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REPORT TO THE CONGRESS

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

LM100561

Assessment Of New York City's Performance And Prospects Under Its 3-Year Emergency Financial Plan

Although New York City has made progress toward the goals it must meet by June 30, 1978, uncertainties exist which indicate it may fall short of its target. The outlook points to a continuing crisis for some years to come and the city may seek further help. If the Congress finds that Federal interest justifies further assistance in meeting the city's financing needs, GAO recommends that the conditions of any such assistance be stringent.

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APRIL 4, 1977

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-185522

To the President of the Senate and the CW000061
Speaker of the House of Representatives

This report presents our assessment of New York City's progress in the first year of its 3-year financial plan and its prospects for the future. It also discusses matters the Congress may wish to consider if further assistance is requested by the city.

The city made progress on several fronts during the first year, including

--making major budget cuts,

--developing a new accounting system, and

--successfully managing debt problems.

Its prospects for the future, however, are not bright. Substantial financing needs and continuing budget pressures will likely present the city with a continuing crisis for some years to come.

Therefore, we believe it is advisable to begin consideration of the appropriate Federal response if the city requests additional Federal assistance, such as direct loans or loan guarantees. Any such assistance to the city or any other local government, we believe, should carry stringent conditions designed so that the pressure on State and local governments for prudent management of their financial affairs is not lessened.

We made our review pursuant to the New York City Seasonal Financing Act of 1975 (Public Law 94-143).

The contents of this report have been discussed with city and State officials, and their comments were considered in the preparation of the report.

B-185522

We are sending copies of this report to the Secretary of the Treasury and the Director, Office of Management and Budget.

Elmer B. Staats

Comptroller General
of the United States

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

ASSESSMENT OF NEW YORK CITY'S PERFORMANCE AND PROSPECTS UNDER ITS 3-YEAR EMERGENCY FINANCIAL PLAN

CONCLUSIONS

AND MATTERS FOR CONSIDERATION BY THE CONGRESS

CONCLUSIONS

New York City faced a financial crisis of major proportions during most of 1975. Toward the end of that year, a combination of Federal and State actions stabilized the situation somewhat. It permitted the city to function in an orderly fashion under a financial plan which called for a combination of revenue increases and budget cuts that would lead to a balanced budget by June 30, 1978.

The city has made progress toward resolving its problems, a goal it must achieve to restore its fiscal independence and stability. It is clear, however, that major problems confront the city during the remainder of the financial plan and in the period immediately following. Despite the obvious difficulties, city officials remain cautiously optimistic about meeting the goal of the financial plan. Their determination is encouraging and indispensable to the city's success.

Although no one can state with certainty whether or not the city will achieve the goals of the financial plan, our assessment, at this point, indicates there are sufficient uncertainties to suggest the city may fall short of its goals. Its success is highly dependent on actions of various levels of government as well as the private sector. Even if the city is successful, it remains uncertain whether it will be able to gain sufficient access to the private credit market or other non-Federal sources for its total financial needs after June 30, 1978.

MATTERS FOR CONSIDERATION BY THE CONGRESS

A variety of proposals for Federal action which would assist New York City have been, and no doubt will continue to be advanced. Proposals range from fundamental changes in the Federal domestic assistance system, such as Federal takeover of welfare, to Federal assistance in regional development efforts to stimulate the economy of the Northeast. This report focuses on the more immediate fiscal questions.

It is clear that the city will require substantial short- and long-term financing after the plan period. The amount of the financing will depend on a number of variables, including the degree of success the city has in carrying out its financial plan. Should the city be unable to meet its total financing needs in the private market, it will likely seek Federal assistance in the form of direct Federal loans, loan guarantees, or a combination of the two.

The Congress can, of course, decide to take no action and leave the problem at the State and local level for resolution. On the other hand, it may find that sufficient Federal interest continues to exist to justify further assistance in meeting the financing needs of the city.

Congress could provide for short-term financing by either extending the New York City Seasonal Financing Act of 1975 along with the terms and conditions associated with the present program or by enacting a loan guarantee program. This would leave long-term financing for operating deficits and the capital program to be provided by other sources. Should the city be unable to gain access to other sources of credit, the Congress could consider enacting a program of direct or guaranteed Federal loans for long-term financing needs.

Federal, State, and city officials have for some time been discussing the concept of loan guarantees. Loan guarantee proposals were considered and reported out of Committee in both Houses of the Congress in the fall of 1975. Neither proposal was accepted, primarily because of the President's announcement that he was prepared to veto any legislation designed to prevent a default by the city. The President was concerned that Federal guarantees would reduce rather than increase the prospect that the city's budget would ever be balanced, and would establish an undesirable precedent which would relieve the pressure on other State and local governments for prudent management of their financial affairs.

In our judgment, any consideration of Federal approaches to assist the city in meeting its financing needs for the post-1978 period should take these concerns into account. The fiscal cornerstone of our decentralized governmental system rests on the proposition that States and their political subdivisions must raise the revenue required to pay for the level of services they elect to provide. The Federal Government, through a multitude of domestic assistance programs, provides massive supplements to State and local programs. However, responsibility for maintaining overall fiscal viability has and must continue to rest at the State and local level.

Therefore, we believe that any program of direct or guaranteed Federal loans to the city or any other local government should carry stringent conditions. Elements of many of the conditions we would envision are already in place under the New York City Seasonal Financing Act or were included in congressional loan guarantee proposals advanced in the fall of 1975. We would recommend the following:

1. Federal loans or loan guarantees should only be made available after a clear demonstration to the Federal Government that the local government has no alternate source for borrowing and the State government is unable to provide needed financing. There should also be a determination by the Federal Government that there is a reasonable prospect for repayment.

2. An independent State board should be established for the duration of any Federal involvement. The board would be responsible for supervising the fiscal affairs of the local government in that it would have the power to approve, disapprove, and modify the localities' budget. Any Federal loans or loan guarantees should be made through the State board, or other appropriate State agency, rather than directly to the locality.

3. To encourage prudent State and local management of financial affairs and to discourage applications, financial disincentives should be attached to any program of Federal loans or loan guarantees. Interest rates on direct Federal loans should be set at a level such that the State or locality does not receive favored treatment over others borrowing in the private market. For loan guarantees, a fee could be required and the interest income could be made subject to the Federal income tax. The fee established could be discretionary based on the Federal Government's evaluation of local and national conditions at the time the guarantees were authorized.

4. The period of Federal loans or guarantees on specific transactions should be limited. For example, any long-term issue could include a provision for automatic termination of the Federal guarantee or for refinancing of direct loans at the end of a specified period, perhaps 5 years, provided the issue could be refinanced at reasonable interest rates in the private market.

5. Provision should be made for Federal audit and review.

6. Long-term borrowing for current operating expenses represents such an undesirable fiscal practice that consideration should be given to a provision which would preclude the use of Federal loans or guarantees for such purposes. The difficulty with such a provision in the case of New York City is that long-term financing of current operating expenses represents one of its major needs for the next several years. While its efforts might not be successful, in our judgment, the city should look to the State or to other sources, such as its pension funds, for this type of financing. As a minimum, long-term loans or guarantees of long-term loans which will provide funds for operating expenses should be approved only if it is absolutely clear that no alternate sources of financing are available and concerted efforts are being made to eliminate the need to borrow for operating expenses.

Federal assistance in the form of loans or loan guarantees would only address the comparatively short-range fiscal aspects of the New York City crisis. While much of the city's crisis can legitimately be attributed to a history of poor financial management, the problem has been exacerbated by social and economic forces which are largely beyond the control of local officials. The seemingly intractable social problems that confront many of the nation's older cities represent one of our major domestic problems and present a range of issues and potential Federal policy responses which are beyond the scope of this report. These issues are considered in a separate GAO report dealing with the longer-term fiscal problems of the New York City area as they relate to the economic conditions of the area.

COMMENTS OF CONCERNED OFFICIALS

We received comments on this report from officials of New York City, the Office of the New York State Special Deputy Comptroller for New York City, and the Emergency Financial Control Board. Their comments are summarized below. The full text of the comments are included as appendixes III through V.

