The Constitutional Debt Limit and New York City

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THE CONSTITUTIONAL DEBT LIMIT AND NEW YORK CITY

During the 1961-1975 fiscal period, New York City's governmental and financial obligations increased more rapidly than its available financial resources. Since the difficult political choice of raising taxes or reducing services to appropriate levels was shunned by city officials, budget deficits grew annually. To close these gaps and

In 1965, Mayor Robert F. Wagner declared in his budget message that he did "not propose to permit [the city's] fiscal problems to set the limits of [its] commitments to meet the essential needs of the people of the city." By 1975, fourteen percent of New York's citizens were on welfare. In addition, the city supported nineteen municipal hospitals, free tuition at the City University, day care centers, foster homes, and many other public services. As a result of attempted income redistribution, much of the tax base was also redistributed causing businesses, and therefore jobs, to leave the city. Auletta, Who's to Blame for the Fix We're In, NEW YORK MAGAZINE, Oct. 27, 1975, at 29, revised & reprinted in K. AULETTA, THE STREETS WERE PAVED WITH GOLD (1979).

3. TABLE 1
NEW YORK CITY RECEIPTS, EXPENDITURES AND BUDGET DEFICITS*, FISCAL YEARS 1967-75
($ in millions)

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Receipts</th>
<th>Expenditures</th>
<th>Budget Deficits</th>
<th>Accumulated Budget Deficits</th>
</tr>
</thead>
<tbody>
<tr>
<td>1966-67</td>
<td>4,346</td>
<td>4,461</td>
<td>-115</td>
<td>-115</td>
</tr>
<tr>
<td>1967-68</td>
<td>5,116</td>
<td>5,263</td>
<td>-147</td>
<td>-262</td>
</tr>
<tr>
<td>1968-69</td>
<td>5,968</td>
<td>6,044</td>
<td>-76</td>
<td>-333</td>
</tr>
<tr>
<td>1969-70</td>
<td>6,469</td>
<td>6,836</td>
<td>-367</td>
<td>-705</td>
</tr>
<tr>
<td>1970-71</td>
<td>7,072</td>
<td>7,359</td>
<td>-287</td>
<td>-992</td>
</tr>
<tr>
<td>1971-72</td>
<td>8,224</td>
<td>8,389</td>
<td>-165</td>
<td>-1,157</td>
</tr>
<tr>
<td>1972-73</td>
<td>9,166</td>
<td>9,636</td>
<td>-520</td>
<td>-1,677</td>
</tr>
<tr>
<td>1973-74</td>
<td>9,723</td>
<td>10,380</td>
<td>-657</td>
<td>-2,334</td>
</tr>
<tr>
<td>1974-75</td>
<td>11,911</td>
<td>12,201</td>
<td>-290</td>
<td>-2,624</td>
</tr>
</tbody>
</table>

(a) Total receipts include general fund, real estate taxes, grants from federal and state governments, sales of property and other receipts (fees, charges, and similar receipts). Total expenditures cover operating expenditures, debt service, liquidation of encumbrances, and redemption of city notes.

present a technically balanced budget, the city resorted to various borrowing techniques. While municipal borrowing is not in itself improper, New York City abused both its short-term and long-term borrowing powers. Additionally, the city used public benefit corporations to avoid constitutional and statutory debt limits. This comment will overview those borrowing techniques used by the City of New York which ultimately led to the fiscal crisis of 1975. Part I will review long-term debt practices; Part II will review short-term debt practices; and Part III will review the city's use of public benefit corporations.

I. Long Term Debt Practices

Most state and local governments finance capital projects by issuing long-term debt, usually in the form of bonds. The rationale for financing capital projects through long-term borrowing is that it permits the repayment of the debt to be amortized over the useful life of the project, thus requiring all taxpayers who benefit from the project to contribute to its payment. The power to issue long-term debt, however, is limited by the New York State Constitution. The constitution limits city debt for general municipal purposes to no more than ten percent of the latest five-year average of full valuation of taxable real estate within the city. The city may incur additional debt for housing and urban renewal purposes. Such debt is limited by two percent of the five-year average of assessed valuation.

4. The City Charter requires the City Council to establish a balanced budget. NEW YORK CITY CHARTER § 1515.
5. "It was the misuse of borrowing that distinguished New York from other cities and was the fundamental cause of the city's most recent crisis." Shalala & Bellamy, supra note 2, at 1124.
6. "Bonds are long-term obligations, maturing in not less than one year. Sold primarily to finance long-term capital investments, bonds have traditionally comprised the bulk of state and local government financing, although this pattern has altered somewhat over the past decade." FORBES & PETERSEN, BACKGROUND PAPER TO BUILDING A BROADER MARKET: REPORT OF THE TWENTIETH CENTURY FUND TASK FORCE ON THE MUNICIPAL BOND MARKET 38 (1976) (quoted in Shalala & Bellamy, supra note 2, at 1124 n.18). Capital projects are also financed, in part, by the receipt of state and federal grants. HOUSE SUBCOMM. ON ECON. STAB. OF THE COMM. ON BANKING, FIN. AND URB. AFFAIRS, SECURITIES AND EXCHANGE COM'N STAFF REPORT ON TRANSACTIONS IN SECURITIES OF THE CITY OF NEW YORK, 95TH CONG., 1ST SESS. ch. 2, at 66 (1977) [hereinafter cited as SEC STAFF REPORT].
7. A. STEISS, LOCAL GOVERNMENT FINANCING 109 (1975) [hereinafter cited as STEISS].
8. N.Y. CONST. art. VIII.
tion of taxable real estate within the city. The constitution excludes from the debt ceilings funds borrowed to finance certain enumerated capital improvements. Consequently, the city's unencumbered margin does not accurately reflect the full extent of the city's outstanding long-term indebtedness.

New York City's budget is subject to further regulation in addition to the restraints imposed by the Constitution. The New York Local Finance Law and the City Charter govern city finances as well. The City Charter requires city officials to prepare two distinct budgets: an expense budget and a capital budget. The expense budget is an estimate of the city's recurring municipal operating expenses for the upcoming fiscal year. It also contains an estimate of incoming revenues to be used to finance the operating expenses.

A major source of revenue for both current operating expenses and

10. N.Y. Const. art. XVIII, § 4.
11. N.Y. Const. art. VIII, §§ 5, 7, 7-a, 11.

12. "The unencumbered debt margin, which differs from the legal debt incurring power, represents the amount of additional appropriations and authorizations for capital expenditures within the debt limit that could be made without exceeding the city's legal authority to borrow." [1978] Comptroller of the City of New York, Ann. Rep. xii [hereinafter cited as 1978 Annual Report].
13. The Temporary Commission on City Finances estimates that due to the many exceptions to the debt limit, the city's outstanding debt is more than 50 percent greater than the apparent debt limit. Temporary Commission on City Finances, Final Report, The City in Transition: Prospects and Policies for New York 161 (1977) [hereinafter cited as Final Report].
15. 1972 New York City Charter (superseded by 1976 Charter) [hereinafter cited as 1972 City Charter].
17. Id. ch. 9. See note 6 supra, and accompanying text.
long-term debt payment is the city’s real estate tax. The real estate tax which the city may impose for expense budget purposes is limited by the New York Constitution to a maximum rate of two and one half percent of the average full valuation of taxable real estate within the city. This limit may only be exceeded to provide for the city’s debt-service obligations. The expense budget, then, is linked to the annual real estate tax levy, a limited revenue source. The City Charter directs the City Council to set the annual real estate tax rate at a level which will produce a balanced expense budget.

While the expense budget is designed to match recurring operating expenses with recurring revenues, the capital budget is designed to finance capital improvements through long-term borrowing and state and federal aid. Capital projects are defined by the City Charter to encompass little more than physical public improvements ("brick and mortar projects"). The city’s ability to finance these projects is limited only by the constitutional debt limits and the marketability of its municipal bonds and notes.

The city’s abuse of long-term borrowing is reflected in the growth

21. N.Y. Const. art. VIII, § 10.
22. Id., art. VIII, § 11. Debt service obligation refers to the amount the city was required to pay in the proceeding fiscal year for interest on and amortization of the debt contracted for a capital project. N.Y. Local Fin. Law § 123.00(b)(1) (McKinney 1968).

Article 8 of the State Constitution requires the city to pledge its full faith and credit for the payment of the principal of and interest on all its debt obligations. Annual appropriations must be sufficient for such payments, except for the principal on certain notes explicitly excluded from the mandatory annual appropriation requirement. The required appropriations are not subject to the limitation of taxes on real estate to 2.5% (the “Basic Tax Limit”) of the latest five-year average full valuation of taxable real estate in the city (the “Tax Base”).

