guarantees which may be issued in the City's 1981 and 1982 fiscal years shall be reduced by the amount of the Corporation's bonds publicly sold during those years. As discussed above, this requirement is consistent with the Financing Plan (as outlined in Exhibit A to the Agreement to Guarantee) which contemplates that the public sale of the Corporation's bonds act as the
first back-up to the extent the City is unable to market publicly its bonds on reasonable terms during its 1981 and 1982 fiscal years, which event now appears likely. However, since this requirement is contained only in the Agreement to Guarantee and not in the Guarantee Act, it may be waived by the Secretary in accordance with Section 7.2 of the Agreement to Guarantee, which provides in relevant part that "[t]he Secretary may waive any provision of [the] Agreement ... which is intended for the benefit of the United States and may consent to any modification of any term [t]hereof ... which is intended for the benefit of the United States as he may deem appropriate." Correspondingly, Section 2.1 of the Agreement to Guarantee specifically provides that the requirement that the amount of the Standby Guarantees in any year be reduced by the amount of the Corporation's bonds publicly sold during such year is subject to the Secretary agreeing otherwise. Consequently, because the Proposed Plan is designed to enable the City to finance its capital needs after the expiration of the Financing Plan without Federal assistance, which, as discussed, is similarly the ultimate objective of the Financing Plan, we believe that the Secretary has the legal power to waive this requirement and that it would be appropriate for the Secretary to grant such a waiver.

The third condition which could affect the Secre-
tary's ability to issue Standby Guarantees is contained in Section 103(4) of the Guarantee Act which provides that prior to the issuance of any Guarantee the Secretary must determine that:

"during the four-year period ending June 30, 1982, the long-term and seasonal borrowing needs of the city . . . will be met through commitments from the State, an agency of the State, private sources, or through the public credit markets, in amounts which will be sufficient to enable the city, when the guarantee authority conferred by this title has terminated, to meet all of its long-term and seasonal borrowing needs through the public credit markets . . . ."

This condition would apparently be satisfied under the Proposed Plan because the primary objective of such Plan is to enable the City to finance its capital needs in the years immediately following the expiration of the Financing Plan through the public sale of the City's and the Corporation's bonds. Although literally read, Section 103(4) could be interpreted to require that the City meet on its own, without assistance from the Corporation, all of its financing needs beginning with its 1983 fiscal year, the legislative history to the Guarantee Act indicates that what is contemplated by Section 103(4) is that the City merely be able to meet its financing "needs in the credit markets without Federal assistance." (S. Rep. No. 95-952, 95th Cong., 2d Sess. 15.) In fact, the report of the Senate Banking, Housing and Urban Affairs Committee states that it is desirable
that the Corporation retain some borrowing authority after the expiration of the Financing Plan in case such authority is required to help the City meet its financing needs once the guarantee authority terminates. (S. Rep. No. 95-952, 95th Cong., 2d Sess. 10.) Thus, we believe that the Secretary would be able to make the determination required by Section 103(4) under the Proposed Plan.

Accordingly, if the Secretary were to waive the requirement contained in Sections 2.1 and 3.3.3 of the Agreement to Guarantee, and assuming all other required conditions precedent to the issuance of the Standby Guarantees are satisfied, we are aware of no legal impediments to the issuance of the Standby Guarantees by the Secretary under the Proposed Plan.

PWRW&G
Summary of Presentation to the Hon. G. William Miller  
Secretary of the Treasury  

by  
The City of New York  
Municipal Assistance Corporation  
For The City of New York  

September 10, 1980  

In the fall of 1978, the City, MAC, State and Federal govern- 
ments together with various financial institutions and City  
and State Pension Funds developed and implemented a plan which:  

- provides capital financing assistance to the City  
during a four year period ending June 30, 1982.  

- provided for the City's gradual reentry into  
the public long term credit markets.  

- required the City to undertake various budgetary  
and management reforms designed to produce GAAP  
balanced operating budgets by no later than fiscal  
year 1982.  

In authorizing the issuance during fiscal years 1979 to 1982  
of up to $1.65 billion of guaranteed City debt as part of the  
plan, the Congress recognized that an orderly program of  
investment in the City's physical infrastructure was essential  
to its fiscal and economic recovery and to its ultimate  
reentry into the long term credit markets.  

To date financings have proceeded according to the plan:  

- The City has issued $750 million of guaranteed  
bonds to the City and State pension funds.
MAC has issued $938 million of the $1.8 billion to be issued to the various financial institutions and City pension funds.

MAC has sold publicly $847 million of its bonds.

The City has met most of its seasonal borrowing requirements during fiscal years 1979 and 1980 through the public issuance of $275 million and $375 million of City notes in 1979 and 1980, respectively.

The proceeds of the long term bond sales have been used to finance the City's capital program, fund the last vestiges of the City's operating budget deficits, meet MAC's capital reserve fund requirements, fund the Guaranty Fund and continue MAC's refunding program.

Although future budgetary problems remain, the City has made considerable progress in controlling its operating budget and revitalizing its capital program.

The City has overhauled its financial reporting and budgetary problems which have enabled it to adopt a GAAP balanced budget for fiscal year 1981 -- a year earlier than required.

The City has met every budget target set out for it.

The City has restrained the growth in total budgetary outlays to 12% while the State's expenditures have grown 33% and the federal government's 66%.