On January 14, 1977, the same day that comments were requested from State and city officials, we also requested comments on this report from the Office of Management and Budget and the Department of the Treasury. Comments have not been received from either agency.

City comments

City officials commented that overall our report was comprehensive, thoughtful, and helpful in discussing the immediate fiscal questions confronting the city. The city reaffirmed its intent to balance its budget for fiscal year 1978 but reiterated its belief that the recovery of New York City will be possible only if the coalition of interests in the unions, financial community, State and Federal Governments, and the public at large continues to work together.

The city believes that a discussion of the alternatives open to the Federal Government in the event it must request Federal assistance is helpful from a planning standpoint. It agrees with the need to provide disincentives for the use of Federal financing aid since it is not desirable to have such aid become a regular part of municipal finance. It contends, however, that some of our proposals are unduly onerous and take on a punitive aspect.

Also, the city believes that Federal assistance should not be contingent on all alternate sources of borrowing being exhausted. It believes that Federal help should come early rather than as a last ditch effort, and the conditions for assistance imposed on the city should be carefully drawn so as not to infringe on the rights of elected city officials or be so punitive as to add to the city's problems.

Special Deputy Comptroller's comments

The State's Special Deputy Comptroller concurred with our conclusion that it is uncertain whether the city will gain sufficient access to the private credit market or other non-Federal sources for its total financial needs after June 30, 1978. He suggested that the most prudent course would be to enact a loan program as soon as possible that would make available, on a standby basis, any necessary financing that was not otherwise available. He believed such a program would assure prospective lenders there was no risk of bankruptcy in the event the city's aggregate needs could not be met and would minimize, if not eliminate, the need for Federal loans or loan guarantees.

Emergency Financial Control Board comments

The Board's Executive Director observed that if the city cannot meet all of its credit needs privately by fiscal year 1979, then it has no other option but to turn to the Federal Government for some form of assistance. He was pleased that this issue was being raised in a new forum, but was concerned that GAO viewed further Federal assistance as running counter to our decentralized form of government and that loans or loan guarantees were acceptable only if the terms were made punitive.

We do not view Federal assistance which stimulates and supports State and local programs as undesirable. However, direct Federal aid to a State or local government with the objective of meeting its overall fiscal needs is a different policy question. In our opinion, safeguards are needed to assure that the pressure for prudent financial management is not lessened.

Contents

CHAPTER 1

INTRODUCTION

New York City has been facing a widely publicized fiscal crisis for about a year and a half. City administrators are confronted with a two-pronged problem. In the short range, they must execute a stringent program to balance the city's budget. In the long range, they must combat a deteriorating economic base so that city revenues will be sufficient to support the level of services provided. Failing that, they must continue to reduce services to a level which can be supported.

This report focuses on the short range fiscal problems and progress the city has made to date. It also addresses the outlook for the period remaining in the city's 3-year financial plan and the period immediately following. The long range economic outlook is the subject of a separate report ("The Long Term Fiscal Outlook for New York City," PAD-77-1).

THE FISCAL CRISIS AND THE EMERGENCE OF A PLAN TO DEAL WITH IT

In early 1975, New York City found itself no longer able to borrow to meet its cash needs. The absence of these borrowings, which are normal and necessary to all cities, created an immediate financial crisis of major proportions. The city lacked funds to meet payrolls and everyday expenses and to repay creditors for previous borrowings coming due.

Through the spring and summer of 1975, city and State officials took a number of actions which enabled the city to remain fiscally afloat, but which were not sufficiently effective to do more than ease the crisis temporarily. Together they arranged for advances of funds from the State; cuts in the city's budget; creation by the State of the Municipal Assistance Corporation (MAC), bonds to be marketed on behalf of the city; creation of an Emergency Financial Control Board as a fiscal overseer of the city's budget; reform of the city's accounting and budgeting practices; and development of a 3-year financial plan to balance the city's budget.

The financial plan

While the immediate crisis of early 1975 was publicly triggered by the city's need for operating cash, the problem was more deeply rooted. A severe budget imbalance existed. The city's 1975-1976 revenue estimate was $11.5 billion when the plan was drawn in October 1975. Against these revenues, $12.5 billion in expenses had been forecast. This left a deficit of approximately $1 billion to be added to prior years accumulated deficits, reported by the city to be $5 billion. To make matters worse, the city, with State approval, had been borrowing to pay for normal operating expenses included in its capital budget. By 1975, these borrowings had grown to more than $700 million annually. Capital budget borrowings should only be used to finance long-range municipal capital improvement projects. Their use in this case tended to disguise the fact that the true 1975-1976 operating deficit approximated $1.7 billion.

City and State officials prepared a plan, approved by the Emergency Financial Control Board on October 20, 1975, to deal with the budget imbalance through a series of sharp budget cuts together with revenue increases where possible. The plan, summarized below, anticipated deficits in the years ending June 30, 1976 and 1977, and a small surplus by June 30, 1978.

SUMMARY OF FINANCIAL PLAN

	Year ending 6/30/76	Year ending 6/30/77	Year ending 6/30/78
	(in millions)		
Revenue	$11,519	$11,981	$12,313
Expenses	12,600	12,913	13,006
Budget imbalance	(1,081)	(932)	(693)
Planned budget cuts and revenue increases	92	462	724
Projected (deficit) or surplus	$ (989)	$ (470)	$ 31

Under State law the $700 million in operating expenses in the capital budget are to be transferred back to the operating budget over a 10-year period.

A better understanding of the magnitude of the city's operating deficit over the 3-year financial plan is gained by including the operating expenses in the capital budget. As shown below, inclusion of these expenses suggests an approximate $1.7 billion operating deficit for fiscal year 1976 and over $.5 billion for fiscal year 1978.

SUMMARY OF FINANCIAL PLAN
CONSIDERING ALL OPERATING EXPENSES

	Year ending 6/30/76	6/30/77	6/30/78
	(in millions)		
Projected (deficit) or surplus per financial plan	$ (989)	$ (470)	$ 31
Operating expenses in capital budget	(697)	(647)	(597)
Total projected operating deficits	$(1,686)	$(1,117)	$(566)

As the end of 1975 approached, city and State officials began seeking solutions for another problem too large to handle without extraordinary action. Short-term debts approximating $2.6 billion were due to mature between December 1975 and November 1976 and MAC encountered market resistance trying to sell its bonds to repay these debts. The city appealed to the State, and the State Legislature declared the debts in moratorium status on November 14, 1975. This action reduced the interest rate on the notes and postponed their maturity to November 1978. It also gave investors the option to convert to MAC bonds. This action tended to heighten the crisis in the public eye and even more severely damaged the possibility of public borrowing by the city.

Later in November an agreement among the clearing-house banks, municipal pension funds, sinking funds, and MAC provided a source of funds to cover the capital needs and operating deficits over the 3-year financial plan. This agreement's principal element was the commitment of trustees of the city's retirement system to invest about $2.5 billion from the pension funds in city or MAC obligations.

Despite all these actions, it was clear that additional assistance was needed and the problem was presented at the Federal level.

In recognition of the actions taken to prevent the city's financial collapse, and the State and city governments' commitment to correct the practices of overspending and overborrowing which had characterized the city's fiscal operations for a number of years, Federal legislation was enacted in December 1975. The New York City Seasonal Financing Act of 1975 (Public Law 94-143) gave the Secretary of the Treasury authority to lend the city up to $2.3 billion annually to meet seasonal financing needs resulting from the city's uneven revenue flow.

The act authorized loans to be made on the finding of a reasonable prospect of repayment and required that all loans mature not later than the last day of the city's fiscal year in which they were made. No new loans may be made unless all matured loans have been paid and the city is in compliance with the terms and conditions of any outstanding loans. Under State law, specific revenues, mostly consisting of funds due to the city from the State, were earmarked for repaying the Federal loans by the end of each year.