24. See note 18 supra.
25. SEC Staff Report, supra note 6, ch. 2, at 66.
26. New York City Charter, § 211, provides in pertinent part: “1. The term ‘capital project’ shall mean: (a) Any physical public betterment or improvement . . . . (d) Any public betterment involving either a physical improvement or the acquisition of real property for a physical improvement . . . .”
27. SEC Staff Report, supra note 6, ch. 2, at 68. See also Final Report, supra note 13, at 156.
of expense budget items financed under the capital budget. As operating costs exceeded available resources, city officials chose to finance expense items from the capital budget. This capitalization of operating expenses is a form of deficit financing, a gap-closing technique used as an alternative to raising taxes and reducing services. "The transfer of operating items to the capital budget derives from the simple political fact that it is easier to impose a tax in some future year than in the current budget." During the 1965-1975 fiscal period, the capitalization of operating expenses rose from $26

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**TABLE 2**

BORROWING FOR CURRENT EXPENSES IN THE CITY OF NEW YORK:
FISCAL YEARS 1965-1975
($ in millions)

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Total City Funds</th>
<th>Borrowing for Current Expenses</th>
<th>Percentage of City Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>1965</td>
<td>$720</td>
<td>$26</td>
<td>3.6%</td>
</tr>
<tr>
<td>1966</td>
<td>590</td>
<td>57</td>
<td>9.7</td>
</tr>
<tr>
<td>1967</td>
<td>538</td>
<td>68</td>
<td>12.6</td>
</tr>
<tr>
<td>1968</td>
<td>673</td>
<td>68</td>
<td>10.0</td>
</tr>
<tr>
<td>1969</td>
<td>619</td>
<td>84</td>
<td>13.6</td>
</tr>
<tr>
<td>1970</td>
<td>800</td>
<td>151</td>
<td>18.9</td>
</tr>
<tr>
<td>1971</td>
<td>1,004</td>
<td>195</td>
<td>19.4</td>
</tr>
<tr>
<td>1972</td>
<td>1,162</td>
<td>226</td>
<td>19.4</td>
</tr>
<tr>
<td>1973</td>
<td>1,342</td>
<td>274</td>
<td>20.0</td>
</tr>
<tr>
<td>1974</td>
<td>1,359</td>
<td>564</td>
<td>41.5</td>
</tr>
<tr>
<td>1975</td>
<td>1,376</td>
<td>724</td>
<td>52.6</td>
</tr>
</tbody>
</table>

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Final Report, supra note 13, at 157.
29. Id.

As early as 1966, the Temporary Commission on City Finances warned that borrowing for current expenses is an unsound practice . . . Its unfavorable influence in the case of New York City may be summarized as follows: It encroaches on borrowing power needed for other purposes. It is detrimental to the City's credit standing. It results in unjustified interest cost. It conceals and postpones the impact of current expenses on taxes. It increases annual borrowing significantly and expands outstanding debt.

Temporary Commission on City Finances, Final Report, Better Financing for New York City 79-80 (1966) [hereinafter cited as TCCF.]
million to $724 million.\(^{31}\) In 1975, over fifty percent of the city’s capital budget appropriations was used to finance operating expenses.\(^{32}\)

The New York Constitution and the New York Local Finance Law restricts those expenses which may be financed out of the capital budget to capital projects having useful lives extending beyond the current fiscal year.\(^{33}\) The constitution limits contracted indebtedness for a capital project to a period no longer than the “probable usefulness of the object or purpose for which such indebtedness is to be contracted.”\(^{34}\) This period is to be determined by or pursuant to general or special laws, which determination shall be conclusive.\(^{35}\) The periods of probable usefulness for certain objects and purposes are cataloged in section 11.00 of the Local Finance Law.\(^ {36}\) Therefore, when the city began to issue bonds to finance operating expenses it had to obtain an amendment to section 11.00 which would assign a period of probable usefulness to particular operating expenses. Such amendments would, in effect, redefine an operating expense as a capital improvement. As so defined, a particular item could then be financed out of the city’s capital budget.

The numerous amendments to section 11.00 illustrate the prevalence of this practice. In 1964, an amendment to section 11.00 assigned a three-year period of probable usefulness to the expenses incurred by a municipality in conducting a special population census.\(^ {37}\) In 1967, another amendment to section 11.00 gave a three-year period of probable usefulness to the cost of codifying municipal laws.\(^{38}\) In 1968, the city sponsored and the legislature enacted an amendment to section 11.00 which assigned a thirty-year period of probable usefulness for “job and business opportunity expansion programs of municipalities.”\(^ {39}\) Pursuant to this amendment, the

\(^{31}\) See note 28 supra.

\(^{32}\) Id.

\(^{33}\) Although the New York City Charter defines “capital project,” the state constitution and the New York Local Finance Law actually controls whether an item may be financed out of the capital budget. A. Schick, supra note 30, at 93.

\(^{34}\) N.Y. Const. art. VIII, § 2.

\(^{35}\) Id.

\(^{36}\) N.Y. Local Fin. Law § 11.00(a) (McKinney 1968).

\(^{37}\) N.Y. Local Fin. Law § 11.00(a)(71) (McKinney 1968).

\(^{38}\) Id. § 11.00(a)(72).

\(^{39}\) N.Y. Local Fin. Law § 11.00(a)(73) (McKinney Supp. 1978).
city financed manpower training programs out of the capital budget.40 These expenses, however, should have been financed through the expense budget.41 In 1973, an amendment to section 11.00 permitted the city to issue bonds in order to pay annual rents owed to the "lessor or sublessor of real property leased or subleased for any public or municipal purpose . . . ."42 Also in 1973, section 11.00 was amended to assign a five-year period of probable usefulness to programs providing social and technical assistance to tenants eligible for public assistance.43 These amendments created capital projects which do not fit the definition of "capital project" found in the City Charter.44 Although the city was criticized as early as 1966 for its growing use of capital funds to finance operating expenses,45 this practice was more appealing to elected officials than customarily politically unpopular tax increases and service reductions.46

40. CITIZENS BUDGET COMMISSION, INC., NEW YORK CITY'S DEBT PROBLEM 11 (July 1973) [hereinafter cited as CBC]. See also note 45 infra.

41. CBC, supra note 40, at 11. "What is . . . . ominous is the concept of treating educational expenses as Capital Budget items . . . . The potential for fiscal mischief by use of this justification, is practically unlimited." Id.

42. N.Y. LOCAL FIN. LAW § 11.00(a)(78) (McKinney Supp. 1978).

43. Id. § 11.00(a)(79).

44. See note 26 supra.

45. TCCF, supra note 29, at 79-80. THE CITIZENS BUDGET COMMISSION, REPORT ON NEW YORK, THE SHADOW BUDGET (June, 1969) [hereinafter cited as THE SHADOW BUDGET]. The Citizens Budget Commission, Inc., located on 110 East 42nd Street, N.Y., N.Y. 10017, is a non-partisan civic research organization supported by public contributions which issues periodic reports on New York fiscal issues.

46. FINAL REPORT, supra note 13, at 156. The city has been ordered to reform its capital budget practices by the 1976 City Charter and the 1975 Municipal Assistance Corporation legislation. Id. at 163.

Notably, the Court of Appeals, in Hurd v. City of Buffalo, 34 N.Y.2d 628, 311 N.E.2d 504, 355 N.Y.S.2d 369 (1974) (memo opinion), aff'g 41 A.D.2d 402, 343 N.Y.S.2d 950 (4th Dep't 1973), held unconstitutional a statute which gave a period of probable usefulness of three years for Buffalo's future requirements for pension and retirement liabilities. 34 N.Y.2d at 629, 311 N.E.2d at 504, 355 N.Y.S.2d at 370. The earlier Appellate Division decision viewed this classification as an ongoing subterfuge of the constitutional debt limit. 41 A.D. 2d at 406, 343 N.Y.S.2d at 952. The Court of Appeals accepted the Appellate Division's view. It noted that if unwarranted assignment of periods of probable usefulness to city operating expenses were allowed, the constitutional limitation would be rendered meaningless. 34 N.Y.2d at 629, 311 N.E.2d at 504, 355 N.Y.S.2d at 370. Unfortunately, by the time Hurd was decided, New York City was annually issuing hundreds of millions of dollars of capital debt to finance expenses. FINAL REPORT, supra note 13, at 69. Despite the constitutional provisions, the damage had been done.
Capitalized expenses were the main component of the "shadow budget." Another practice employed to reduce the current expense budget was the exclusion of certain items from the total expense budget, notwithstanding that these items remained in the budget of individual city departments. A preface to the expense budget made reference to these items, but the dollar figures were not included in the officially-promulgated budget. These expenses were camouflaged, resulting in an inaccurate and misleading budget total. Importantly, these hidden expenses were, to a major extent, accounted for by capital funds.

These practices did not go uncriticized. The Citizens Budget Commission pointed out the desirability of full disclosure and called for prudence in ending the practice of "borrowing to meet recurring operating expenses." Counsel for Governor Rockefeller also noted problems in amending section 11.00 to allow current budgetary appropriations to be excluded from the constitutional tax limit of a city. "[This] may be viewed by the courts as a distortion of constitutional intent." Issued as a warning against the passage of the amendments, this advice went unheeded, and amendments to section 11.00 were continuously enacted. Thus, instead of taking the

47. See note 45 supra.
48. For example, in 1969 there was a lump-sum deduction from the total budget, indicated as follows:

Less: Capital Budget, Special and Assessment Funds; Real Property Fund; Housing Fund; Funds from Limited Profit Housing Companies; State Aid for Urban Renewal; State Aid and Private Funds for the Construction of Community Mental Health Centers; State Aid for Capital Projects and Sundry Income Expenditures Included in Budget: $256,772,853.

Importantly, as the Citizens Budget Commission pointed out, "Nowhere [did] this budget inform the public, except by intensive detailed analysis, that $157.6 million of this shadow budget, or over sixty per cent, represent[ed] borrowing." The Shadow Budget, supra note 45, at 2.

49. The Shadow Budget, supra note 45, at 2.
50. E.g., in 1969-70 capital funds accounted for more than 60 per cent of the Shadow Budget (approximately $158 million). Id. at 4.
51. Id. at 6.
52. Special Counsel to the City of New York, A Report to the Securities and Exchange Commission 46 (1977) [hereinafter cited as Special Counsel's Report]. The New York State Constitution sets limitations on the amount which a municipal unit can raise by real estate taxes for local purposes. The limit is expressed as a percentage of the average full valuation of taxable real estate (e.g., 2 per cent for New York City). N.Y. Const. art. VIII, § 10. See notes 8 & 21 supra and accompanying text.
53. See notes 37-44 supra and accompanying text.
financially prudent approach of tightening its fiscal belt, the city chose to finance municipal services by debt financing.

The practice of using long-term borrowing to finance current operating expenses causes several harmful effects. The costs of operating expenses are increased as a result of the interest costs incurred on debt repayment. The limit on the real estate tax which the City may impose to finance operating expenses is circumvented because the limit does not apply to the repayment of debt service obligation. This, in turn, results in higher real estate tax rates. Finally, the City's debt incurring power is reduced, thereby restricting the City's power to borrow for legitimate capital improvements.