Projected capital spending has increased to a total of $4.7 billion for fiscal years 1981 to 1985. Over 70% of this amount represents investment in the City's basic infrastructure.
Despite this progress, it appears unlikely that the City will be able to sell publicly its bonds in the amounts originally anticipated. To provide the necessary resources to assure adequate financing for the City's renewed capital program, MAC and the City have proposed an extension of the existing plan through December 1984. (See Table 1.) Specifically, the plan:

- anticipates that the City will sell at least $1.7 billion of its bonds in the public markets during fiscal years 1981 to 1985.
- requires MAC to sell approximately $1.9 billion of its bonds publicly during the period ending December 31, 1984.
- projects that the remaining $862 million of MAC's private placements to the financial institutions and pension funds will be completed as scheduled and that the City will complete the issuance of the remaining $900 million of its bonds to be guaranteed under the New York City Loan Guarantee Act of 1978.

MAC's issuance capacity is insufficient to provide for shortfalls in City issuances and the absence of the remaining $900 million of guaranteed City debt to be issued during fiscal years 1981 and 1982. (See Figure 1 and Table 2.)
TABLE 1

Financing Requirements and Sources
Fiscal Years 1981 to 1985

(In $ Millions)

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</tr>
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<td>Total</td>
<td>887</td>
<td>1,225</td>
<td>1,100</td>
<td>1,100</td>
<td>1,000</td>
<td>5,312</td>
</tr>
</tbody>
</table>

Sources

| City - Guaranteed     | 300  | 600  |      |      |      | 900   |
| - Public*             | 100  | 200  | 300  | 400  | 700  | 1,700 |
| MAC - Private         | 537  | 325  |      |      |      | 862   |
| Public                | 400  | 400  | 400  | 350  | 300**| 1,850 |
| Sub-Total             | 1,337| 1,525| 700  | 750  | 1,000| 5,312 |

Reserve for Future Capital Requirements
(Deposes)/Withdrawals

|                   | (450)| (300)| 400 | 350 | 0    | 0     |

Total for Current Requirements

|                  | 887 | 1,225| 1,100| 1,100| 1,000| 5,312 |

* To the extent City public issues vary from the indicated schedule, MAC issues may be adjusted accordingly.

** To be issued during first six months of fiscal year 1985.
AGGREGATE MAC ISSUANCE FOR THE PURPOSE
OF STATUTORY LIMITATION UNDER PROPOSED PLAN
Fiscal Years 1981 to 1985

In Billions

12
11
10
9
8
7
6
5
4
3
2
1
0


Proposed Plan
Proposed Plan
Proposed Plan
Without Guarantees
Without Guarantees and
Assuming No City Issuances
<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Proposed Plan</td>
<td>7,646</td>
<td>8,221</td>
<td>8,621</td>
<td>8,971</td>
<td>9,271</td>
</tr>
<tr>
<td>Proposed Plan Without Guarantees</td>
<td>7,846</td>
<td>8,646</td>
<td>9,246</td>
<td>9,896</td>
<td>10,000*</td>
</tr>
<tr>
<td>Proposed Plan Without Guarantees And Assuming No City Issuances</td>
<td>7,946</td>
<td>8,946</td>
<td>9,846</td>
<td>10,000**</td>
<td>10,000**</td>
</tr>
</tbody>
</table>

* To provide for all of the financing requirements in 1985 would require MAC to exceed its statutory issuance limitation by $196 million. If alternative financing sources are unavailable, the City's level of capital expenditures must be reduced by that amount.

** To provide for all of the financing requirements in 1984 and 1985 would require MAC to exceed its statutory issuance limitation by $896 million and $1,896 million, respectively. If alternative financing sources are unavailable, the City's level of capital expenditures must be reduced by the aggregate $2,792 million by 1985.
March 4, 1980

The Honorable Don Edwards, Chairman
Subcommittee on Civil and Constitutional
Rights
U.S. House of Representatives
Washington, D.C. 20515

Dear Representative Edwards:

The Governmental Debt and Fiscal Policy Committee of the Municipal Finance Officers Association (MFOA) has recently taken a position in support of amending the Bankruptcy Reform Act of 1978 as it affects certain types of municipal debt. MFOA represents 8,000 members who are state and local government finance officials, appointive or elective, and public finance specialists.

As was pointed out at your Subcommittee hearings on November 28, 1979, certain bonds issued by state and local governments which have been secured by a specific pledge of tax or other revenues will become unsecured obligations of the municipality upon the commencement of a bankruptcy proceeding. The members of our Governmental Debt and Fiscal Policy Committee unanimously agreed that the uncertainty created by this section of the Bankruptcy Code can adversely affect the marketing of certain tax-exempt bonds.
We hope that the Subcommittee on Civil and Constitutional Rights will adopt the changes which were suggested by state and local government representatives at the November 28, 1979, hearings. If you or your staff should need further information from MFOA, please contact Jeff Esser, our Washington Director of Liaison, at 466-2014.

Sincerely,

Robert M. Odell
City Treasurer
Los Angeles, California
and
Chairman, Governmental Debt and Fiscal Policy Committee, MFOA

JLE: ugb

cc: Representative John F. Seiberling
Professor Charles F. Vihon

bcc: Mr. Thomas De Rogatis
February 27, 1980

The Honorable Don Edwards
Chairman
Subcommittee on Civil and Constitutional Rights
U.S. House of Representatives
Room 407
House Office Building Annex One
Washington, D.C. 20515

Re: H.R. 5447/S. 658

Dear Chairman Edwards:

We understand that the Subcommittee on Civil and Constitutional Rights is now continuing its consideration of technical amendments to the Bankruptcy Reform Act of 1978. As you recall, the Public Securities Association, which represents dealers and dealer banks that provide underwriting and financial advisory services to state and local governments, testified at the Subcommittee hearing on November 28, 1979 regarding the effects of certain provisions of the Act on the municipal securities market.