Under the act, the city pays interest on these loans at a rate of one percent above the current average market yield on outstanding Treasury obligations of comparable maturities. In effect, New York City was helped at little or no cost to the Federal Government. The Secretary of the Treasury's authority to make loans to the city terminates on June 30, 1978, which coincides with the period covered by the financial plan. The objective of all parties associated with fashioning the rather complex financial recovery plan was to permit the city's return to the private credit market subsequent to June 30, 1978.

With the Federal assistance in place, and the immediate cash crisis resolved temporarily, the city set out at the end of 1975 to implement its financial plan.

A year has passed since that time and this report is a review of the city's major fiscal events of the year and the prospects for the remaining years of its plan and the period immediately following.

SCOPE OF REVIEW

We prepared this report during the course of our monitoring work under the provisions of the Seasonal Financing Act. Our work, being conducted both in New York City and in Washington, D.C., includes reviews of city records, discussions with city officials, regular attendance as observers at Emergency Financial Control Board meetings, and coordination with the State Special Deputy Comptroller for New York City and officials of the Department of the Treasury.

This report is based primarily on information available as of December 1976. It recognizes but does not fully address the city's proposed revisions to the financial plan submitted to the Emergency Financial Control Board in January 1977.

CHAPTER 2

THE CITY'S PROGRESS DURING THE FIRST YEAR OF THE PLAN

The first period of the financial plan (October 1975 through June 1976) was one of progress. The city realized more revenues than originally planned, managed its debt with some success, began the design and implementation of an accounting system, and implemented budget cuts without major disruptions of city services. The city's progress was unfortunately marred by the fact that it was unable to hold expenses to the levels originally projected. The indicated deficit for the year ended June 30, 1976, shows that the city fell short of its original plan by approximately $124 million.

The financial recovery plan represents a complex package of revenue and expenditure actions. The revenue side of the plan included receipts from new taxes authorized by the State in November 1975. Higher personal income, corporation, estate and cigarette taxes, establishment of a minimum personal income tax on preference items, a minimum general corporation tax, and an extension of the sales tax to cover certain personal services made up this package. These tax actions were expected to yield $85 million in the first year and $200 million in both the second and third years of the plan.

Toward the end of the first year, the city took additional revenue actions when the City Council raised the real estate tax rate from $8.19 per $100 of assessed valuation to $8.795. This action, together with better collection efforts, is expected to increase revenues in the second year of the plan by $240 million.

Other revenue adjustments were made in an effort to offset the city's deteriorating economic base. State legislation was enacted allowing securities dealers to take a tax credit for stock transfer taxes they pay on certain market transactions. This tax change was designed to stem the tide of securities dealers leaving New York City. For similar reasons the recently enacted bond transfer and estate taxes were repealed.

MAJOR BUDGET CUTS WERE MADE

Perhaps the most highly publicized aspects of the financial crisis are the expenditure reductions planned by the city under the financial plan.

A total of $200 million in annual expenditure reductions was planned for the first year. These reductions consisted of approximately $48 million in specifically identified personnel reductions and $152 million in other reductions of city services. These reductions were expected to produce only $92 million in cash savings through June 30, 1976, because the reductions would not be in place for the full year.

Personnel reductions

Early in the implementation of the plan, city officials realized that some of the required budget reductions had to be made through layoffs but others could be achieved by not replacing employees who retired or quit for personal reasons. This was recognized in State legislation which required that employee attrition be used where possible to reduce the number of layoffs which would otherwise be required.

Accordingly, the city scheduled layoffs estimated to produce a budget savings of $10 million with the remaining $38 million savings to be achieved from retirements and resignations which seemed, at that time, to be running above normal.

These personnel savings were over and above reductions of about 31,000 employees which the city reported as being achieved in 1975 before the financial plan was implemented.

It is very difficult to accurately measure the number of employees who left the city payroll between the start of the financial plan and the end of the first year. Significant time lags, sometimes several months, pass before new employees get on the payroll and others get off. That condition, combined with the lack of differentiation between city employees and employees funded under Federal and other programs, make it impossible to determine how many employees are on the payroll and paid by city tax levy funds at any point in time.

We attempted to calculate the payroll level at the start of the plan and the level at June 30, 1976, for all employees whose payroll is processed by the City Comptroller, regardless of their salary source. These figures, which exclude certain covered organizations such as the Health and Hospitals Corporation and the City Housing Authority, are comparable with figures reported monthly by the city to the Secretary of the Treasury. Our work indicated that the total payroll had been reduced from approximately 273,000 to 262,000, a reduction of 11,000. While we do not believe these figures to be precise because of the time lags and other related problems, it is clear that the city made progress in reducing its payroll.

Other budget cuts

Beyond the personnel reductions, the city identified about 120 specific projects where budget cuts could be effected during the first year. These projects ranged from eliminating and consolidating fire stations to closing day care centers and reducing available facilities for the elderly.

As the plan progressed, the city issued monthly reports on a project-by-project basis. The State officials monitored and tested these reports. By March 1976 the city claimed that it was virtually on target with these savings and that it had already realized $117 million in actual budget reductions. The State disputed certain savings but projected that $39 million would be accomplished. By June the city claimed the full savings had been realized. State officials have not reported on these claimed accomplishments.

During the course of our oversight work in this area we reviewed some of the city's claimed savings and the work of State officials in verifying those savings. We also tested some specific savings independently.

It was obvious to us that certain savings had been accomplished but it was impossible to measure those savings accurately. Some of the actions taken by the city--for example, saving on a light or telephone bill--in one month could not be projected as a savings every month since the realization of the savings depended on future diligence by management.

In fiscal year 1977 the city discontinued reporting savings on a project-by-project basis. The city's position is that progress must be assessed by determining whether total expenditures are being kept within acceptable levels. They believe that tracking and measuring individual budget reductions could be counterproductive because it tends to focus attention on budget cuts rather than the overall expenditure level which is the real problem.

While we agree with the logic of the city's position, we also believe that some monitoring of specific budget cuts is necessary so that the city would have early warning of possible shortfalls. In an October 1976 report to the Secretary of the Treasury we recommended that the city resume its monitoring of specific budget reductions. The Treasury Department disagreed, stating that other systems implemented on July 1, 1976, would provide satisfactory information. Rather than imposing the burden of reinstituting a monthly reporting system on the city, the Department stated it would undertake whatever periodic studies were necessary to determine whether the city is accomplishing necessary administrative actions.

REVISIONS TO THE FINANCIAL PLAN

During the first year of the plan it became apparent that overall city spending was running significantly above the anticipated level. These overruns were recognized in plan modifications approved by the Emergency Financial Control Board.

In March and April 1976 the Board approved a modification which increased estimated revenues and expenditures for each year of the financial plan. For fiscal year 1976, the effect of these revisions was to increase the anticipated budget deficit for the year by $207 million.

The last modification affecting the first year of the plan was approved by the Board in June 1976. This modification made no change in the budget deficit for fiscal year 1976, but made equal increases in estimated revenue and expenditure levels for the year.

Both modifications evidenced the serious difficulties the city was encountering in achieving its original spending goals for the first year of the financial plan. Estimated expenditures increased by $347 million while revenues to offset this expenditure growth were expected to increase by only $140 million.

FIRST YEAR RESULTS WERE WORSE THAN ORIGINALLY PROJECTED BUT BETTER THAN THE LATEST PROJECTION

The city's financial reports for the year ended June 30, 1976, showed that expenditures exceeded the original financial plan by $217 million. The $93 million in revenues realized in excess of the plan offset this somewhat. The net of these figures indicates the city's performance was

$124 million worse than anticipated in the original plan. The year's performance, however, was better than the more pessimistic figures projected in the latest modifications to the financial plan.

The schedule on page 11 compares the city's actual experience for the year ended June 30, 1976, against its original and latest revision to the financial plan by major revenue and expenditure classifications. In relation to its original plan, the city experienced significant expenditure overruns in social services, education, and debt service, and a significant expenditure underrun among smaller functions which are included under the "Other" category.

On the revenue side, general fund revenues (which include receipts from various sources including the sales, income, and stock transfer taxes) and real estate taxes were about at the level anticipated in the original plan. Federal and State aid and other revenues were better than anticipated.

In comparing the city's accomplishments to its financial plans it was necessary to make certain adjustments so that the financial plans would be comparable to the city's year-end financial statements.