The Temporary Commission on New York City Finances noted several additional adverse effects of funding expenses through the issuance of long-term debt, such as increased debt service costs. The Commission stated:

First, the city's infra-structure was inadequately maintained in part because capital funds were diverted for operating rather than capital purposes. Second, the city's ability to borrow money for legitimate purposes at competitive costs was inhibited. Third, its debt load pushed up debt service costs.

54. CBC, supra note 40, at 3.
55. See text accompanying note 21 supra.
56. See note 22, supra and accompanying text.
57. CBC, supra note 40, at 3.
58. Id. Additionally, the reduction of the City's debt-incurring power encourages the use of public benefit corporations to finance capital construction, see notes 131-60 infra, as the debt contracted by these corporations is not applied to the City's debt limit. CBC, supra note 40, at 3.
59. The Temporary Commission on New York City Finances is a group whose members were appointed by Mayor Abraham Beame, to study and make recommendations concerning the City of New York's long term financial problems and prospects.
60. Debt service is the cost of interest and principal due on outstanding debt. See note 22 supra, and accompanying text. The following table sets forth the increase in debt service costs, dollar and percentage wise, for fiscal years 1961-1975.
which reduced the amount of money available to deliver services.\textsuperscript{61}

Clearly, then, existing state constitutional provisions were ineffective in preventing uncontrolled debt incurrence and its adverse effects.\textsuperscript{62} Instead, as one report pointed out “[i]t seemed as if the city could borrow for anything.”\textsuperscript{63}

As current expenses were capitalized, charges were made against the debt limit.\textsuperscript{64} In order to accommodate this charge the city excluded other debt from the constitutional limit figures. The method employed to accomplish this has been referred to as the “two to ten

| TABLE 3 |
| DEBT SERVICE COSTS FOR THE CITY OF NEW YORK: FISCAL YEARS 1961-1975 ($ in millions) |

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Debt Service</th>
<th>Fiscal Period</th>
<th>Percentage Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>1961</td>
<td>$ 402</td>
<td>1961-1976</td>
<td>473.1%</td>
</tr>
<tr>
<td>1962</td>
<td>400</td>
<td>1961-1966</td>
<td>46.5</td>
</tr>
<tr>
<td>1963</td>
<td>400</td>
<td>1966-1971</td>
<td>40.9</td>
</tr>
<tr>
<td>1964</td>
<td>433</td>
<td>1971-1976</td>
<td>177.6</td>
</tr>
<tr>
<td>1965</td>
<td>470</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1966</td>
<td>589</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1967</td>
<td>672</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1968</td>
<td>650</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1969</td>
<td>667</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1970</td>
<td>676</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1971</td>
<td>830</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1972</td>
<td>932</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1973</td>
<td>1,598</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1974</td>
<td>1,269</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1975</td>
<td>1,948</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

\textsuperscript{61} \textit{Final Report}, supra note 13, at 73.

\textsuperscript{62} \textit{Final Report}, supra note 13, at 71.

\textsuperscript{63} See note 46 supra.

\textsuperscript{64} Committee on Municipal Affairs of the Association of the Bar of the City of New York, \textit{Proposals to Strengthen Local Finance Laws in New York State}, 34 The Record 68, 77 (Jan./Feb. 1979, No. 1/2) [hereinafter cited as Proposals].

\textsuperscript{64} It should be noted, however, that even though capital funds were used, these expenditures were officially carried in the expense budget and to a large extent, obfuscated in the "Shadow Budget." See notes 45 & 48 supra and accompanying text.
percent debt exclusion switch."\textsuperscript{65} Under the New York Constitution's ten percent limit on long-term debt, if the project which is financed generates revenues that cover twenty-five percent or more of the debt service requirements of a year (i.e., projects which are partially self-sustaining), the long-term debt may be excluded from the ten percent figure to the extent debt service is so covered.\textsuperscript{66} However, exclusion from the additional two percent debt limit for housing and urban renewal projects requires that the project be completely self-sustaining in order for the debt to be excluded from the debt limitations.\textsuperscript{67} In 1968, New York City sponsored an amendment to section 150.00 of the Local Finance Law which would expressly permit the "debt exclusion switch."\textsuperscript{68} This allowed the city to charge debt issued for housing and urban renewal purposes to the ten percent limit where the project was only partially self-sustaining.\textsuperscript{69} The city took advantage of the debt exclusion switch to partially finance the Mitchell-Lama project.\textsuperscript{70} Pursuant to the amendment the city excluded approximately $1 billion of the $1.2 billion in Mitchell-Lama related debt in fiscal year 1975-1976.\textsuperscript{71} Had Mitchell-Lama debt remained chargeable only to the housing and urban renewal two percent limit, little of that debt could have been excluded under section 152.00 because most of the city's Mitchell-Lama projects were not self-sustaining.\textsuperscript{72} This was exactly the type

\textsuperscript{65} Special Counsel's Report, supra note 52, at 77.

\textsuperscript{66} N.Y. Const. art. VIII § 5(C). The Local Finance Law specifies what debt may be excluded from the debt limits. See N.Y. LOCAL FIN. LAW § 123.00 (McKinney 1968). Before the city can exclude any debt from its total outstanding indebtedness, the city must file an exclusion application with the state comptroller. The state comptroller must consent to the exclusion. Id. §§ 123.00(g)-123.00(j).

\textsuperscript{67} N.Y. Const. art. XVIII, § 4.

\textsuperscript{68} N.Y. LOCAL FIN. LAW § 150.00(d) (McKinney Supp. 1978). This section states that the two percent housing debt limit shall not apply "to the extent that there is a sufficient margin of debt contracting power to cover indebtedness for housing . . . purposes contracted pursuant to article eighteen of the constitution within the debt limit established by section four of article eight of the constitution" unless the finance board decides to charge the debt or any part of it to the two percent limit. Id. § 150.00(d)(ii). The rationale for this amendment was the distinction made between the constitutional power to incur debt and the debt limit to which it may be charged.

\textsuperscript{69} Id.

\textsuperscript{70} See note 117 infra.

\textsuperscript{71} [1975-1976] ANNUAL REPORT, supra note 18, at 143.

\textsuperscript{72} "Fully 66 city Mitchell-Lama projects—two out of three in the entire portfolio—could meet only their operating expenses. They had insufficient funds to pay debt service, reserve
of debt that the two percent limit was designed to regulate. However, by charging the debt against the ten percent category, these issues would be subject to more liberal exclusion provisions. Vacancies were then created for other debt, specifically debt misused for operating expenses. Obviously, this transfer between debt limits resulted in a substantial amplification of the city's borrowing power.

II. Short-term Debt Financing Devices

A. Reserve Funds and Budget Notes

The city's short-term borrowing power was also utilized to generate funds which would otherwise have been unavailable to the city. In contrast to long-term borrowing, short-term borrowing may properly be used to finance current expenses. The cash flow of expected revenues often do not meet current expense requirements. For example, taxes may not be paid until the close of the fiscal year. Borrowing is then necessary to meet such cash-flow problems. However, this power was also abused.

An example of abuse was the annual depletion of legally-created reserve funds, one of which is termed the "rainy day fund." This fund was designed to provide the city with a source of cash in times of deficient tax collections. The City Charter originally obligated

requirements, and returns on equity." D. MUCHNICK, FINANCIAL REALITY IN PUBLICLY ASSISTED MIDDLE-INCOME HOUSING 17 (1977) [hereinafter cited as MUCHNICK].

Since most of the Mitchell-Lama projects could not pay debt service requirements, it is difficult to imagine how the city could obtain any exclusion of Mitchell-Lama debt. The "exclusion applications" prepared by the city (N.Y. LOCAL FIN. LAW § 123.00(h) (McKinney 1968)) were unavailable at the time of this writing notwithstanding the fact that these exclusion applications are public records to be kept on file in the office of the City's chief fiscal officer. Id. § 123.00(j). The exclusion applications should contain the mathematics involved in determining if the city qualified for a debt exclusion. At this time, one can only assume that the exclusion was not sought on a project by project basis. The city must have treated all the projects as one for exclusion purposes. In this way, the surplus revenue generated by productive projects would make up for less productive projects.

73. Id. § 152.00(b). The facility with which this switching was accomplished is exemplified by testimony given to the SEC's staff by Steven Clifford, Special Deputy Comptroller. "Q: What types of housing debt are discharged against the two percent limitation? A: I don't know. They used to transfer things back and forth between the ten and the two. I never understood it." SEC STAFF REPORT, supra note 6, at 16.

74. The fund is officially titled the "Tax Appropriation and General Fund Stabilization Reserve Fund." N.Y. CITY CHARTER ch. 6, § 128 (1976).

75. Id.
CONSTITUTIONAL DEBT LIMIT

the city to appropriate sufficient money to maintain the reserve fund's prescribed level. In 1963, however, an amendment to the City Charter was passed which relieved the city of this obligation. As a result, between 1961 and 1965 the fund's reserve decreased from $70 million to $155 thousand. There were similar depletions of other reserve funds (e.g., the tax deficiency account).

A second practice employed to meet cash flow needs was the issuance of budget notes. Budget notes were payable from the succeeding years' budgets. The authority to issue these notes was conferred to bridge a current budget gap. However, this authority was also abused. In fiscal years 1962 through 1965, the City of New York issued budget notes in the amounts of $10, $27, $30 and $39 million, respectively.