At the Subcommittee hearing, PSA and others involved in state and local government finance pointed out the need to provide legislative relief from the possible effects of Section 552 of the Act on municipal revenue bonds and other hybrid obligations which may be secured by particular revenues of the governmental unit and by the full faith and credit of the issuer. It was our belief that members of the Subcommittee recognized the effects of Section 552 on municipal financial practices and intended to give careful consideration to remedial legislation during markup of the technical amendments bill. PSA believes the following important points should be considered in drafting the appropriate amendments.

1. State and local government financings differ significantly from corporate financings in that, generally, a municipality is unable to pledge its
assets when borrowing money. Instead, it pledges either its taxing power or particular revenues (or both) as security to bondholders.

2. State laws determine the types and amounts of debts municipalities can issue. Such laws may provide for revenue bond issues or for hybrid obligations known as "double-barreled" general obligation revenue bonds. Some states, for example require that all bonds issued by a municipality, even those secured by particular revenues, be general obligations of the issuer. In any event, state laws will provide limitations on the revenues that can be pledged by issuing jurisdictions.

Sec. Advisory Commission on Intergovernmental Relations, Significant Features of Fiscal Federalism 1976-77, Volume II Revenue and Debt, Table 61 and Table 62.

3. The issuance of "double-barreled" obligations can enable municipalities to work out financial difficulties and, thereby, avoid a municipal debt adjustment proceeding under federal law. We believe this is consistent with the intent of Congress in drafting the federal statutory framework for municipal debt adjustment.

PSA believes that federal bankruptcy law should not unnecessarily interfere with state control over municipal financial affairs. Therefore, we urge the Subcommittee to provide the broadest possible relief to enable municipalities to pledge any sources of moneys as security for bonds as may be permitted under state law. We would be pleased to discuss with you or your staff any specific language that may be considered to accomplish this objective.

Sincerely,

[Signature]

Lawrence H. Brown
Chairman

LBB:ad

cc: All Subcommittee members
STATEMENT OF ROGER KLEIN
EXECUTIVE DIRECTOR OF THE
PUBLIC SECURITIES ASSOCIATION
BEFORE THE SUBCOMMITTEE ON CIVIL AND CONSTITUTIONAL RIGHTS
OF THE
HOUSE JUDICIARY COMMITTEE
REGARDING THE EFFECTS OF
THE BANKRUPTCY REFORM ACT OF 1978
ON THE MUNICIPAL SECURITIES MARKET

Washington, D.C.
November 28, 1979
The Public Securities Association (PSA) is pleased to provide its comments regarding the potential effects of the Bankruptcy Reform Act of 1978 on the financing practices of state and local governments. PSA is a national trade association representing some 280 dealers and dealer banks which provide underwriting and financial advisory services for state and local governments.

In recent months, participants in the municipal securities market have been made aware of some of the potential effects of Section 552 of the Bankruptcy Reform Act on financings by governmental units. The total impact of Section 552 on prospective municipal bond and note issues, as well as outstanding obligations, has not yet been fully determined. However, we are aware of at least one instance in which a municipality, the City of Cleveland, was unable to market a proposed note issue because of the uncertainty created by Section 552 of the Act. It appears that the application of this provision to municipal financing practices could affect the security of holders of municipal revenue bonds and other hybrid obligations which may be secured by particular revenues of the governmental unit and by the full faith and credit of the issuer.

The Senate has provided partial relief from the effects of Section 552. It appears, however, that the remedial action taken by the Senate would apply only to holders of municipal revenue bonds. We urge this Committee to go further by extending relief to holders of hybrid municipal obligations such as the "double-barreled"
general obligation revenue bonds. PSA believes that the unique characteristics of municipal operations and financing practices warrants remedial action by this Committee with respect to the application of Section 552 to municipalities.

Chapter 9 of the new bankruptcy code and its legislative history acknowledge the distinctions between state and local governments and private corporations. In creating the federal statutory framework for the adjustment of debts of a municipality, Congress recognized that federal supervision of a bankrupt municipality is a matter of serious consequence that should be avoided, if at all possible. As we have seen, current Section 552 can foreclose the possibility of a municipality's escaping from default by issuing obligations, as permitted under state law, that would provide adequate security to investors to cause them to purchase the obligations.

A municipality differs significantly from a corporation in its ability to provide security for the money it borrows. A governmental unit exists to provide essential services to its residents. It in turn finances its capital expenditures by selling securities to investors. Debt services on these obligations is paid through either tax receipts or user charges with respect to facilities built with bond proceeds.

Generally, a municipality is unable to pledge its assets when borrowing money in the municipal market. Instead, it pledges either its taxing power or particular revenues as security for the bonds. The promise made to bond and noteholders is that
future tax receipts or revenues pledged will be sufficient to pay
debt service costs. Therefore, the holder of the municipality's
obligations looks to future revenues for payment.

The types and amounts of debt that can be issued by various
state and local governmental units are determined by state law.
Political subdivisions may issue revenue bonds or general obligation
bonds secured by a particular tax or source of revenues. Some
municipalities, such as the City of New York are required to issue
general obligation debt, even if the obligations are payable from
particular revenues (see the attached November 13, 1979 letter
from the Comptroller of the City of New York).

Hybird obligations, such as general obligation notes and bonds
secured by specific revenues, have been used by municipalities such
as the City of New York and Yonkers, New York to finance their
continuing requirements and to avoid the need to resort to
Chapter 9 proceedings. We believe that federal bankruptcy law
should not have the effect of precluding the issuance of obligations
that are permitted under state law, particularly when the result
may be to force a municipality into Chapter 9 proceedings. To
deny the use of this financing tool to municipalities is inconsistent
with the general policy of Chapter 9 and does not take into
consideration the unique and continuing nature of municipal
governments.