In its original plan for fiscal year 1976 the city included an amount for estimated disallowances of Federal and State aid which included a provision for both the current and prior fiscal years. Later in the year, the city decided that the provision for disallowances applicable to prior fiscal periods should not have been included and eliminated $145 million for such estimated disallowances from its financial statements. Therefore, we made the same adjustment to the original financial plan.

The second adjustment in the amount of $209 million was made to both the revenue and expenditure estimates of the original plan. These amounts were applicable to Federal grants received under the Comprehensive Employment and Training Act of 1973 and other programs, and were reported in the city's financial statements but not included in the original plan.

Finally, because the operating expenses financed through the capital budget were included in the city's financial statements, these items were included in both the revenue and expense categories in the original and revised plans.

COMPARISON OF NEW YORK CITY'S

FIRST YEAR'S RESULTS

TO ORIGINAL AND REVISED FINANCIAL PLAN

	Original plan (note a)	Revised plan	Actual through June 30, 1976 (UNAUDITED)	Actual vs. original plan better/[worse]	Actual vs. revised plan better/[worse]
	(in millions)				
Revenues					
General fund	$ 4,041	$ 3,978	$ 4,045	$ 4	$ 67
Real estate taxes	2,967	2,967	2,966	[1]	[1]
Federal/State aid	4,518	4,709	4,587	69	[122]
Other revenues	347	381	411	64	30
Capital fund borrowings (note b)	697	675	654	[43]	[21]
Total revenues	$12,570	12,710	12,663	93	[47]
Expenses					
Dept. of Social Services	2,831	2,947	2,926	[95]	21
Board of Education	2,045	2,106	2,092	[47]	14
Police Department	653	653	652	1	1
Board of Higher Education	466	481	479	[13]	2
Environmental Project Admin.	354	353	356	[2]	[3]
Fire Department	277	283	285	[8]	[2]
Health and Hospitals Corporation	688	674	663	25	11
Debt service - Municipal Assistance Corporation	386	492	462	[76]	30
Debt service	1,784	1,812	1,847	[63]	[35]
Pensions	1,150	1,149	1,137	13	12
Other	2,780	2,811	2,732	48	79
Total expenditures	13,414	13,761	13,631	[217]	130
Difference	$ [844]	$[1,051]	$ [968]	$[124]	$ 83

a/These amounts contain adjustments made by GAO to make them comparable to the city's financial statement. The adjustments are described on page 10. Appendix I contains a reconciliation to the original plan.

b/These amounts are not revenues but are borrowings to finance operating expenses in the capital budget. A proper classification of revenues would increase the indicated deficit at June 30, 1976, from $968 to $1,622 million.

It is encouraging that the city's first year performance did not produce as large a deficit as had been anticipated in the financial plan modifications. The indicated $968 million deficit at June 30, 1976, was $83 million less than the anticipated $1,051 million deficit. In our judgment, however, any optimism generated from this comparison must be tempered. An analysis of the principal fiscal features of the entire first year shows that the city encountered serious difficulties in controlling its expenditures and that the year-end deficit was $124 million higher than anticipated under the original plan. Further, inclusion of the $654 million in operating expenses financed by borrowings through the capital budget increases the indicated year-end deficit to about $1.622 billion.

The city's financial statements used in the preceding comparisons have not been audited. Because of the widely recognized deficiencies in the city's accounting system, the results of the comparisons must be viewed with some caution. State law and the credit agreement under which the Federal seasonal loans are made require that the city establish an accounting system by July 1, 1977, which would enable an auditor to perform an annual audit and render an opinion. Until the accounting system is in place and tested it will not be possible to fully rely on the financial data produced by the city.

PROGRESS WAS MADE TOWARD AN ACCOUNTING SYSTEM

The city and its contractors have made remarkable progress toward the implementation of a new accounting system. In the months which have passed since the first contracts were awarded, the accomplishments of the city and its contractors far exceed those which would normally be expected in such a complex system development effort.

In spite of this progress, the new accounting system will not be completely implemented by July 1, 1977. We are reporting separately on this matter and suggesting that the city concentrate its efforts on those aspects of the system which appear to be the more critical ones. The city generally agreed with our observations and has already outlined an action program to improve the chances of meeting its objectives.

SUCCESSES IN MANAGING SHORT-TERM DEBT, AND FINANCING OPERATING DEFICITS AND CAPITAL NEEDS

Efforts to manage the city's short-term debt and satisfy its financing needs during the first year of the plan, although fraught with difficulties, were successful.

In the 6-year period through fiscal year 1975, the city accumulated a cash deficit of about $6.6 billion, which it financed by increasing its long- and short-term debt by about $6.5 billion. During the same period, city short-term debt more than tripled, increasing to over $4.5 billion; and long-term debt rose by more than half to $6.8 billion. By 1975 total debt stood at more than $11 billion.

When the city was denied access to the credit markets in the spring of 1975 the most difficult problem it confronted was obtaining the financing needed to repay its short-term debt and to provide funds for its projected operating deficits and capital needs. To avoid the possibility of default, the State advanced $800 million to the city and some commercial banks lent it $275 million to meet the city's needs for the year ending June 30, 1975.

In June of 1975 the State created MAC to assist in providing essential services to its inhabitants and to instill investor confidence in city debt issuances. MAC was to refinance a substantial portion of the city's short-term debt by replacing more than $3 billion of the debt with long-term MAC obligations. MAC experienced difficulties in marketing its bonds and managed to sell only $1.8 billion before the market closed to it in late August 1975.

To obtain further financing, the State arranged a package that would provide about $1.8 billion to the city for the period September to November 1975. This included a $750 million loan from the State in return for (1) a $250 million one-year note from the city, (2) a $250 million one-year note from MAC, and (3) $250 million in long-term MAC bonds. The remainder of the package included $1 billion of MAC bonds purchased by banks, city pension and sinking funds, the State Insurance Fund, and other institutions.

These sales brought total MAC bond sales to almost $3.1 billion, but in November 1975 there was still $2.6 billion in short-term notes outstanding. The notes were held by the public, banks, pension funds, and sinking funds. With no prospects for MAC to refinance the notes, the New York State

Legislature on November 14, 1975, declared a moratorium on principal repayments until November 1978. This action also reduced the interest payable on the notes during the moratorium and gave investors the option to convert their notes to MAC bonds.

During the first year of the financial plan there were successes in managing the debt in moratorium. MAC, through negotiations with eleven banks and several city pension funds, further extended maturities for $819 million of the notes. These notes will mature between November 1978 and July 1986. Another $200 million, held by city sinking funds, were exchanged for long-term city bonds. Finally, MAC was able to convert another $616 million of the notes to long-term debt.

Although these actions reduced the debt in moratorium to about $1 billion, the legality of the moratorium was being challenged through the State courts. In the first year of the plan, lower State courts upheld the constitutionality of the moratorium. However, the lower courts' decision was overturned by the State Court of Appeals in November 1976, creating an unanticipated problem for the city in the second and third years of the financial plan.

In arranging for the city's remaining financing needs, MAC, working with several city employee pension funds, was able to negotiate a sale of long-term bonds which brought $500 million into the city during 1976 and a commitment for an additional purchase of $2 billion before June 1978. Together with prior purchases of city and MAC securities the pension funds will have invested about $3.8 billion in the city by June 1978. This would represent a significant portion of the total investments of the fund and, more significantly perhaps, cement a unique partnership of labor and management during the city's crisis.

CHAPTER 3

THE CITY'S PROSPECTS THROUGH JUNE 1978

While the first year could be fairly assessed as one of progress, despite some difficulties in controlling expenditures, the outlook for the second and third years is less optimistic.

Almost half of the city's remaining budget balancing actions are beyond its control because they depend on Federal and State government actions to either assume city costs or approve other changes in city assistance programs which will have the effect of reducing the city's costs. In addition, the city plans to raise $350 million to meet its projected cash needs. To raise the cash, the city is relying on Federal action to assist in the sale of city mortgages.