B. Revenue Anticipation Notes

To meet continuing budget requirements, the legislature provided for the issuance of "revenue anticipation notes" (hereinafter "RANs"). These were notes issued in expectation of certain tax revenues (e.g., state aid for education, local non-property taxes, etc.) connected with activities occurring in April, May, and June of the current year, but not scheduled for payment until the subsequent year. The funds received from the sale of RANs allowed the city to balance the current year's budget with the estimated reve-

76. Id.
77. N.Y. CITY CHARTER ch. 6, § 128g (1979).
78. Proposals, supra note 63, at 75.
79. Id. § 127 (1976). See also TEMPORARY COMMISSION ON CITY FINANCES, FINAL REPORT, BETTER FINANCING FOR NEW YORK CITY 57, table 3 (1966).
80. N.Y. LOCAL FIN. LAW §§ 29.00(j), 29.00(k) (McKinney 1968).
81. Proposals, supra note 63, at 76. Robertson, Going Broke the New York Way, FORTUNE, Aug., 1975, at 146-47. Limitations on the amount of budget notes are enumerated in N.Y. LOCAL FIN. LAW § 29.00(a)(2) (McKinney 1968). In 1965 Mayor Wagner authorized the sale of these notes in excess of legal limits. See note 2 supra.
82. 1965 N.Y. LAWS ch. 441 (codified at N.Y. LOCAL FIN. LAW § 25.00(c)(2) (McKinney 1968)).
83. [1974-1975] NEW YORK CITY COMPTROLLER'S ANN. REP. pt. 6-C (Temporary Debt.).
84. Proposals, supra note 63, at 76. "Such borrowing was limited to the difference between the amount of the specific type of revenue estimated by the City and the amount actually collected at the time of issuance of the notes." SPECIAL COUNSEL'S REPORT, supra note 52, at 54.
nues of the following year.\textsuperscript{85} RANs were a desirable fiscal device because they provided for an increase in current revenues without violating the debt limitations imposed by article VIII, as short-term debt is expressly exempted from the debt limitations of that article.\textsuperscript{86} As one might predict, the amount of outstanding RANs steadily increased as the city regularly took great advantage of this authority.\textsuperscript{87} As one critic warned, the authorization of the issuance of RANs was the "institutionalizing" of a "bad budgeting procedure."\textsuperscript{88}

The amendment discussed above which relieved the city of its obligation to maintain the reserve funds\textsuperscript{89} also allowed RANs to be issued based on estimated revenues rather than actual revenues collected or received during the preceding fiscal year, as had been previously required.\textsuperscript{90} Debt was then issued upon the basis of poten-

\begin{table}[h]
\centering
\begin{tabular}{|c|c|}
\hline
As of June 30 & Millions \\
\hline
1965 & $56.6 \\
1966 & 45.0 \\
1967 & 93.8 \\
1968 & 93.8 \\
1969 & 93.8 \\
1970 & 116.7 \\
1971 & 131.3 \\
1972 & 150.0 \\
1973 & 162.1 \\
1974 & 298.3 \\
\hline
\end{tabular}
\caption{RANs Outstanding Redeemable from general fund revenues}
\end{table}

\textsuperscript{85.} Special Counsel's Report, supra note 52, at 53.
\textsuperscript{86.} N.Y. Const. art. VIII, § 5.
\textsuperscript{87.} The following table shows the almost six-fold increase in RANs outstanding between 1965 and 1974, redeemable from general fund revenues:
\textsuperscript{88.} Special Counsel's Report, supra note 52, at 54 (Senator Marchi).
\textsuperscript{89.} See notes 74-79 supra and accompanying text.
\textsuperscript{90.} Prior to the amendment to the City Charter, if $500 million in revenue had been received as of the end of year one, and $400 million had been received by the end of year two, outstanding RANs could not exceed $100 million. SEC Staff Report, supra note 6, at 20.
tially inflated income estimates, without any assurance that the money would be available to meet the additional debt service requirements. In essence, RANs were issued based on insufficient or non-existent revenues. A 1975 audit report on the city, prepared by the Office of the New York State Comptroller noted that “the city had included as accounts receivable substantial amounts that were not collectable or where the likelihood of collection was extremely remote—such as claims for reimbursement of disallowed costs, claims in excess of stipulated limitations, and claims that had been rejected but were on appeal.” The Office also observed that “the significant overstatements of receivables . . . meant that revenue anticipation notes issued by the city and which were stated to be supported by federal and state receivables were not so supported.” When these budgeted revenues did not materialize, new notes were issued to pay off old, resulting in a cumulative deficit.

This practice of reissuing notes after their maturity date, resulting, in effect, in an extension of the maturity date of the original issue, is known as “rolling-over.” Short-term notes effectively created a long-term debt. This “long-term debt”, however, was not controlled by the relevant constitutional restrictions. As expected, due to fiscal expediencies, this procedure became an important and often-used financing device.

The situation was worsened by an additional amendment to the

91. Id. at 19.
92. Id. at 25.
93. “Roll-over” refers to the issuance of new debt to pay the principal and interest on previously issued notes as they mature. It is simply the replacement of old with new debt and, therefore, does not reduce the amount of principal.
94. The following table indicates the increase in the roll-over problem during fiscal years 1961-1975. Whenever new issues of notes equal redemptions, outstanding debt remains the same, the city having rolled-over the entire amount.
Local Finance Law in 1971. This amendment permitted the issuance of RANs based on revenues receivable from federal and state governments on an *overall basis*. These revenues were aggregated for the issuance of the RANs, whether or not these funds were earmarked for definite categorical purposes (i.e., capital or operational). Consequently, "it [was] almost impossible to determine exactly how the proceeds of these obligations were utilized."

**C. Tax Anticipation Notes**

Because short-term debt coupled with the rolling-over practice was such an effective fiscal device, it was employed in several other forms. In addition to the RANs, the city also issued tax anticipation notes (hereinafter "TANs"). These notes are short-term obliga-

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Issued</th>
<th>Redeemed or Cancelled</th>
<th>Increase (Decrease)</th>
<th>Notes Issued/ Redeemed</th>
</tr>
</thead>
<tbody>
<tr>
<td>1961</td>
<td>$687,700,000</td>
<td>$685,700,000</td>
<td>$2,000,000</td>
<td>1.0029</td>
</tr>
<tr>
<td>1962</td>
<td>842,238,000</td>
<td>815,138,000</td>
<td>27,100,000</td>
<td>1.0331</td>
</tr>
<tr>
<td>1963</td>
<td>807,658,800</td>
<td>704,300,000</td>
<td>105,358,800</td>
<td>1.1463</td>
</tr>
<tr>
<td>1964</td>
<td>1,166,728,800</td>
<td>1,081,758,800</td>
<td>84,970,000</td>
<td>1.0786</td>
</tr>
<tr>
<td>1965</td>
<td>1,469,889,800</td>
<td>1,260,128,800</td>
<td>209,861,000</td>
<td>1.1658</td>
</tr>
<tr>
<td>1966</td>
<td>1,645,597,560</td>
<td>1,704,532,800</td>
<td>(58,942,240)</td>
<td>0.9653</td>
</tr>
<tr>
<td>1967</td>
<td>2,076,036,800</td>
<td>1,907,855,360</td>
<td>168,151,440</td>
<td>1.0886</td>
</tr>
<tr>
<td>1968</td>
<td>2,427,717,000</td>
<td>2,369,399,000</td>
<td>58,318,000</td>
<td>1.0244</td>
</tr>
<tr>
<td>1969</td>
<td>3,270,995,000</td>
<td>3,216,957,000</td>
<td>54,038,000</td>
<td>1.0167</td>
</tr>
<tr>
<td>1970</td>
<td>4,400,925,000</td>
<td>3,860,005,000</td>
<td>540,920,000</td>
<td>1.1398</td>
</tr>
<tr>
<td>1971</td>
<td>6,512,240,000</td>
<td>5,481,060,000</td>
<td>1,031,180,000</td>
<td>1.1881</td>
</tr>
<tr>
<td>1972</td>
<td>5,248,960,000</td>
<td>4,918,110,000</td>
<td>330,850,000</td>
<td>1.0673</td>
</tr>
<tr>
<td>1973</td>
<td>4,003,285,000</td>
<td>4,136,980,000</td>
<td>(132,695,000)</td>
<td>0.9678</td>
</tr>
<tr>
<td>1974</td>
<td>7,305,915,000</td>
<td>6,407,550,000</td>
<td>898,365,000</td>
<td>1.1403</td>
</tr>
<tr>
<td>1975</td>
<td>8,395,745,000</td>
<td>7,271,445,000</td>
<td>1,124,300,000</td>
<td>1.1547</td>
</tr>
</tbody>
</table>

**TABLE 5**

**SHORT-TERM DEBT OF NEW YORK CITY:**

**FISCAL YEARS 1961-1975**

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95. *N.Y. Local Fin. Law* § 25.00(b)(2) (McKinney 1978).
96. *Id.*
97. *Special Counsel's Report, supra* note 52, at 59.
98. *N.Y. Local Fin. Law* § 24.00 (McKinney 1968).
tions issued in anticipation of real estate tax revenues. Expense budgets were based on full collection of these revenues. However, the figures used occasionally did not reflect actual incoming funds.99

For example, in 1975, the Annual Report of the Comptroller listed real estate taxes receivable in an amount of $502.2 million.100 Based on this figure, the city had outstanding TANs of $380 million.101 However, much of the taxes receivable included receivables which represented tax-exempt property. Such property included publicly-owned property ($126.6 million), diplomatic property ($4.7 million), Mitchell-Lama property ($53.0 million),102 "in rem" property ($54.4

99. The following table illustrates the figures for accrued real estate taxes receivable which were used by the city as support for the issuance of TANs:

<table>
<thead>
<tr>
<th>TABLE 6</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>NEW YORK CITY TAX ANTICIPATION NOTES:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>FISCAL YEARS 1963-1975</td>
<td></td>
</tr>
<tr>
<td></td>
<td>($ in millions)</td>
<td></td>
</tr>
<tr>
<td>As of June 30</td>
<td>TANs Outstanding</td>
<td>Taxes Receivable</td>
</tr>
<tr>
<td></td>
<td></td>
<td>per Annual Report</td>
</tr>
<tr>
<td>1963</td>
<td>$ 63.1</td>
<td>$ 94.2</td>
</tr>
<tr>
<td>1964</td>
<td>77.4</td>
<td>104.7</td>
</tr>
<tr>
<td>1965</td>
<td>88.8</td>
<td>115.9</td>
</tr>
<tr>
<td>1966</td>
<td>100.3</td>
<td>130.3</td>
</tr>
<tr>
<td>1967</td>
<td>136.5</td>
<td>168.8</td>
</tr>
<tr>
<td>1968</td>
<td>147.5</td>
<td>176.4</td>
</tr>
<tr>
<td>1969</td>
<td>155.5</td>
<td>187.5</td>
</tr>
<tr>
<td>1970</td>
<td>170.0</td>
<td>204.9</td>
</tr>
<tr>
<td>1971</td>
<td>206.0</td>
<td>241.9</td>
</tr>
<tr>
<td>1972</td>
<td>232.0</td>
<td>282.8</td>
</tr>
<tr>
<td>1973</td>
<td>265.0</td>
<td>337.5</td>
</tr>
<tr>
<td>1974</td>
<td>317.0</td>
<td>408.5</td>
</tr>
<tr>
<td>1975</td>
<td>380.0</td>
<td>502.2</td>
</tr>
</tbody>
</table>

SEC STAFF REPORT, supra note 6, at 29.
However, in an August, 1975 audit report, the Office of the State Comptroller considered over eighty per cent of the taxes receivable to be unavailable to the city. [1974-1975] NEW YORK STATE COMPTROLLER AUDIT REP. No. NYC-26-76, at 4.
102. Mitchell-Lama properties are properties which are legally permitted to apply for
and property belonging to Penn Central, a bankrupt corporation ($43.9 million). Moreover, the city did not realistically account for taxes which, although due, were not collected because of defaulting taxpayers, cancellations or remissions. State auditors estimated these uncollectibles to be $125.7 million in 1975. Therefore, receivables attributable to these two categories amounted to over $408 million, or eighty-one percent of the total figure used to support TAN issuance. As the State Comptroller's Office succinctly observed: "The City's budgetary and accounting practices result[ed] in an inflated estimate of real estate taxes to be collected to balance the annual expense budget, and [did] not make adequate provision for taxes that [would] not be collected. The result [was] that budgeted real estate tax amounts [were] not . . . realized . . . ." The same office noted further that "for the most part, the revenue shortfall was met by continued borrowing." Hence, deficit expansion was greatly intensified through the misuse of TANs.

The State Local Finance Law expressly provides for rolling-over of TANs for a four year period following the maturity date of the original issuance. The rollover is allowed on the theory that these taxes may be collected during this period, and so, in order to use these assets prior to collection, the notes are reissued. As the Municipal Finance Commission to the Governor explained, the four year limit is imposed because "[s]uch taxes outstanding and uncollected after the termination of such [four year] period are assets of doubtful value and consequently the notes issued in anticipation of their collection should be redeemed no later than the termination

"shelter rent exemptions" which amount to abatements of real estate taxes. SEC Staff Report, supra note 6, at 31 n.2. See also note 117 infra.

103. Property classified as "in rem" is that which, because of non-payment of real estate taxes, is in the process of being foreclosed. S.E.C. Staff Report, supra note 6, at 31 n.2.

104. Id. at 32.

105. Proposals, supra note 63, at 77.

106. SEC Staff Report, supra note 6, at 32.


108. Id.

109. The statute, in relevant part, reads: "Tax anticipation notes issued pursuant to this paragraph shall mature within one year from the date of their issuance and may be renewed from time to time." The statute adds that each renewal shall be for a period not to exceed the close of the fourth fiscal year succeeding that in which the original notes were issued. N.Y. Local Fin. Law § 24.00(a)(6) (McKinney 1968) (emphasis added).
of such period."  

Since original estimates of real estate tax receivables were so unrealistic and inaccurate, the roll-over allowance aggravated the situation. Conveniently, the city could use the legal roll-over in order to meet its TAN debt service needs, unsatisfied by the over-estimations allegedly supporting them. Coupled with the misuse of RANs, huge deficits were incurred.

D. Bond Anticipation Notes

Bond anticipation notes (BANs) are another short-term borrowing device used excessively by the city prior to the fiscal crisis of 1975. BANs are sold to provide a temporary source of revenue in anticipation of a subsequent sale of long-term municipal bonds. Generally, a municipality sells bonds to generate the money needed to finance capital projects such as the construction or rehabilitation of schools, public buildings, sewers and housing. Municipalities often issue BANs to finance the early stages of a capital project until bonds are sold, at which time the project is said to be in "permanent" financing. The proceeds of the bond sale are then used to redeem the previously issued BANs.

---

111. STEISS, supra note 7, at 184.
113. STEISS, supra note 7, at 184.
114. Id. At the time the financial market rejected city bonds and notes, BANs accounted for more than one quarter of the city's outstanding short-term debt, as illustrated by the following table.

**TABLE 7**

NEW YORK CITY SHORT-TERM DEBT AS OF JUNE 30, 1975

($ in millions)

<table>
<thead>
<tr>
<th>Type of Note</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Budget Notes</td>
<td>—</td>
</tr>
<tr>
<td>Tax Anticipation Notes</td>
<td>380</td>
</tr>
<tr>
<td>Revenue Anticipation Notes</td>
<td>2,560</td>
</tr>
<tr>
<td>Bond Anticipation Notes</td>
<td>1,570</td>
</tr>
<tr>
<td>Urban Renewal Notes</td>
<td>30</td>
</tr>
<tr>
<td><strong>Total Short-Term</strong></td>
<td><strong>4,540</strong></td>
</tr>
</tbody>
</table>

[1976] MAC REPORT, supra note 1, at 8.
The issuance of BANs is a fiscally prudent part of the financial management of capital projects when properly used. A municipality can finance a capital project in phases by relying on BANs for temporary financing. "This procedure has the advantages of avoiding interest payments on the full amount of funding until it is actually required, of avoiding the accumulation of idle funds, and of greater flexibility in choosing the most advantageous time to market long-term bonds." However, as with the budget practices discussed above, BANs were abused.

A typical practice was the use of BANs to finance the Mitchell-Lama project. The city rolled-over its BANs as they matured, continually renewing the debt without paying any principal. Had the city issued bonds for Mitchell-Lama projects, the city's annual debt service would have included the payment of both principal and interest. Consequently, by rolling-over its Mitchell-Lama BANs,

115. STEISS, supra note 7, at 184.
116. See notes 74-115 supra and accompanying text.
117. In 1955, the New York State Legislature enacted the Limited-Profit Housing Companies Law, now commonly known as the Mitchell-Lama Act. Mitchell-Lama refers to the two state legislators who sponsored the N.Y. Priv. Hous. Fin. Law art. II (McKinney 1976); see Wall St. J., July 21, 1978, at 1, col. 1. The New York City Mitchell-Lama program is supervised by the Housing Development Administration (HDA) according to policies determined by the State Legislature and the City Council. ECONOMIC AND DEVELOPMENT COUNCIL OF NEW YORK CITY, INC., CONSULTANT'S REPORT TO NEW YORK CITY HOUSING AND DEVELOPMENT ADMINISTRATION, ON IMPROVING MITCHELL-LAMA HOUSING SUPERVISION 4 (1975) [hereinafter cited as CONSULTANT'S REPORT]. The purpose of the law was to promote the construction of safe and sanitary housing for people of modest means. N.Y. Priv. Hous. Fin. Law art. II, § 11 (McKinney 1976). The Mitchell-Lama Act offered New York City a solution to the migration of middle-class families to the surrounding suburbs. Id. § 11-a(2).

To accomplish its purpose, the Mitchell-Lama Act attempted to induce private housing developers to enter into business arrangements they would normally avoid. Id. § 11. This section states that inadequate housing conditions in municipalities requires "speedy relief which cannot readily be provided by the ordinary unaided operation of private enterprise ...." Naturally, this required the creation of business incentives in a construction market where none had previously existed. These incentives were provided by the State and City governments which were authorized to offer low-interest, long-term mortgage loans and real estate tax abatements to housing companies organized pursuant to the Mitchell-Lama Act. J. DeSALVO, NEW YORK CITY'S MITCHELL-LAMA HOUSING PROGRAM 2 (1971). In return for these benefits, the housing companies accepted governmental regulation of construction, profits, dividends, rent structure and tenant selection. Id.
118. See note 93 supra and accompanying text.
119. N.Y. LOCAL FIN. LAW § 21.00(f) (McKinney 1968). This section allows the City to issue serial bonds to finance middle-income housing. These bonds may be retired by making
the city's annual debt service for Mitchell-Lama debt only included the payment of interest on BANs. Therefore, the city's debt service for its Mitchell-Lama projects was kept as low as possible; the lower the debt service, the greater the possible exclusion under section 123.00.\textsuperscript{120}

The city needed to roll-over its BANs in order to avail itself of the debt exclusion provided by section 123.00. This practice of continuing to roll-over BANs, however, could not have occurred without the aid of the New York State Legislature. Local Finance Law, section 23.00, requires that BANs issued to make loans to limited-profit housing companies "or the renewals of such notes, may extend not more than five years beyond the original date of issue of such notes."\textsuperscript{121} In 1966, the city sponsored legislation to extend the maximum renewal period of BANs. In that year, the state legislature amended section 23.00 to extend the renewal period of BANs issued in 1961 to six years.\textsuperscript{122} Similar amendments were enacted yearly from 1968 to 1976.\textsuperscript{123}

The legislative memorandum filed in support of the 1971 amendment requested that the renewal period of BANs be extended because of the high interest rate on long-term borrowing.\textsuperscript{124} The memorandum emphasized the relation between "interest payable on permanent bonds" and the "rent levels at the affected projects."\textsuperscript{125}

\textsuperscript{120} See note 66 supra.