Flexibility in structuring financings is an important factor
in keeping interest costs low for state and local governments.
Section 552, because it reduces flexibility, may cause many financially sound governmental units to incur higher borrowing costs.
Chapter 9 of the bankruptcy code appears to have been drafted carefully to maintain the balance between the need for states to maintain control over municipal affairs and the desirability of a uniform procedure for the adjustment of municipal debt, if bankruptcy cannot be avoided. We believe remedial action by this Committee with respect to Section 552 is consistent with those objectives.

PSA would be pleased to cooperate with the Committee to fashion the appropriate relief.
November 13, 1979

Mr. Lawrence H. Brown, Chairman
Public Securities Association
One World Trade Center
New York, New York 10048

Dear Mr. Brown:

I was pleased to learn about the Public Securities Association's recommendation that the Bankruptcy Reform Act of 1978 be amended to provide for recognition of the rights of holders of municipal general obligation revenue debt in the event of a bankruptcy proceeding. This amendment would improve materially the ability of all municipalities to meet both their long and short-term financing needs in the public credit markets.

As matters stand, the Bankruptcy Act's provisions respecting the treatment of property acquired by a debtor after the commencement of a proceeding are unsatisfactory. It seems illogical that holders of revenue obligations which contain the additional security feature of the pledge of the "faith and credit" of the issuer should be treated less favorably than the holders of straight revenue bonds. Additionally, while Senate Bill 658 was intended to remedy the original Act's treatment of after-acquired property in the case of municipal bankruptcy, the revisions may create serious market and related difficulties for those municipal issuers, like the City of New York, whose debt must by law be a general obligation.

The short-term debt recently issued publicly by the City of New York has been "general obligation" revenue anticipation notes. The monies earmarked for repayment of these notes are segregated as provided by State law for the benefit of noteholders.
However, given the "hybrid" nature of these obligations, they would not be protected by present "after-acquired property" provisions of the new Bankruptcy Code. Were the City able to represent to prospective lenders that its debt instruments would remain in a protected position in the event of a bankruptcy, such a representation would significantly improve the City's ability to market its debt.

If I can be helpful to the Public Securities Association in this matter please do not hesitate to call on me.

Sincerely,

[Signature]
November 5, 1979

Honorable Don Edwards
Chairman
Subcommittee on Civil and
Constitutional Rights
United States House of Representatives
407 House Annex #1
Washington, D.C. 20515

Dear Congressman Edwards:

We are writing in connection with your subcommittee's consideration of a House counterpart to Senate Bill 658 (passed by the Senate on September 7, 1979), which contains technical amendments to the new Federal Bankruptcy Code. We are troubled by Section 928(c) of the Senate Bill and its House counterpart, Section 928, both of which exclude municipal revenue debt obligations from the scope of the after-acquired property provisions of Section 552 of the Code. The effect of this exclusion will be to ensure that these revenue obligations would be paid at maturity from a specific revenue stream or other designated source irrespective of the issuer's filing of a debt adjustment petition.

Although we are in complete agreement with the broad objectives of this proposal, we strongly object to the provision as currently drafted because its coverage has been restricted to revenue obligations payable solely from specifically identified revenues. As a result, every municipal issuer which is required by state law to further secure revenue obligations with a pledge of its faith and credit is excluded from the scope of the proposed amendment.* The irony of this situation is that holders of these obligations who have additional security provided by the pledge of faith and credit will actually wind up with less protection in the event of the filing of a petition, an outcome which was surely not intended.

* In the State of New York, for example, all municipal issuers have been required since 1938 by the State Constitution to pledge their faith and credit to their debt obligations.
Hon. Don Edwards

November 5, 1979

It is difficult for us to imagine that Congress intends to create two unequal classes of issuers of municipal revenue debt obligations—those who are permitted by state law to issue debt backed only by specifically identified revenue, and those who are required by state law to issue general obligation debt. Substantial adverse market impact will almost certainly result with respect to the latter's revenue obligations due to this unnecessary dichotomy. Enclosed for your review is a report from the firm of Prescott, Ball & Turbin, which reflects some of the confusion which the proposed new bankruptcy statute has already caused in the financial community.

To remedy this inequity, we urge that, at the very least, the word "solely" be omitted from the proposed amendment. This deletion would remove the discrimination which presently exists against all general obligation issuers without affecting the meaning and intent of the provision. We should mention that it would actually be inconsistent to include the word "solely" in the proposed amendment, since the Code draws no distinction between recourse and non-recourse creditors.

A second and equally important problem arises from the fact that provisions in the Code applicable to municipalities are derived in part from terminology used in the Uniform Commercial Code which do not, in fact, accurately describe the arrangements used to provide for repayment of municipal revenue debt obligations. For instance, all revenue obligations are not issued pursuant to a written security agreement between the creditor and the municipality referring to property and proceeds, as is contemplated by Section 928. Accordingly, we urge that further consideration be given to the important differences between municipal debt obligations and financings in the commercial context for purposes of the Code. We recommend a provision in the form enclosed to resolve the problem presented by Section 929(c) and its House counterpart as presently drafted, and would be pleased to discuss this proposal or any other with you.
We believe that our position is consistent with existing Section 552 of the Code, which recognizes an exception to the termination of security interests in after-acquired property where the security interest attaches to proceeds realized upon a specific pledged receivable. Since the security of a holder of municipal revenue debt obligations fits conceptually into this category, in that the holder has an interest in a specifically identified revenue source (e.g., state general revenue sharing) payable at a specific time, it is logical that the proposed amendment allow the holder's security interest to attach to the monies as the specified revenue is paid.