Beyond these two factors is the recent decision by the New York State Court of Appeals declaring as unconstitutional the moratorium imposed by the State legislature. Although the budget cuts and operating cash problems were anticipated and included in the financial plan, principal payments on the moratorium debt were not.

POSSIBLE PROBLEMS IN CLOSING THE REMAINING BUDGET GAP

At the time of our review, the city estimated that actions totaling $821 million were needed during the second and third years of the plan to close the budget gap. In total, the city planned actions of $862 million, or $41 million more than was necessary. The plan requires a combination of budget cuts and revenue increases totaling $461 million to be accomplished by the city, $296 million to be accomplished in cooperation with the State, and the remaining $105 million to be dependent on Federal actions. These actions are detailed in appendix II.

Planned city actions

A detailed program of specific city actions was prepared and in part implemented as a first step toward meeting the city's goal of $461 million.

The city considers itself on target with its cost reductions because its budget has been reduced by the planned second year cuts and its spending levels are below that budget. This analysis is difficult to confirm since the city's expense totals do not include all encumbrances or commitments made by city agencies. The difficulties encountered in controlling expenditures during the first year of the plan are a source of concern and suggest that city management faces an extremely difficult task in the second and third years.

In any case, the accomplishment of these savings should be within the control of city officials and to that extent they may present less of an uncertainty, in terms of the overall plan, than the actions requiring Federal and State participation.

<u>Planned State actions</u>

The city is anticipating that the State will act favorably in several areas resulting in budget savings of $296 million. The State, which is also experiencing fiscal difficulties, is being called upon to assume (1) higher education costs totaling $149 million, (2) the cost of city courts and probation operations totaling $97 million, and (3) the city's costs of corrections activities totaling $30 million. In addition, the city expects the State to approve changes in medical assistance programs resulting in a savings of $20 million.

<u>City university senior colleges</u>

The city announced its intention to discontinue funding for the senior colleges of the City University of New York. In fiscal year 1977 it plans to reduce its contribution to these colleges for a savings of $36 million. In fiscal year 1978, the city expects to save an additional $113 million by completely phasing out funding for these institutions. Recently, city officials revised the estimated savings for the third year downward to $97 million.

The city can make these reductions unilaterally without State legislative action, since support of senior colleges is not a mandated expense of the city. However, State law requires that State funding of the City University of New York be in the same amount as city funding. For fiscal years 1976 and 1977, the State appropriated funds in excess of the funds provided by the city. Without a similar future action by the State legislature, the city's no support policy for senior colleges in fiscal year 1978 will bring forth a like policy from the State and result in the closing or severe curtailment of senior colleges.

A resolution of this matter between the city and the State may result in a modification to the city's savings program.

Court and probation costs

In August 1976 the State agreed to assume court costs but took no action on probation costs. However, the State only agreed to assume court costs gradually over a 4-year period rather than immediately as proposed in the city's plan. With the State's action falling significantly below the city's expectations, the city has estimated a shortfall in its financial plan of $20 million in fiscal year 1977 and $75 million in fiscal year 1978.

Correction costs

The city's plan proposed that the State assume correction costs starting April 1, 1978. This would save the city $30 million in the third year of the financial plan. The State legislature did not act on this proposal in its 1976 session. Barring such action in the future, the city will face a $30 million shortfall.

Reduction in medical assistance costs

The city indicated it would take action to reduce its medical assistance costs by $10 million in fiscal year 1977 and $20 million in fiscal year 1978. It detailed seven areas where these cost reductions would take place. It would, for example, require prior approval for mental health services and allergy treatments for Medicaid patients. It also anticipated contracting for laboratory services rather than paying individual fees to laboratories.

Many of these proposals have not received needed State or Federal approvals. As a result, the city anticipates that only $2.5 million in savings for fiscal year 1977 will be achieved, creating a shortfall of about $7.5 million.

Planned Federal actions

The city is planning on three favorable actions by the Federal Government to ease its budget balancing problem by $105 million. The plan anticipates the substitution of $50 million of Federal community development funds for city funds. Similarly, Federal housing subsidies would save $40 million if substituted for city rent subsidies. Another $15 million could be saved if the Federal Government provides rent subsidies for the elderly.

Community development funds

The city is eligible to receive $100 million in community development funds in fiscal year 1977 and $150 million in fiscal year 1978. It intends to use the $50 million increment in 1978 to offset city funds currently supporting municipal services and programs which would otherwise have to be reduced or eliminated. The city plans to apply in June 1977 for the $150 million. If the city meets the requirements of the community development program, the Department of Housing and Urban Development (HUD) can approve the city's application within 75 days after its receipt.

HUD regulations require that community development funds not be used "* * * to reduce substantially the amount of local financial support for the community development activities* * *." Should the Department conclude that the city's substitution of the $50 million in Federal funds for its own funds violates this maintenance of effort requirement, the city's application may not be approved and a significant shortfall may result.

Public housing subsidies

Section 8 of the Housing and Community Development Act of 1974 provides subsidies to families for meeting their rental obligations. The city proposed to save $15 million in fiscal year 1977 and $40 million in fiscal year 1978 by using Federal funds as a substitute for a portion of its public housing subsidy. HUD has already rejected the proposal because the city would not give families a choice as to where they reside. The freedom of choice provision is an integral part of the section 8 program.

The city said the resultant fiscal year 1977 shortfall will be made up by other budgetary savings. Alternate reductions for the $40 million shortfall in fiscal year 1978 have not been detailed.

Senior citizens rent increase exemption program

The city also proposed using section 8 funds as a substitute for its program granting exemption from rent increases for senior citizens. It estimated the substitution would save $15 million in both fiscal years 1977 and 1978.

Once again, HUD approval was needed for this action. The city abandoned this proposal before submitting it to HUD when certain administrative difficulties were discovered. As a result, the city is left with an additional $15 million shortfall in its reduction program in both the second and third years of the financial plan.

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In recognition of some of the shortfalls discussed above, the Emergency Financial Control Board (EFCB) ordered the city to submit plans for alternate budget balancing actions totaling $135 million. The city prepared plans for such actions and implemented $50 million of them. It also held $85 million in reserve as standby actions to be implemented should additional shortfalls occur in the second plan year. As of December 31, 1976, none of the standby programs had been implemented.

In addition to these alternate cuts, the city also appropriated a general reserve of $100 million in the second plan year as a safeguard against expenditure overruns or revenue shortfalls.

In January 1977, the city submitted a revised program to close the budget gap. The revision, which reaffirms the city's intent to balance its fiscal year 1978 budget, recognizes an increase of $144 million in required budget balancing actions. The increase was largely due to unforeseen and uncontrollable shortfalls in tax revenues and increases in pension costs. As a result, the estimated fiscal year 1978 budget gap to be eliminated is $586 million and unless other remedial measures can be implemented quickly, the gap could range as high as $725 million. As with the city's previous program, the proposed revision calls for substantial budgetary relief actions which are beyond the direct control of the city.

As of January 31, 1977, the EFCB had not approved the city's revised program.

DIFFICULTIES IN RAISING NEEDED OPERATING CASH

In addition to obtaining cash from existing borrowing arrangements, the plan calls for the city to raise $350 million to meet its cash needs during 1977 and 1978. The city decided to meet this need by selling city-owned assets. A tentative arrangement was worked out under which the city would seek Federal insurance on city-held housing project mortgages. Once the insurance was obtained, the city believed it could sell the mortgages and raise the needed cash.

The transaction is complicated because each mortgage will be insured at a different percentage based on assessments by HUD. The difference between the current mortgage amount and the portion HUD insures will continue to be held by the city but payments due will be held in abeyance until the insured first mortgage is paid in full.

Because the HUD insurance will vary from mortgage to mortgage it is impossible to determine with certainty the value of the mortgages which must be sold to raise $350 million.

Various estimates of the potential success of this effort were made during 1976. The city initially expected to realize the full $350 million by the spring of 1977. Subsequently, a shortfall of $30 million to $110 million was estimated. The city's January 1977 estimate indicates a 1977 shortfall of $150 million but expects the full realization of $350 million some time during fiscal year 1978.