\textsuperscript{121} N.Y. LOCAL FIN. LAW § 23.00(b) (McKinney 1968).

\textsuperscript{122} 1966 N.Y. Laws ch. 205.

\textsuperscript{123} 1968 N.Y. Laws ch. 135; 1969 N.Y. Laws ch. 168; 1970 N.Y. Laws ch. 4; 1971 N.Y. Laws ch. 4, 1972 N.Y. Laws ch. 202; 1973 N.Y. Laws ch. 845; 1974 N.Y. Laws ch. 885; 1975 N.Y. Laws ch. 367; 1976 N.Y. Laws ch. 64; Section 23.00(b) was also amended in 1978. 1978 N.Y. Laws ch. 167. The renewal period of BANs issued before 1965 was extended to 16 years. Id. The ease with which the city was able to convince the state legislature to amend existing statutory requirements, rather than comply with those requirements, is evident from the frequent amendments passed to the Local Finance Law.

\textsuperscript{124} 1971 N.Y. Laws ch. 4 at 2342.

\textsuperscript{125} Id.
Because the Mitchell-Lama program was intended to be self-sustaining,\textsuperscript{126} the cost of financing the program was to come from the rents paid by Mitchell-Lama tenants.\textsuperscript{127} Therefore, an increase in the cost of borrowing would theoretically require a corresponding increase in rents.\textsuperscript{128} The rent structure at most Mitchell-Lama projects, however, was at no time high enough to make the program self-sustaining.\textsuperscript{129} The city rolled-over its Mitchell-Lama BANs to avail itself of the debt exclusion provided by the Local Finance Law and to avoid imposing substantial rent increases upon Mitchell-Lama tenants. As a result, the city did not amortize its Mitchell-Lama debt and the burden of paying for the program has been shifted to future generations. 

III. Public Benefit Corporations

Public authorities, or public benefit corporations (PBCs), are separate legal entities\textsuperscript{130} created by the legislature\textsuperscript{131} in order to promote

\begin{itemize}
\item \textsuperscript{126} CONSULTANT'S REPORT, supra note 117, at 5.
\item \textsuperscript{127} N.Y. PRIV. HOUS. FIN. LAW § 31(1)(a) (McKinney 1976).
\item \textsuperscript{128} CONSULTANT'S REPORT, supra note 117, at 8.
\item \textsuperscript{129} Based on data available in 1975, one study estimates that 66 out of 101 Mitchell-Lama projects had average monthly deficits of approximately $45 per rental unit. MUCHNICK, supra note 72, at 17.
\item \textsuperscript{131} Legislative authority for the creation of Public Benefit Corporations is found in the New York State Constitution article X, section 5. The constitutional provision requires that
a governmental purpose. In the New York Public Authorities Law, the New York State Legislature has classified the PBCs into general categories embracing such diverse governmental purposes as constructing and maintaining parks, highways, bridges and tunnels, markets, public utilities, ports, and parking facilities.

The legislature defines a public benefit corporation as a body or authority possessing characteristics of both corporations and bodies politic. Unlike private corporations incorporated under the New York State Business Corporation Law, the corporate powers of a public authority are restricted to the specific types of business activ-

public corporations be created only by special act of the legislature. This provision has been construed to mean that a public corporation must be created by the state legislature itself, rather than by local government or an administrative officer. City of Rye v. Metro. Transp. Auth., 24 N.Y.2d 627, 634, 249 N.E.2d 429, 432, 301 N.Y.S.2d 569, 572-73 (1969).

The authorities are governmental in scope since the projects developed and services provided are all matters of state concern intended to benefit the people of the State. See note infra and accompanying text.

Examples include the Bethpage Park Authority, N.Y. PUB. AUTH. LAW §§ 200-214 (McKinney 1970); New York State Thruway Authority, id. §§ 350-375; Triborough Bridge and Tunnel Authority, id. §§ 550-571; New York State Bridge Authority, id. §§ 525-542; Central New York Regional Market Authority, id. §§ 825-845; Power Authority of the State of New York, id. §§ 1000-1016; Buffalo Sewer Authority, id. §§ 1175-1185. PBCs have also undertaken to build and operate a planetarium at the American Museum of Natural History, N.Y. PUB. AUTH. LAW §§ 1625-1639 (McKinney 1970) (American Museum of Natural History Planetarium Authority); to research and develop the use of atomic energy, id. §§ 1850-1870 (N.Y.S. Energy Research and Development Authority); to improve employment opportunities, id. §§ 1800-1834 (New York Job Development Authority); to provide financing, e.g. N.Y. PRIV. HOUS. FIN. LAW §§ 40-61 (McKinney 1976) (New York State Housing Finance Agency), N.Y. UNCONSOL. LAWS §§ 7411-7431 (McKinney 1979) (New York State Medical Care Facilities Finance Agency Act); to construct housing and other facilities, e.g., N.Y. PUB. AUTH. LAW §§ 1675-1692 (McKinney 1970) (Dormitory Authority); to support cultural institutions, N.Y. GEN. MUN. LAW §§ 325-331 (McKinney Supp. 1978) (Trust for Cultural Resources for the City of New York).

Typically, since the public authority is serving a public purpose, the property and income of the authority and the interest on its bonds are tax-exempt. Comm'r v. White's Estate, 144 F.2d 1019 (2d Cir. 1944). Tax exemptions may be granted only by general law and in the case of public authorities this legislative-granted tax exemption is repealable. N.Y. CONST. art. XVI, § 1. See Comment, An Analysis of Authorities: Traditional and Multicounty, 71 MICH. L. REV. 1376, 1383-85 (1973); Quirk & Wein, A Short Constitutional History of Entities Commonly Known as Authorities, 56 CORNELL L. REV. 521, 578-81 (1971) [hereinafter cited as Quirk & Wein].

See, e.g., N.Y. PUB. AUTH. LAW § 202 (McKinney 1979) (Bethpage Park Authority); id. § 352 (New York State Thruway Authority); id. § 1263 (McKinney Supp. 1978) (Metropolitan Transportation Authority); id. § 1282 (New York State Environmental Facilities Corporation).
ity granted by the statutes creating them. Members of the boards of directors of statewide or regional public authorities are appointed by the Governor with the consent of the senate. The legislature has also mandated that some of these board members must hold high office in the state government (ex officio directors). The legislative objective is to provide the authority with information on state programs and, if possible, to coordinate activities. In sum, the board members are to serve as liaisons to the state administration.

The projects traditionally financed by public authorities were revenue-producing facilities or service facilities for which there was a charge or fee. The projects were therefore self-sustaining and the bonds sold to finance them were secured by the projects' own revenues. More recently, however, public authorities have begun

135. Among the usual corporate powers conferred upon a public authority are the powers to sue and be sued, possess a corporate seal, acquire, sell, or dispose of real and personal property, make by-laws, fix rates and collect fees or tolls for the use of its facilities (so called "user charges"), and make contracts, borrow money and issue evidences of indebtedness. E.g., Metropolitan Transportation Authority, N.Y. PUB. AUTH. LAW §§ 1265-1266 (McKinney 1970 & Supp. 1978); Dormitory Authority, id. § 1678; Nassau County Bridge Authority, id. § 654. In addition, some public authorities have been empowered to condemn property, e.g., Nassau County Bridge Authority, id.; Dormitory Authority, id. § 1678; Erie County Water Authority, id. § 1054 (McKinney 1970); Trust for Cultural Resources of the City of New York, N.Y. GEN. MUN. LAW § 329 (McKinney Supp. 1978).

136. There are 42 statewide or regional authorities in which the Governor participates in the appointing of members to the authority boards. For a complete listing, see N.Y. DEP'T OF AUDIT AND CONTROL, 1978 ANNUAL REPORT OF THE COMPTROLLER 38 [hereinafter cited as 1978 AUDIT AND CONTROL ANNUAL REPORT].

137. Examples include the Triborough Bridge and Tunnel Authority, N.Y. PUB. AUTH. LAW § 552 (McKinney 1970) (Members of the Board of Directors of the Metropolitan Transportation Authority to serve ex officio on the Triborough Bridge and Tunnel Authority) and the Central New York Regional Market Authority, id. § 827 (Commissioner of agriculture and markets to serve as member ex officio).

138. But see MORELAND ACT COMMISSION, RESTORING CREDIT AND CONFIDENCE, A REFORM PROGRAM FOR NEW YORK STATE AND ITS PUBLIC AUTHORITIES 62-63 (1976) [hereinafter cited as MORELAND REPORT] where the authors recommend that the statewide public authorities should have no ex officio directors.

139. Revenue-producing facilities operated by authorities include ports (Port of Oswego Authority, N.Y. PUB. AUTH. LAW §§ 1350-1370 (McKinney 1970), dams (Power Authority of the State of New York, id. §§ 1000-1016), airports (Ogdensburg Port Authority, id. § 1379), and parks (Bethpage Park Authority, id. §§ 200-214).

140. Services rendered include water (Suffolk County Water Authority, N.Y. PUB. AUTH. LAW §§ 1075-1092 (McKinney 1970 & Supp. 1979)), gas and electric power (Albany Light, Heat and Power Authority, id. §§ 1025-1044) and transportation (Metropolitan Transportation Authority, id. §§ 1260-1278).

141. 1978 AUDIT AND CONTROL ANNUAL REPORT, supra note 136, at 35; XI NEW YORK STATE


144. See, e.g., N.Y. Unconsol. Laws §§ 4401-4417 (McKinney 1979) (Facilities Development Corporation Act); id. §§ 7411-7431 (New York State Medical Care Facilities Finance Agency Act).