We can understand your staff's desire not to grant exceptional treatment to any particular type of security, since the Code is designed to provide a general plan for debt adjustment and is intended neither to address particular types of claims, nor to be a tool for encouraging particular sorts of investments. We would point out, however, that by leaving the provision as it presently exists, the bill will enhance one group of municipal revenue debt obligations as investments at the expense of the other for no apparent reason. Since the proposed amendment is clearly not "technical" in nature, we believe it should not be enacted in its present form without at least the opportunity for hearings on the matter.

For all of the foregoing reasons, we urge your subcommittee to give favorable consideration to our proposal when considering this important legislation.

Very truly yours,

Allen G. Schwartz
Corporation Counsel

cc: Senator Edward M. Kennedy
Senator Dennis DeConcini
Congressman Peter Podino
Charles Vihon, Esq.
Suggested Revenue Obligation Provision:

"If any holder of obligations of the debtor is given any rights under applicable non-bankruptcy law to payment of such obligations in whole or in part from specifically identified revenues, including tax revenues, proceeds, rents, profits, or other similar moneys of the debtor, then such rights shall extend to such revenues to the extent permitted under applicable non-bankruptcy law."
S. 658

IN THE HOUSE OF REPRESENTATIVES

SEPTEMBER 11, 1979
Referred to the Committee on the Judiciary

AN ACT

To correct technical errors, clarify and make minor substantive changes to Public Law 95-598.

1 Be it enacted by the Senate and House of Representa-
2 tives of the United States of America in Congress assembled,
3 TITLE I—AMENDMENTS TO TITLE 11 OF THE
4 UNITED STATES CODE
5 SEC. 101. Section 101(2)(D) of title 11 of the United
6 States Code is amended by striking out “or all” immediately
7 after “business”.
8 SEC. 102. (a) Section 101(8)(B) of title 11 of the United
9 States Code is amended by striking out the colon at the end
10 thereof and inserting a semicolon in lieu thereof.
"judicial", and inserting "action or" immediately before "proceeding".

Sec. 167. Chapter 9 is amended by the addition of a section 928 as follows:

"Sec. 928. (a) Except as provided in subsections (b) and (c) of this section, property acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case.

(b) Except as provided in sections 506(c), 544, 545, 547, and 548 of this title and subsection (c) of this section if the debtor and a secured party enter into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to proceeds, product, offspring, rents, or profits of such property, then such security interest extends to such proceeds, product, offspring, rents, or profits acquired by the estate after the commencement of the case to the extent provided by such security agreement and by applicable nonbankruptcy law, except to the extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise.

(c) If the debtor and a secured party enter into a security agreement before the commencement of the case and the
obligation of the debtor is secured by a security interest in
and is payable solely from specifically identified revenues in-
cluding tax revenues, proceeds, rents, profits, or other similar
moneys of the debtor, then such security interest shall extend
to such revenues including specified tax revenues, proceeds,
rents, profits, or other similar moneys acquired by the estate
after the commencement of the case to the extent provided
by such security agreement and by applicable nonbankruptcy
law.”.

SEC. 168. Section 943(b)(5) of title 11 of the United
States Code is amended to read as follows:

“(5) except to the extent that the holder of a par-
ticular claim has agreed to a different treatment of
such claim, the plan provides that on the effective date
of the plan each holder of a claim of a kind specified in
section 507(a)(1) of this title will receive on account of
such claim cash equal to the allowed amount of such
claim; and”.

SEC. 168A. Section 1103(b) of title 11 of the United
States Code is amended by striking out “A person” and in-
serting in lieu thereof “An attorney or accountant”.

SEC. 169. (a) Section 1103(c)(1) of title 11 of the United
States Code is amended by striking out “or debtor in posses-
sion”.

A BILL

To correct technical errors, clarify and make minor substantive changes to Public Law 95-598.

1 Be it enacted by the Senate and House of Representa-
2 tives of the United States of America in Congress assembled,
3 TITLE I—AMENDMENTS TO TITLE 11 OF THE
4 UNITED STATES CODE
5 SEC. 101. Section 101(1) of title 11 of the United
6 States Code is amended by striking out the second "account-
7 ant" and inserting "an individual" in lieu thereof.
SEC. 166. Section 922(a)(1) of title 11 of the United States Code is amended by inserting “a” immediately before “judicial”, and inserting “action or” immediately before “proceeding”.

SEC. 167. Chapter 9 is amended by the addition of a section 928 as follows:

“SEC. 928. (a) Except as provided in subsections (b) and (c) of this section, property acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case.

(b) Except as provided in sections 506(c), 544, 545, 547, and 548 of this title and subsection (c) of this section if the debtor and a secured party enter into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to proceeds, product, offspring, rents, or profits of such property, then such security interest extends to such proceeds, product, offspring, rents, or profits acquired by the estate after the commencement of the case to the extent provided by such security agreement and by applicable nonbankruptcy law, except to the extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise.
“(c) If the debtor and a secured party enter into a security agreement before the commencement of the case and the obligation of the debtor is secured by a security interest in and is payable solely from specifically identified revenues including tax revenues, proceeds, rents, profits, or other similar moneys of the debtor, then such security interest shall extend to such revenues including specified tax revenues, proceeds, rents, profits, or other similar moneys acquired by the estate after the commencement of the case to the extent provided by such security agreement and by applicable nonbankruptcy law.”