The city's actual experience on the first six projects submitted to HUD has been disappointing. City officials advised us that they expected to realize, after refinancing and related costs, an average of about 65 percent of the value of the city mortgages.

As shown below, the yield on the first six projects approved by HUD will only be about 46 percent:

Project name	City mortgage amount	HUD insured amount
Tanya Towers	$ 5,315,200	$ 2,298,400
Phipps Plaza East	5,168,900	2,167,900
Hamilton Housing	4,900,000	2,414,600
Park Lane Apts	7,863,000	6,793,200
Highbridge Housing	9,460,000	5,872,900
Stevenson Towers	3,594,500	2,364,000
Total	$36,301,600	$21,911,000
Less: Estimated costs		5,061,441
Net		$16,849,559

This whole transaction is further complicated by the fact that the use of funds finally realized is restricted under the New York State Local Finance Law. City officials advised us that according to the law, the proceeds must be applied to the retirement of bond anticipation notes which were used initially to finance the projects and which are now part of the moratorium debt. They also told us that if the moratorium debt is satisfied through other financing arrangements, the legal restriction will not affect the use of the proceeds.

We cannot predict how successful the city will ultimately be in selling the mortgages, but the possibility of a shortfall exists. The city's effort is further complicated by the possible restriction on fund use.

NEED FOR ADDITIONAL FUNDS TO RETIRE MORATORIUM DEBT

The city's second and third year financing burden was significantly increased when the New York State Court of Appeals ruled in November 1976 that State legislation placing part of the city's debt in moratorium was unconstitutional. Because the ruling also required that holders of debt in moratorium be paid promptly, the city is now faced with the task of raising approximately $1 billion not included in the financial plan.

The city had expected that the constitutionality of the moratorium, although challenged in the courts, would eventually be upheld. Accordingly, the city did not expect the debt to come due until November 1978. The financial plan does not require that any reserves be set aside to provide for the payment. The city had hoped that the Municipal Assistance Corporation would be able to restructure the debt.

The original moratorium debt of $2.6 billion has been reduced to about $1 billion. As described in chapter 2, most of this reduction was achieved by (1) several banks and the pension funds agreeing to extend the maturities of $819 million of the notes and (2) MAC success in converting approximately $600 million in notes to long-term MAC bonds in two separate exchange offers.

With the court ruling upsetting the moratorium, it is possible that these successes may be reversed because those creditors who converted or extended their notes may elect to bring action to be paid along with the other creditors who did not convert. This is a real possibility because the extension agreement of the banks and pension funds appears to have been contingent on the constitutionality of the moratorium. If the banks and pension funds demand payment, the city will have to raise $1.8 billion. If all groups of creditors demand payment, the city may have to raise as much as $2.4 billion.

Various plans were considered as a result of the court's direction that the city and the creditors work out a payment plan. At the time this report was being prepared for publication, the city faced a critical cash crisis and impending default because of the lack of an agreement on a financing package to redeem the moratorium debt. The inability to produce a payment plan centered on disagreements between the city, banks, and pension funds as to the degree of outside fiscal control over future city budgets.

In the absence of an agreement, the pension funds suspended their program of purchasing city securities. Therefore, on February 25, 1977, the city requested a $255 million loan under the Seasonal Financing Act. The Department of the Treasury did not agree to make the loan because it determined there is no reasonable prospect of loan repayment until the moratorium problem is resolved.

In early March a financing package was arranged to redeem the approximately $1 billion in moratorium notes, and the Treasury agreed to make the requested loan. A major element of the package was to offer noteholders the opportunity to exchange their notes for high interest long-term MAC bonds. While we have not evaluated all elements of the package, the initial response to the exchange offer, according to MAC officials, has been very encouraging.

CHAPTER 4

AFTER THE PLAN - A CONTINUING CRISIS?

During the remaining months of the financial plan, the city must (1) make up for the shortfalls indicated in their savings programs, (2) raise large amounts of operating cash, and (3) arrange for the funding of the moratorium debt. Even if all these actions are accomplished, the city may still find itself with a fiscal crisis. Assuming the city balances its budget in accordance with the financial plan, available data suggests the city's real operating deficit will still exceed $600 million. In addition to borrowings needed to finance this deficit, the city will also need to borrow significant sums to meet its seasonal financing needs presently provided by the Federal loans, and to finance needed capital improvements.

If inflationary pressures continue, the city's problems will be intensified. Expenditure levels will become more and more difficult to cut on top of the cuts already effected, and revenue growth will be limited by the deteriorating economic base of the city.

In short, it appears that the city may be faced with a continuing fiscal crisis for some years to come.

CITY WILL HAVE SIGNIFICANT FINANCING NEEDS AFTER THE PLAN

The amounts are imprecise, but it is clear that the city's financing needs will remain very heavy after the period covered by the financial plan.

Operating budget imbalance

Although the city has not prepared a projection of its revenues and expenses in the post-1978 period, it appears that two major items which can be identified at this time will cause an operating imbalance in excess of $600 million in the year immediately following the plan. This, of course, assumes that the city is totally successful in meeting the goals of its financial plan.

By June 30, 1978, the city plans to have transferred to the operating budget approximately $185 million of the $700 million in the operating expenses which were being funded under its capital budget. The remaining $515 million, although technically in the capital budget and presumably financed with borrowings, will, in fact, constitute a significant operating budget imbalance in the year immediately following the plan.

The second major item is the need for additional funding of the pension system. A city-appointed commission which studied the adequacy of city pension fund contributions reported in April 1976 that the city should increase its net pension contributions to begin reducing the plan's unfunded accrued liability. The amount of the increase is uncertain but could exceed $100 million per year.

The amount of the operating deficit in the post-1978 period is subject to a multitude of variables and assumptions. It seems clear, however, that even if the city successfully balances its budget as required by the plan, it will still face significant operating deficits which will have to be financed in the post plan period.

Capital budget needs

The city's financial plan provides for a decrease in capital expenditures over the 3-year period to a budgeted level of about $1 billion in fiscal year 1978. Because one-half of this amount represents operating expenses, which should be included in the operating budget, the true capital budget level is about $500 million. This is an austerity level capital budget, down significantly from the levels before the plan. During the 3 years preceding the fiscal crisis, the capital budget, excluding operating expenses, averaged about $1.5 billion annually. Assuming a capital program equal to that of fiscal year 1978, the city will need to borrow about $500 million for the 1979 program plus the amount needed to fund the operating expenses remaining in the capital budget.

Seasonal needs

The Federal loan program will expire on June 30, 1978, and the city will have to arrange for an alternate source to meet its seasonal financing needs. Experience suggests that approximately $2 billion is needed at the peak of the city's seasonal needs.

It is impossible to predict whether the city will be able to reenter the credit market immediately following the plan's end, but it is clear that significant borrowings will be necessary. Considering the budgetary pressures on the State, and the already heavy commitment by the pension funds, these would appear to be questionable sources for future borrowing of the magnitude required.

CONTINUING BUDGET PRESSURES

The city will continue to face extraordinary financial pressures beyond the period covered by the financial plan. Our analysis indicates that its ability to achieve balanced budgets and operate without deficits in the future will be aggravated by a changing and deteriorating economic base.

The city plans to bring its budget into balance by 1978 and must maintain a balance in its expenditures and revenues in the post-1978 period. Achievement of these goals will be affected by economic factors such as persistent inflation and high rates of unemployment as well as administrative factors, such as the city's ability to plan, initiate, and execute budget balancing actions. The city's strategy has been to maintain selected programs, reduce program levels where it can, and, in general, to keep the price tag of continued services at lower levels (lower than they otherwise would be) by limiting wage increases of city employees and by effecting other economies.

The impact of these and other economic and social factors on the city's long-term economic viability make it necessary to explore expenditures and revenues beyond 1978. Our projections and analysis of the economic trends for the city are presented in our report on the long term fiscal outlook for New York City (PAD-77-1). In that report, we project that New York City will likely be under continued financial stress for some years to come. Barring major Federal or State policy shifts, the implications of these projections are that the city will have to address its fiscal problem by implementing further expenditure reductions or by raising more revenues. Such budget balancing actions, while they may tend to have a deleterious effect on the city's overall economy, in both the short and long term, must nonetheless be made if the city is to regain fiscal stability and function without external controls.