146. In February, 1975, the New York State Project Finance Agency (PFA), N.Y. Unconsol. Law §§ 6361-6382 (McKinney 1979), was created by the legislature to provide long-term financing to the Urban Development Corporation (UDC), id. §§ 6251-6289. Formed in 1968, the UDC was created to undertake urban development activities covering such wide and diverse activities as the construction or improvement of industrial, manufacturing, commercial, educational, recreational and cultural facilities and housing accommodations for families of low income. Id. § 6252. By January 1975, UDC was facing financial collapse. A bond anticipation note issue of $104.5 million was due on February 25th, and approximately $370 million was needed to complete the 20,000 housing units already under construction. In February, the UDC defaulted on its notes and the PFA was created "[i]n order to assist in the completion of projects to which the corporation [UDC] is contractually obligated, to provide for the orderly marketing of obligations to finance such completion, and to provide for the orderly payment of debt service of the corporation. . . ." Id. § 6362. The PFA was to acquire funds from appropriations by the State and from the sale of its notes and bonds. Id.

147. N.Y. Const. art. VII, § 11.

148. Full faith and credit debt is the State's direct, or guaranteed, debt.

149. Should the legislature not appropriate monies for debt service payments, the Constitution requires the comptroller to set aside from the first revenues of the General Fund (i.e.
need not fulfill the requirements of the constitution in order to issue bonds. Nor are their bonds backed by the state's taxing power. Public authorities have thus proliferated because of the freedom they enjoy from the constitutional restraints on the issuance of debt. The amount of money borrowed by PBCs has been increasingly greater than that borrowed by the state. As of 1977, New York State public authorities had $15 billion in outstanding debt as opposed to the state's full faith and credit debt which totalled $3.7 billion. Thus, the state's "nonguaranteed debt" was approximately four times greater than its guarantee full faith and credit debt.

the State treasury, see note 165, infra.), a sum sufficient to meet these payments. N.Y. Const. art. VII, § 16.
150. N.Y. Const.: arts. VII & VIII.
151. Both the New York Constitution and virtually all of the legislative acts creating the authorities disclaim any liability of the state on authority debt. N.Y. Const. art. VII, § 8(1); see also N.Y. Pub. Auth. Law § 1269 (McKinney 1970) (Metropolitan Transportation Authority).
152. N.Y.S. Dept't of Audit and Control, New York State Comptroller's Studies on Issues of Public Finance: Debt-Like Commitments of the State of New York 2 (Study No. 2, Jan. 1973) [hereinafter cited as Debt-Like Commitments of N.Y.S.].

Apparently, the Port of New York Authority, now known as the Port Authority of New York and New Jersey, N.Y. Unconsol. Laws §§ 6401-7171 (McKinney 1979) was the first authority created in New York. 1921 N.Y. Laws ch. 154. By 1974 over 200 authorities had been created by the New York State legislature. A. Walsh, The Public's Business 5 (1978).
155. Id. at 25.
156. "Nonguaranteed" state debt is debt incurred by public authorities. The U.S. Census Bureau defines this "nonguaranteed" state debt as: long-term debt payable solely from pledged specific revenue producing activities (university and college dormitories, toll highways and bridges, electric power projects, public building and school building authorities, etc.) or from specific non-property taxes includes only debt that does not constitute an obligation against any other resources of the State if the pledged sources are insufficient.

1 N.Y. Dept't of Audit and Control, Statewide Public Authorities: A Fourth Branch of Government 3 (study no. 1, 1972).
157. The following table shows the trend in the State's outstanding voter approved Full Faith and Credit debt and the bonds and notes outstanding of the 42 Statewide or regional authorities:
Despite constitutional\textsuperscript{158} and legislative\textsuperscript{159} provisions disclaiming the state's liability for public authorities' obligations, various financing arrangements have been devised by which the state has, in fact, committed its financial resources. Generally, these financial arrangements fall into two main categories: (1) lease-purchase agreements and (2) "moral obligation" commitments.

A. Lease Purchase Agreements

Under a lease-purchase agreement, the PBC agrees with the state\textsuperscript{160} to finance,\textsuperscript{161} and sometimes construct, a capital improve-

\begin{table}[h]
\centering
\begin{tabular}{lrr}
\hline
\textbf{Year} & \textbf{Nonguaranteed Authority Debt\textsuperscript{1}} & \textbf{Full Faith and Credit State Authority Debt\textsuperscript{2}} \\
\hline
1972 & 10,589\textsuperscript{3} & 3,362.2 \\
1973 & 12,057 & 3,451.3 \\
1974 & 13,254 & 3,448.4 \\
1975 & 14,150 & 3,508.9 \\
1976 & 14,935 & 3,641.4 \\
1977 & 15,284 & 3,706.1 \\
1978 & - & 3,698.5 \\
\hline
\end{tabular}
\caption{Table 8}
\end{table}

1. Based on Fiscal Years ended in the indicated calendar years.
2. Based on the fiscal year ending March 31st.
5. Art. X, § 5 of the New York State Constitution provides that:
\[n\]either the state nor any political subdivision thereof shall at any time be liable for the payment of any obligations issued by . . . a public corporation heretofore or hereafter created, nor may the legislature accept, authorize acceptance of or impose such liability upon the state or any political subdivision thereof; but the state or a political subdivision thereof may, if authorized by the legislature, acquire the properties of any such corporation and pay the indebtedness thereof.

159. Typically, the provision in the legislative acts provides that "[t]he bonds and notes shall not be a debt of the state of New York nor shall the state be liable thereon and such bonds and notes shall contain on the face thereof a statement to that effect." See, e.g., N.Y. PUB. AUTH. LAW § 1866 (McKinney 1970 & Supp. 1978) (New York State Energy Research and Development Authority).

160. Sometimes the state enters into a long-term contract with a retirement system or with a municipality. A municipality will issue its own bonds to finance the capital improve-
ment or facility needed by the state. The authority issues the bonds and uses the proceeds to finance the construction of the needed facility. The state, as owner of the land, contracts to: (1) convey or lease the land to the public benefit corporation, (2) be reimbursed from bond proceeds for any "first instance" appropriations, and most importantly, (3) pay rentals high enough to provide for the debt service due on the authority's bonds. At the completion of the contract or at the end of the lease term, title to the land is transferred back to the state for little or no consideration.

The rental or lease payments made by the state are derived from revenues received through taxes, fees, or earmarked revenues which would otherwise have gone into the state's general fund. The state thereby becomes involved in long-term "debt-like commitments" to build public-purpose facilities without the requisite voter approval. Although the lease payments are not full faith and credit state debt, it is ultimately the state's credit which secures the authority's bonds.

161. The PBC often enters into a contract with another PBC to provide the financing instead of financing the construction by issuing its own bonds. See note 168 infra.

162. For an explanation of "first instance" appropriations or advances see notes 204-09 infra and accompanying text.


165. DEBT-LIKE COMMITMENTS OF N.Y.S., supra note 152, at 14. The state's general fund receives virtually all its revenue from taxes and certain other miscellaneous revenue items. It is the most significant of the funds administrated within the state treasury. (There are approximately 175 other funds within the state treasury). The General Fund is divided into 3 separate funds: the Local Assistance Fund (assists municipalities and school districts), the State Purpose Fund (covers expenses of operating the Judicial, Legislative, and Executive branches of government), and the Capital Construction Fund (covers cost of highways, parkways, lease-rental payments, etc.). Furthermore, "first instance" appropriations are disbursed from the General Fund. For an explanation of "first instance" appropriations, see notes 204-09, infra and accompanying text.

166. DEBT-LIKE COMMITMENTS OF N.Y.S., supra note 152, at 14. See text accompanying notes 147-50 supra.

167. DEBT-LIKE COMMITMENTS OF N.Y.S., supra note 152, at 14. As the building authority
Lease-purchase agreements have been used to finance a variety of projects: State University and mental hygiene facilities; health and correctional facilities; the reconstruction and the repair of state highways; and the construction of state office buildings.

is thus dependent on state government for its income, the PBC's debt should be treated as state debt. As state debt, any surplus or profits should likewise have to be considered state money. The state, rather than the PBC, would be free to use the surplus as it chooses.

168. The New York State Housing Finance Agency funds these facilities, but does not construct or initiate projects. Rather, it finances the work of private developers or other PBCs by granting construction or mortgage loans or by entering into lease-purchase arrangements. In the case of lease-purchase arrangements, a PBC enters into a lease agreement with the Housing Finance Agency which then issues its own bonds in order to finance the PBC. Rental payments owed by the PBC to the Housing Finance Agency are paid from state monies pursuant to the lease-purchase contract entered into between the state and the PBC. DEBT-LIKE COMMITMENTS OF N.Y.S., supra note 152, at 19-21.

In 1962, the legislature created the State University Construction Fund (SUCF), a public benefit corporation. N.Y. Educ. Law § 371 (McKinney 1969). The SUCF can "construct, acquire, reconstruct, rehabilitate, and improve such facilities, other than dormitories, (dormitories can only be constructed by agreement with the Dormitory Authority), by its own employees, [or] by agreement with . . . any state agency . . . ." Id. § 376(2). However, the SUCF cannot issue its own bonds. Id. § 377. Further, any agreement entered into by the SUCF and a public benefit corporation (other than the Dormitory Authority) must provide for (1) the construction or rehabilitation of the facility, and (2) the leasing of the facility to the SUCF upon the completion of the project. Id. § 378(3). Thus, the SUCF has authority to enter into lease-purchase agreements with HFA whereby HFA finances the construction of the university facilities. Then pursuant to the contract between the state and the SUCF, money from the State University Income Fund (which includes student tuition and fees) is transferred to the "rental reserve accounts" of SUCF, id., to the extent necessary to meet lease payments due the Housing Finance Agency from the SUCF. DEBT-LIKE COMMITMENTS OF N.Y.S., supra note 152, at 19-21.

The amount of debt the Housing Finance Agency may incur to finance state university facilities, N.Y. Priv. Hous. Fin. Law § 47-a(2)(b) (McKinney 1976) and mental hygiene facilities, id. § 47-b(2)(b), is limited to $3 billion and $705 million, respectively.