SEC. 168. Section 943(b)(5) of title 11 of the United States Code is amended to read as follows:

“(5) except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that on the effective date of the plan each holder of a claim of a kind specified in section 507(a)(1) of this title will receive on account of such claim cash equal to the allowed amount of such claim; and”.

SEC. 168A. Section 1103(b) of title 11 of the United States Code is amended by striking out “A person” and inserting in lieu thereof “An attorney or accountant”.
November 1, 1979


QUESTION PRESENTED

Should the City of New York (the "City") file a petition for bankruptcy under the Federal Municipal Bankruptcy Act of 1978 (the "Act"), what would be the consequence to the sales tax, the stock transfer tax and the unallocated per capita State aid revenues appropriated and available to the Municipal Assistance Corporation For The City of New York ("MAC")?

CONCLUSION

Sections 904 and 922 of the Act concern themselves with the property of the petitioner for bankruptcy; in this case, the City. The money which MAC receives to fulfill its requirements is State money. The City has no claim to said funds until MAC has satisfied all of its requirements; consequently these sections do not affect MAC's ability to receive such money.

DISCUSSION

I. MAC's Funding

Chapters 168 and 169 of the Laws of New York of 1975 amended the New York Public Authorities Law thereby creating MAC. Article 10, Sections 3030 et seq. (McKinney). MAC's purpose is to . . . "creat[e] investor confidence in the
obligations of [the City] . . . " N.Y. Pub. Auth. Law §3031 (McKinney). To fulfill this purpose MAC receives appropriations from two special funds established by the New York State Finance Law (the "Finance Law") and held in the custody of the Comptroller of the State of New York (the "State"), the Municipal Assistance State Aid Fund ("MASAF") and the Municipal Assistance Tax Fund ("MATF"). The Finance Law provides that the State Comptroller shall make payments from these special funds to MAC, in accordance with certificates from MAC.

Per capita State aid is money which is distributed from the State's general fund for the support of local government. N.Y. State Fin. Law, §54 (McKinney). The money is allocated pursuant to a formula contained in the Finance Law, Section 54(2). In all cases, except the City, the money payable to a locality is paid to the chief fiscal officer. In the case of the City, however, the money is specifically allocated by statute to certain uses, including a special account in the MATF and the MASAF for MAC. N.Y. State Fin. Law, §54 (7) (c)(vi), (vii) (McKinney). Any such payment out of the general fund is subject to prior appropriation by the State Legislature. N.Y. Const., Art. 7, §7.

The sales tax which is deposited in the MATF, is currently being imposed and collected by the State. The sales tax, however, had previously been imposed and collected by the City. In 1975
when the Municipal Assistance Corporation Act was enacted, the State suspended the right of the City to impose the sales tax and enacted a State tax identical to that which had been previously levied by the City and determined that the proceeds of the tax would be deposited in the MATF applicable to MAC. N.Y. Tax Law, 1107, §2010(f); N.Y. State Fin. Law, §92-d (McKinney). As with moneys in the general fund, such tax revenues being held by the State may only be paid out after appropriation by the State Legislature. N.Y. Const., Art. 7, §7; Saratoga Assn. v. Horse Breeding Fund, 22 NY 2d 119.

This prompted a lawsuit by holders of City general obligations who claimed that the legislation impaired their constitutional right against impairment of contract. The Court of Appeals in Quirk v. Municipal Assistance Corporation for the City of New York, upheld the constitutionality of sections 2010(f) and 1107. 41 N.Y. 2d 644 (1977), dism. 434 U.S. 808 (1977). Essentially, the Court held that the plaintiffs had no right to expect that the City would continue to collect the sales tax and upheld the suspension and reimposition by the State of such sales tax. The opinion states:

There is no requirement, either in the State Constitution or in any undertaking in the City bonds, that the diverted taxes be continued directly payable to the City. There is not, and never has been, an agreement, express or implied, that the revenues of these taxes be used to repay City bonds. Thus, since the challenged diversion does not impair any contractual obligations, the Federal Constitution is not violated...." (emphasis added) 41 N.Y. 2d 644, 646
Pursuant to the State Constitution the State Legislature has broad discretion with regard to taxes other than certain real estate taxes. Article 8, §12 and Article 16.

The money in the MATF is credited to a special account for use by MAC. Should there be a balance in such account after MAC has met its obligations the money is paid to the chief fiscal officer of the City. The statute makes it very clear that the money is primarily for the use of MAC:

In no event shall the [State] comptroller pay over and distribute any revenues (other than the amount to be deducted for administering, collecting and distributing such sales and compensating use taxes) to any person other than the municipal assistance corporation unless and until the aggregate of all payments certified to the comptroller as required by such corporation as of such date in order to comply with its agreements with the holders of its notes and bonds and to carry out its corporate purposes, including the maintenance of the capital reserve fund, which remain unappropriated or unpaid to such corporation shall have been appropriated to such corporation and shall have been paid in full. N.Y. State Fin. Law, §92-d (McKinney).

Similar language may be found in Section 92-e of the Finance Law with reference to the MASAF.

Should the money in the MATF and MASAF be insufficient to satisfy MAC's obligations a third fund, the stock transfer tax fund ("STTF") has been created. N.Y. State Fin. Law, §92-d (7) (McKinney). The STTF is funded by revenues collected in payment of the State stock transfer taxes. N.Y. State Fin. Law, §92-d (2) (McKinney). If MAC does not utilize the money in the STTF it is appropriated to the stock transfer incentive
fund and then to the City for support of the local government. The procedure with respect to STFF is similar to that of the MATF and the same rules apply.