SCHEDULE RECONCILING

ORIGINAL PLAN TO ADJUSTED ORIGINAL PLAN

FOR FISCAL YEAR 1976

	Original financial plan net of capital funds	Capital funds for operating expenses	Original financial plan including capital funds	Adjustments	Original financial plan as adjusted
	(in millions)				
Revenues					
General fund	$ 4,041	$ -	$ 4,041	$ -	$ 4,041
Real estate taxes	2,967	-	2,967	-	2,967
Federal/State aid	4,164	-	4,164	145	4,518
				209	
Other revenues	347	-	347	-	347
Capital funds (note a)	-	697	697	-	697
Total	11,519	697	12,216	354	12,570
Expenses					
Dept. of Social Services	2,817	14	2,831	-	2,831
Board of Education	1,871	174	2,045	-	2,045
Police Department	648	5	653	-	653
Board of Higher Education	351	115	466	-	466
Environmental Protection Administration	296	58	354	-	354
Fire Department	275	2	277	-	277
Health and Hospitals Corporation	627	61	688	-	688
Debt service--Municipal Assistance Corporation	386	-	386	-	386
Debt service	1,784	-	1,784	-	1,784
Pensions	1,091	59	1,150	-	1,150
Other	2,362	209	2,571	209	2,780
Total	12,508	697	13,205	209	13,414
Differences	$ [989]	$-0-	$ [989]	$145	$ [844]

a/These amounts are not revenues but borrowings to finance operating expenses in the capital budget.

APPENDIX I

SUMMARY OF NEW YORK CITY'S PROGRAM TO CLOSE THE BUDGET GAP FISCAL YEARS 1977 AND 1978 (note a)

	Fiscal year 1977	Fiscal year 1978 (note b)
	---(in millions)---	
City actions		
1976-1977 budget reduction program	$214	$214
Additional program reductions resulting from managerial improvements	-	100
Reduction in welfare costs not mandated by statute		
Public assistance	20	40
Medicaid savings - Health insurance plan	5	10
Purchase of power from alternate source	16	30
Withdrawal from Social Security	-	43
Reduction in certain employee fringe benefits	24	24
Subtotal	279	461
City proposals requiring State action		
Phase out of support for City University	36	149
State assumption of court and probation costs	24	97
State assumption of corrections activities	-	30
Reduction in medical assistance not mandated by statute	10	20
Subtotal	70	296

a/Does not reflect proposed revisions to the program to eliminate the fiscal year 1978 budget gap submitted to the Emergency Financial Control Board on January 6, 1977. As of January 31, the proposed revisions had not been approved by the Board.

b/Fiscal year 1978 amounts are cumulative.

	Fiscal year 1977	Fiscal year 1978
	---(in millions)---	
City proposals requiring Federal action		
More flexible use of community development funds	-	50
HUD section 8 subsidies as a substitute for city public housing subsidies	15	40
HUD section 8 subsidies as a substitute for senior citizen rent increase exemptions	15	15
Subtotal	30	105
Total	$379	$862

The City of New York Office of the Mayor Office of Management and Budget

Municipal Building
New York N Y 10007

Donald D Kummerfeld
Director

February 16,1977

Mr. Francis X. Fee
Regional Manager
United States General Accounting Office
26 Federal Plaza
New York, N.Y. 10007

Dear Mr. Fee:

We have reviewed your draft report entitled "Interim Assessment of N.Y.C.'s Performance and Prospects Under Its 3-Year Emergency Financial Plan". Overall we find your report to be comprehensive, thoughtful and a helpful discussion of the immediate fiscal questions confronting the City. We are pleased to note that you feel the City has made progress toward resolving its problems.

We recognize that the City's problems and solutions are complex and we concur in your assessment that our problems have "been exacerbated by social and economic forces which are largely beyond the control of local officials." Complex though these problems are, we reaffirm our intent to balance our budget for FY78. As pointed out by Mayor Beame in his "Program to Eliminate the Budget Gap FY 78" and stated in a separate GAO report on "The Long Term Fiscal Outlook for NYC", assistance will be needed from many sources if the City is to be successful in resolving its financial problems. Mayor Beame stated, "The recovery of NYC will be possible only if the coalition of interest in the unions, financial community, State and Federal governments, and the public at large continues to work together." The G.A.O. report held similar views as indicated by the statement "We believe that the solution (to the City's problems) involves a complex combination of actions that to be fully effective need to be developed in concert with each other."

Toward this end we have initiated several programs to assure that our goals are met. They are:

- The $50 million (annualized) substitute Cost Reduction Program
- The Mayor's "Program to Eliminate the Budget Gap FY 78"
- The Mayor's Economic Recovery Plan

We feel that these items must be considered in any discussion, analysis, or review of the City's fiscal problems and its attempt to resolve them, and we urge that they all be considered prior to publication of a final report. Consideration should also be given to the recent report issued by the Senate Banking Committee on "The New York City Loan Program" compiled as a result of Banking Committee hearings held on 12/20 and 12/21/76. All of these items attest to the City's actions to balance its Budget.

We will continue to implement the austerity programs detailed in the above programs, as well as the programs outlined on 3/25/76 by Mayor Beame to close the FY77 and FY78 Budget gap. The City is on, or ahead of target in achieving the reductions detailed in the March 25, 1976 program to close the FY77 gap. For those few items that were not achieved, the City developed the Substitute program cited above, which more than assures full accomplishment of the fiscal year reduction goals to be carried forward to FY 1978.

Your draft report discusses the alternatives open to the Federal government in the event the "...City is unable to meet its financing needs from other sources, and requests Federal assistance." Certainly a discussion of alternatives open to the Federal government is helpful from a planning stand point. Your report, however, discusses Federal loans only as a last resort, with "stringent conditions" attached. Interest rates and loan guarantee fees would be set so high as to be disincentives used to discourage a locality from seeking Federal aid. Long term assistance would be limited and an independent State board [See GAO note, p. 33.] would be established to supervise the fiscal affairs of the locality. We can understand and agree with the need to provide disincentives for the use of federal financing aid, since it is not desirable to have such aid become a regular part of municipal finance. We do feel, however, that the proposals set forth in your report are unduly onerous in this regard and take on a punitive aspect.

More specific comments regarding your suggestions follow.

Recommendation:

1. A federal board, chaired by the Treasury Secretary must be throughly convinced that other alternative sources of borrowing are non existent.

Francis X. Fee - 3 - February 16, 1977

Comment:

Your report assumes the worst case alternative, i.e. the City being unable to meet its financing needs from any other source, and at that point turning to the Federal government for assistance. We question the premise upon which your overall scenario is based and which leads to your first suggestion. Specifically, to wait until all other sources of borrowing are closed before turning to the Federal government would be costly and inefficient. At that point options are more restrictive, time would be running out, and acting in the rush of a last ditch crisis would cause chaos and confusion. It might be wiser to have Federal government participation and concern at an earlier stage, and as expressed earlier in this report, in concert with other interested parties. Early Federal government concern and participation might assist in preventing crises from developing to the point where all avenues are closed.

Recommendation:

2. An independent State board, [See GAO note, p. 33.] should be established as long as there is Federal involvement. This board would be responsible for supervising the fiscal affairs of the local government. Any Federal loans or guarantees would be made through the State board rather than directly to the locality.

Comment:

Depending upon its structure this might be an infringement upon the rights of the elected City officials to perform their normal functions of running the City without outside interference. However, we concur that some sort of monitoring committee is needed. Such a committee should be assured that the aggregate fiscal goals are being met and the budget is adhered to, and information should be available for them to confirm such compliance. The establishment of the details of the budget, and the right to establish priorities within the budget, however, must remain with the local officials.

Recommendation:

3. The interest rate on any guarantee or loan should be at a level that would encourage the locality to return to the private credit market as soon as possible. A loan guarantee fee should be charged and interest income from guaranteed loans should be subject to Federal Income Tax.

Francis X. Fee - 4 - February 16, 1977

Comment:

We recognize that the interest on a direct loan should not give the locality favored treatment over other localities borrowing in the private sector. It should not, however, be set so high as to add to the very problems faced by the local government. A loan guarantee fee on a City bond issue would be in order if it were reasonable. As discussed at the 2/5/77 meeting, the application of Federal Income Tax on interest earned from guaranteed loans should be investigated further by the G.A.O. legal department.

Under the conditions of the existing loan, it was mandated that NYC install a new computerized financial accounting system. We think it would be in order if the Federal government used part of the interest charged on any loan to defray the cost of establishing systems such as this, which are required to meet the very conditions of the loan.

Recommendation:

4. The time of Federal long term loan guarantee should be limited. A provision should be included for automatic termination of the Federal guarantee or for refinancing of direct loans at the end of a specific period.

Comment:

We see no problem with this recommendation. It is a condition of our present loan. However, the repayment schedule should be set to take into consideration the financial condition of the City so that it does not recreate the very problems with which it was designed to help.

Recommendation:

5. Provision should be made for Federal audit and review.

Comment:

We concur, and the authority to do this already exists.

[See GAO note, p. 33.]

[See GAO note, p. 33.]

Recommendation:

7. Long term borrowing for current operations expenses is an undesirable fiscal practice. Only as a last resort should the use of Federal loans or guarantee be used for this purpose.

Comment:

We are currently in the process of phasing out capital support for operating expenses. We recognize that this past practice was not in anyone's best interest and the schedule set up by the State to liquidate this problem over a ten year period is being met.

All of the above comments were discussed at a meeting held on 2/4/77 between N.Y. General Accounting Office personnel, NYC Office of Management and Budget personnel, and a member from the office of the Deputy Mayor for Finance.

[See GAO note, p. 33.]

GAO personnel indicated they would take all comments under consideration in their preparation of the final report. If there are any questions regarding this response please contact me.

Sincerely,

Donald D. Kummerfeld

Donald D. Kummerfeld
Director, Office of Management
and Budget

GAO note: Deleted comments referred to material contained in the draft report which has been revised or not included in the final report.

STATE OF NEW YORK
DEPARTMENT OF AUDIT AND CONTROL
OFFICE OF SPECIAL DEPUTY COMPTROLLER
FOR THE CITY OF NEW YORK
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SIDNEY SCHWARTZ
SPECIAL DEPUTY COMPTROLLER

February 10, 1977

Mr. Edward F. Hefferon
General Accounting Office
26 Federal Plaza
New York, NY

Dear Ed:

Thank you for the opportunity to comment on your draft report "Interim Assessment of New York City's Performance and Prospects Under its 3-Year Emergency Financial Plan." Dr. Rider has spoken to you by telephone regarding some particular comments that he had on the report. I offer these additional comments on some of the report conclusions and suggest an option for Federal financing which you might consider.

I concur completely with the GAO conclusion that it is uncertain whether the City will gain sufficient access to the private credit market or other non-Federal sources for its total financial needs after June 30, 1978. I would urge, however, the need for Federal legislation to ensure that the required financing is available. You suggest that a Federal loan should provide for an EFCB-like control mechanism with power to supervise the fiscal affiars of the City. Would this be needed? It may be that an organization with powers limited to ensure that a balanced budget (achieved without further borrowing to fund deficits) is attainable and attained would be sufficient.

[See GAO note, p. 35.]

I agree that the City's practice of long term borrowing to meet operating expenses is undesirable, but unless an extension is authorized by MAC, the City is required to phase out this financing over 10 years. The City's financial plan implements this requirement for the 3-year period ending June 30, 1978.

In my view, if the Federal government accepts an ultimate obligation to rescue the City from bankruptcy (which could result from its inability to find financing), the most prudent course would be to enact a loan program as soon as possible that would make available, on a standby basis, any necessary financing to the extent that it was not otherwise available. Under this program prospective lenders would be assured that there was no risk of bankruptcy in the event that the City's aggregate needs could not be met. This would, I believe, result in the City's being able to borrow for these needs at a lower cost than would otherwise be possible. Such a program would provide a rational basis for the City's financial management over the next few years. It also minimizes the actual use of a Federal loan or loan guarantee, and could even result in the loan never being used.

I hope these comments are of help in the preparation of your final report.

Sincerely,

Sidney Schwartz

SS/jt

cc: S. Berger

GAO note: Deleted comments referred to material contained in the draft report which has been revised or not included in the final report.

State of New York
Emergency Financial Control Board
For the City of New York

270 Broadway
New York, New York 10007
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Stephen Berger
Executive Director

January 28, 1977

Mr. Francis X. Fee
Regional Manager
United States General
Accounting Office
26 Federal Plaza
New York, New York 10007

Dear Mr. Fee:

I have reviewed with my staff the drafts of the GAO reports Concerning New York City's Longer Term Fiscal Outlook and Interim Assessment of New York City's Performance and Prospects Under Its Three Year Emergency Financial Plan.

[See GAO note, p. 38.]

The "Long Term Outlook" report raises several important issues with which I strongly agree. New York City's economic base has been declining for some time and at least part of this decline can be attributed to the actions of previous administrations which built a tax and service structure that is inhospitable to business and the middle class and could not be sustained by the region's declining economic base. It is also true that the City's budget is made up of many expenses which are largely uncontrollable such as pension costs, debt service, some social service and health costs, and to some extent, collective bargaining contracts. The point that the City has seriously weakened its economic base in order to serve its short term political and budgetary needs is a point that has been made in the past and is still valid. Most importantly, I agree with the report's recognition of the fact that major federal policy shifts are needed to address some of the problems of the nation's cities. As the report makes clear, the federal government has in the past directed specific forms of aid on a regional and categorical basis so a precedent for a changed federal role in urban affairs does exist. The shift in investment of national resources to the sun belt and away from the Northeast must be reversed. Discriminatory Federal reimbursement formulas for such areas as social services, health care and transportation must be changed.

The "Short Term Outlook" report also makes several points which I feel are important. The report correctly points out that there was never a guarantee that a balanced budget in FY 1978 combined with management and budgetary improvements would enable the City to meet all of its credit needs in the private credit market by FY 1979. It was felt that such actions would, however, contribute to the restoration of the City's credit rating.

The report also recognizes the stability that the financial plan has provided to the City and the progress that has been made so far under the plan. These are all issues that are frequently overlooked but are properly acknowledged in the report. The most important issue that the report recognizes is that many of the problems faced by New York City and other cities in this country are intensified, if not caused, by economic and social conditions which are outside of local control. As Governor Carey pointed out in testimony before the Senate Committee on Banking, Housing and Urban Affairs on December 21, 1976, because of New York State's own tenuous position in the private credit market, there is a limit as to the amount of assistance that the state can provide to New York City. If the City cannot meet all of its credit needs privately by FY 1979, then it has no other options but to turn to the federal government for some form of assistance. These are issues that have been raised locally for some time and I feel that it is good that they are finally being raised in a new forum.

[See GAO note, p. 38.]

Mr. Francis X. Fee -3- January 28, 1977

[See GAO note, p. 38.]

The fact that the role of the federal government in local affairs is particularly confused is underscored by these two reports. The "Long Term Outlook" report gives a number of precedents for federal involvement in local affairs and describes a number of ways in which this might be done. In contrast, the "Short Term Outlook" report describes such activities as counter to our "decentralized form of government" and sees any form of government loan or loan guarantee progam as acceptable only if the terms of such aid are made punitive. Since this report praises the determination of those in the City and State governments and seems to indicate that they are acting in good faith, it is somewhat unclear as to why the City needs additional inducements to seek credit through the private market. This is particularly difficult to understand since the report admits that many of the City's problems are not within the City's powers to address.

I appreciate the opportunity to comment on the GAO reports and I hope that you find my comments helpful.

Sincerely,

Stephen Berger

GAO note: Deleted materials were comments by the Executive Director stating that the two reports nad conflicting conclusions concerning the city's prospects for balancing its budget by June 30, 1978. The language of both reports has been clarified.

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