II. The Act

Section 922 of the Act provides that should the City file a petition for bankruptcy there would be an automatic stay of the enforcement of a lien on or arising out of taxes or assessments owed to the City. May MAC's revenues be viewed as being the City's "taxes or assessments" which would have the effect of impairing MAC's ability to pay its debt promptly if the City should file a petition for bankruptcy?

From the previous discussion it is clear that both the sales tax and the stock transfer tax are neither City "taxes or assessments," since they are State imposed levies, nor does the City have a lien on such taxes. In Wein v. City of New York, 36 N.Y. 2d 610, 370 N.Y.S. 2d 550 (1975), the Court considered whether the use of the stock transfer tax and the per capita State aid, allocable and otherwise payable to the City, as a source of payment of the obligations of the Stabilization Reserve Corporation ("SRC"), was in violation of Section 1, Article VIII of the New York Constitution which prohibits a city from loaning its credit to a public corporation. Although this is not the issue presented in this memorandum the analysis by the Court is helpful.
The Court assumed for the purpose of the argument that both the STTF funds and the per capita State aid are the property of the City. However, the Court, recognizing that such payments to the City are subject to prior appropriation by the Legislature, states that "[t]he moneys received by or due to the [C]ity is a gift for all purposes and may be used by the [C]ity in the manner therein described, and under no circumstances may it be deemed a lien." (emphasis added) 36 N.Y. 2d 610, 619, 370 N.Y.S. 2d 550, 557. This is consistent with the statement in Quirk with regard to the rights of holders of general obligations of the City, to wit, "[i]t only assumes that out of the revenues which are collected, money must be provided to satisfy obligations to the bondholders . . ." (emphasis added) 41 N.Y. 2d 644, 647.

These excerpts make it clear that the per capita State aid and the moneys derived from the STTF are not the "taxes or assessments" of the City nor does the City have a lien on such amounts. This same analysis would apply with regard to the sales tax. The amounts of sales tax, stock transfer tax and the unallocated per capita State aid which the City receives are gifts from the State, therefore Section 922 is not applicable.

Section 904 of the Act provides that should the City file a petition for bankruptcy it could consent to the Bankruptcy Court's interference with any of its property or revenues. Since the amount of sales tax, stock transfer tax and unallocated per capita State aid which the City receives from the State is a gift, it does not become the property or revenues of the City until they are received. Therefore, the City would not
be able to consent to allow an interference with the revenues from the sales tax, the stock transfer tax or the per capita State aid until after MAC had satisfied its obligations.

To summarize, the three sources of revenues referred to above which MAC receives are neither "taxes or assessments" nor the "property or revenues" of the City. The sales tax and the stock transfer tax are State imposed taxes and the revenues from per capita State aid are derived from State funds. The amounts appropriated from such sources are gifts from the State. Although the City may receive some of the moneys from per capita State aid and such taxes, such receipt is permitted only if there is a balance in either the MASF, MATF or STTF after MAC has satisfied its requirements. Any action by the Bankruptcy Court with respect to this balance would not affect MAC's ability to collect such revenues.
PSA Urges House Subcommittee To Amend Bankruptcy Reform Act

From The Bond Buyer Bureau

WASHINGTON, Oct. 30 — To help cities in financial difficulty sell their bonds, the Public Securities Association today urged a House subcommittee to amend the Bankruptcy Reform Act of 1978 so that holders of so-called “hybrid” obligation bonds, as well as revenue bonds, would not have to stand in line with other creditors if a municipality filed for bankruptcy.

In a letter to the House Judiciary Committee's Civil and Constitutional Rights Subcommittee, the PSA said changes are needed because, “it is important for municipalities, especially those in financial difficulty, to have available a variety of financing mechanisms that will be accepted by investors to enable them to regain financial stability.”

Under the Bankruptcy Reform Act, which went into effect Oct. 1, bonds that are secured by a pledge of specific taxes or other revenues, including general obligations, so-called “double-barreled” general obligations and revenue bonds, become unsecured obligations when bankruptcy proceedings are started.

“This problem, if not remedied, will have serious adverse effects on the marketing of bonds of municipalities, particularly those which are experiencing financial difficulties,” the letter signed by PSA Chairman Lawrence H. Brown, senior vice president of Northern Trust Co. of Chicago, said.

Although the Senate recently passed a bill making technical amendments to the Bankruptcy Act that would exempt revenue bonds, the PSA asked the House Subcommittee to carry the change one step further and exempt so-called hybrid obligations, such as the double-barreled bonds which are general obligations secured by a specific pledge of certain revenue taxes.

Subcommittee sources indicated today that the House panel, which is to consider its proposed changes on Thursday, intends to follow the Senate and exempt revenue bonds.

But the source hinted that the panel might not exempt so-called hybrid obligations at this time because some panel members feel that such an exemption would be more than technical and hearings on such a plan should be held first.

Exempting revenue bonds is considered technical, according to Capitol Hill sources, because Congress did not intend to include them in the original Act.

The exemption of hybrid obligations, with their pledge of specific revenues, is considered essential to aid any city that is on the brink of financial trouble because prospective bondholders would be willing to purchase them with the knowledge that the revenues would be safe from a bankruptcy proceeding.

Such hybrid obligations were used in 1978 to help Yonkers, N.Y., which was on the brink of bankruptcy. The City issued $32.6 million in hybrid bonds -- general obligations backed up by specific tax revenues -- and was able to avert disaster.

However, Cleveland, which is now in default, had considered issuing similar hybrid bonds recently until it discovered that under the new Bankruptcy Act the bonds, despite the pledge of certain revenues, would become unsecured obligations if the City filed for bankruptcy. Without the assurance that the revenues would go first to the bondholders, prospective buyers indicated they were not interested and the issue never got off the ground, according to market sources.

Bankruptcy

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SPECIAL STUDY

TO: Municipal Research Recipients

RE: Implications of the New Bankruptcy Code

In our continuing research relating to the quality and security which underlies municipal bond issues, we have discovered an existing item which merits communication to our subscribers. In particular, we feel that our subscribers should be aware of the possible implications of Section 552, Chapter 9, of the new Bankruptcy Code, which becomes effective on October 1, 1979.

BACKGROUND

The Congress of the United States has passed a new Bankruptcy Code (Public Law 95-598) which becomes effective on October 1, 1979. The law makes certain changes to Chapters 10 and 11, which deal with corporate reorganizations and bankruptcies; and to Chapter 9, which deals exclusively with municipal bankruptcies.

Based on our own review of the Code, we believe that one provision may create unforeseen market and disclosure difficulties for municipal issuers who have secured or will secure their debt obligations with a pledge of future tax receipts or other future revenues. The source of our concern is Section 552, Chapter 9, which is incorporated into Chapter 9 by reference. In broad terms, it provides that property acquired by a debtor (the issuer) after the filing of a Chapter 9 petition will not be subject to the lien of the pre-filing security agreement. In other words, under the provisions of Section 552, the lien or pledge of future revenues or taxes securing the payment of bonds or notes might not be effective for revenues or taxes acquired after the filing of Chapter 9 proceedings. Thus, holders of bonds or notes may be deprived of their bargained-for collateral, since the promised pledge of a future stream of municipal income, such as sales and income taxes, and other pledged revenues, will no longer be enforceable following the institution of bankruptcy proceedings. By its terms, Section 552 does not apply to liens against property "in hand" at the time the Chapter 9 petition is filed. Nevertheless, it would appear that this section may have application to a broad range of currently used financing devices where a future revenue stream is pledged to secure the payment of municipal obligations.

ANALYSIS

We believe that Section 552 may not materially affect the security of those bond issues which have been secured by a first mortgage lien as opposed to a pledge of revenues since the bankruptcy court would have a capability of controlling those assets covered by the mortgage. However, bond issues which have been secured solely by the pledge of future taxes and revenues may lose the security provision if a bankruptcy case has been filed.
This provision is probably applicable to municipalities, state and local authorities, such as school districts, power authorities, sewer and water systems, and others.

It is possible that Section 552 will not materially change existing law, since legal experts in the insolvency field state that cases decided under the present Bankruptcy Act show a lack of certainty regarding the enforceability in bankruptcy of a pledge of future revenues. Nevertheless, this new provision, which seems to remove all uncertainty (in a negative manner) as to the validity of a lien on post-petition revenues, may well have a significant impact on the customary "bankruptcy exception" now found in bond counsel opinions and on the disclosures made in the official statements of issuers.

The application of Section 552 to municipalities may not have been intended. As noted earlier, this Section is incorporated in Chapter 9 by reference and does not seem to have been drafted with its Chapter 9 implications in mind. It appears that the principal objective of the drafters of Section 552 was to cut off the "floating lien" permitted under Article 9 of the Uniform Commercial Code which runs in favor of inventory and accounts receivable financiers. However, the typical commercial transaction involving this type of collateral is so structured that the amount of the indebtedness never exceeds a specified percentage of the value of the collateral in existence at any given time. Therefore, the secured creditor may not suffer unduly by being cut off from liens on future property of this kind. However, the typical municipal issue, which is secured by future revenues, is so structured that the holder is seldom fully secured by the revenues on hand and must therefore look to future revenues for payment.

A determination as to whether Congress intended to have this applicable to governmental units can only be clarified through the actual filing of a bankruptcy case in which a precedent setting decision is made by a court or specific act of Congress. Usually legislative history provides some guidance to courts and attorneys as to Congress's intent, but on this particular point, there appears to be no definite legislative history.

The ramifications of Section 552 may be to deprive those municipalities who must need to employ financings involving specific tax or revenue pledges of the opportunity to enter the credit markets, thereby increasing the likelihood of a filing under Chapter 9. This result seems all the more to be unintended and unsound in view of the other safeguards built into the new bankruptcy legislation, which are designed to assure the availability of funds for the purpose of continuing the operations of the municipality during the pendency of the Chapter 9 proceeding. These include an automatic stay on the lender's right to resort to its collateral; the ability of the municipality to obtain new financing during the bankruptcy proceeding secured by "super liens," senior to all existing liens; and the power (subject to appropriate protection of the secured lender's rights) to modify permanently the rights of secured lenders.
Investors when analyzing specific investment opportunities should make a determination as to whether the purchase of a particular security is warranted given that it may, in the future, become the equivalent of an unsecured loan. Certainly, particular attention should be paid to this provision on the lower quality securities.

This law does not take effect for several months and it is possible that amendments could be made to alleviate the potentially serious and apparently unforeseen effect of Section 552. However, if our interpretation of the provision is correct, it would apply to all municipal investments issued before and after the effective date. We recommended that municipal investors consider its potential impact in their existing portfolios and, as well, future investments.

We would further recommend that investors review the new Bankruptcy Code and, if appropriate, seek legal counsel as to the ramifications it may have on present and future commitments in municipals.

While the opinions expressed herein are primarily of a legal nature (and we do not practice law), we have related the matters discussed herein with several law firms knowledgeable in municipal bankruptcy matters. Their views indicate that our concerns as to the potential effect of Section 552 may have merit.

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