The financing of mental hygiene facilities is analogous to that of state universities: the financing is undertaken pursuant to agreements between HFA and a PBC and rental payments are paid from monies which have been traditionally part of the general revenue of the state.

169. The New York State Dormitory Authority funds health and correctional facilities. The financial plans established to construct these facilities are comparable to those designed to construct state university facilities. The legislature creates a fund or PBC which constructs the projects with financing obtained by bond issues of another PBC. See note 169 supra. For a detailed analysis, see DEBT-LIKE COMMITMENTS OF N.Y.S., supra note 152, at 20-22; 1978 Audit and Control Annual Report, supra note 136, at 27-28.

170. State and highway construction is financed by the New York State Thruway Authority. The reconstruction and repair of state highways differs from the other arrangements in that a PBC is not created. Instead, the Commissioner of transportation is authorized to enter into contractual agreements, on behalf of the state, with the Thruway Authority for the financing of construction needed on state highways. N.Y. High. Law § 10-a (McKinney Supp.
Correspondingly, the debt of the authorities resulting from lease-purchase arrangements has increased substantially since 1963. In that year, the debt outstanding as a result of state lease-purchase agreements totalled $46 million.\(^\text{172}\) State lease-purchase rental payments for the fiscal year 1977-1978 were $328 million and are projected to be $355 million in the fiscal year 1978-1979.\(^\text{173}\)

The constitutionality of lease-purchase arrangements was challenged in *N. Y. Public Interest Research Group, Inc. v. Levitt*.\(^\text{174}\) Plaintiffs petitioned the New York Supreme Court to declare invalid a lease-purchase arrangement entered into by the state and Albany County in 1965. Albany County was to finance, through bond issues, the construction of the Albany South Mall, which consists of state offices and cultural facilities.\(^\text{175}\) The state contracted to lease the buildings and make rental payments, for a period of forty years, equal to the principal and interest on the indebtedness incurred by the county, title to the property was to vest in the state after the expiration of the lease.\(^\text{176}\)

Plaintiffs alleged that the agreement constituted the contracting of state debt without the approval of the people at a general election and was therefore in violation of the state constitution.\(^\text{177}\) The merits of the case were never reached. Both the supreme court and the appellate division held that the statute of limitations had run on the plaintiffs' cause of action and that the cause of action was barred by laches, since the construction of the Mall was nearly

\(^{172}\) State office buildings are financed by retiring systems and municipalities. *Debt-like Commitments of N.Y.S.*, supra note 152, at 17-19.

\(^{173}\) A table indicating the financial status of the individual authorities and municipalities pursuant to lease-purchase agreements is also given in the Annual Report.


\(^{175}\) *Id.* This mall is now known as the Nelson A. Rockefeller Plaza.

\(^{176}\) *Id.* at 671, 395 N.Y.S.2d at 610.

\(^{177}\) *Id.* at 671, 395 N.Y.S.2d at 609-10. See note 147 *supra* and accompanying text.
completed. The effect on PBCs would have been wide-ranging had the court held these lease-purchase arrangements unconstitutional. In the absence of constitutional amendment, or other financial arrangement, the municipalities and public authorities involved would have been solely responsible for the payments of principal and interest on bonds issued by PBCs.

B. Moral Obligation Bonds

Where a public authority is authorized by statute to maintain a debt or rental reserve fund, and this fund is depleted below a prescribed level, the state is permitted to appropriate state monies to replenish the fund. The commitment of the state to provide assistance to an authority with insufficient funds to meet its rental or debt payments is referred to as its "moral obligation." The nature of this commitment is twofold: first, the payments, according to the provisions of the authorities' enabling statutes, are permissive rather than mandatory; second, although the statutory provisions do not impose a legal obligation on the state to make any payments, bond market analyses noted that the state is "morally" obligated to apportion money to an authority when needed. In the words of a major bond rating service, 'it is expected that the State of New York will remain at all times under strong moral

179. The state currently owes approximately $3.5 billion in rental payments.
180. A debt or rental service reserve fund provides a margin of safety to bondholders in that it provides monies to meet the debt service of the corporation.
181. See note 189-9 infra and accompanying text.
182. The Dormitory Authority apparently originated the "moral obligation" commitment. As stated by the Moreland Commission:

The clearest forerunner of the present moral obligation bond was a device employed by the Dormitory Authority in the late 1950's. It issued revenue bonds that carried a covenant promising that the Authority would not fail to inform the State of any depletion in its bond reserves, and would ask the state for an appropriation to replenish them. The moral obligation housing bond [of the Housing Finance Agency] created in 1960 differed only in that it was backed by statutory assurance that such an appropriation would be proposed by the Governor to the legislature.

MORELAND REPORT, supra note 139, at 86.

Many lease purchase arrangements are also supported by "moral obligation" commitments. An example is the State University Construction Fund (SUCF), N.Y. EDUC. LAW § 371(1) (McKinney 1969). See note 168 supra.
183. 1978 AUDIT AND CONTROL ANNUAL REPORT, supra note 136, at 27.
184. Id.
suasion to maintain its schedule of charges and programs of aid to the end that these bonds will remain in good standing." Furthermore, except in a limited number of cases, no provision is made for the repayment of any state assistance to debt service reserve funds. However, because the letter, if not the spirit, of the constitution is not violated, this extension of such credit is not subject to constitutional referendum requirements. Thus, as a practical matter, the credit of the state stands as security for the indebtedness of the authorities.

The enabling statutes of the various public authorities specify how state funds are to be appropriated in the case of a "moral obligation." The typical statutory provision states that if the authority has insufficient revenues, that is, reserve funds do not cover the "amount of principal and interest maturing and becoming due" in the following year, or if the authority becomes obligated to draw on the reserve, its chairman informs the Governor and the State Director of the Budget. Under its "moral obligation," the legisla-

185. Id.

186. DEBT-LIKE COMMITMENTS OF N.Y.S., supra note 152, at 36. As of 1974, four Public Authorities (the Job Development Authority, N.Y. PUB. AUTH. LAW § 1828 (McKinney 1970), the Mortgage Agency, id. § 2408(4) (McKinney Supp. 1978), the New York State Energy Research and Development Authority, formerly known as the Atomic and Space Development Corporation, id. § 1860-a(4), and the Battery Park City Authority, id. § 1977-b(4)), were required to repay the state for the "normal obligation" assistance it provided. Typically, the provision provides that:

[a]ll amounts paid over to the authority by the State . . . [pursuant to the reserve fund support clause] shall constitute and be accounted for as advances by the state to the authority and, subject to the rights of the holders of any bonds or notes of the authority theretofore or thereafter issued, shall be repaid to the State from all available operating revenues of the authority in excess of debt service reserve fund requirements and operating expenses.

Id. § 1860-a(4) (N.Y.S. Energy Research and Development Authority).

187. See note 147 supra and accompanying text.

188. As early as 1938, it was recognized that there was a strong possibility of State credit backing the obligations of the public authorities. A 1938 constitutional committee report states that if creditors of a particular Authority which could not meet its obligations, elected to foreclose on the Authority's project "the municipality or the state might feel itself bound to take over the debt of the defaulting authority, not only to prevent foreclosure of what is after all public property, but also, perhaps to salvage the public credit, which would otherwise be damaged." XI NEW YORK STATE CONSTITUTIONAL CONVENTION COMM. REPORT: PROBLEMS RELATING TO HOME RULE AND LOCAL GOVERNMENT 243 (1938).

189. The following excerpt from the Housing Finance Agency Act illustrates the statutory language used to set forth the state's commitment:

[t]o assure the continued operation and solvency of the agency for the carrying out
ture then apportions state monies to the debt service or rental re-
serve found of the authority.190

The state has hitherto guaranteed the financial community's expec-
tation that the bonds of a public authority are properly paid.191
For instance, from 1975-1978, the legislature, in accordance with the
"moral obligation" provision of the State Housing Finance Agency
(HFA), appropriated $10.1 million to the HFA to replenish its debt
service reserve fund.192 During the same period, the state provided
a total of approximately $381 million in "moral obligation" finan-
cial assistance.193 As of March 31, 1978, there was approximately
$10.5 billion in "moral obligation" bonds and notes outstanding.194

of the public purposes of this article, provision is made . . . for the accumulation in
the . . . reserve fund of an amount equal to the maximum amount of principal and
interest maturing and becoming due . . . in any succeeding calendar year on . . .
bonds of the agency then outstanding. . . . In order further to assure . . . mainte-
nance of the . . . reserve fund, there shall be annually apportioned and paid to the
agency for deposit in the . . . reserve fund such sum, if any, as shall be certified by
the chairman of the agency to the governor and director of the budget as necessary to
restore the . . . fund to an amount equal to the maximum amount of principal and
interest maturing and becoming due . . . in any succeeding calendar year on . . .
bonds of the agency then outstanding: . . . (emphasis added).
(McKinney Supp. 1979) (New York State Environmental Facilities Corporation); N.Y. Educ.
Law § 371(1) (McKinney 1969) (State University Construction Fund).
191. The 1978 Comptroller's Annual Report states:
The fiscal stability of the State is related, at least in part, to the fiscal stability of the
authorities. The closing of the public securities market in 1975 to bonds and notes
issued by UDC [Urban Development Corporation] and certain other authorities and
by the State resulted in the State's taking action to sustain investor confidence in, and
to provide for the fiscal stability of the authorities and the State itself to prevent
disruption of the operations of the authorities.
Further recognition of the "moral obligation" of the State is found in § 583 of the Public
Authority Law where the statute in reference to the Thousand Islands Bridge Authority
states: "The bonds, notes, and other obligations of the authority shall not be a legal or moral
debt of the state. . . . No recent action by the state in recognizing any legal or moral
obligation for any indebtedness of any other authority shall in any way be construed as
creating any liability for any indebtedness of this authority." (emphasis added). N.Y. Pub.
193. Id.
billion, the Municipal Assistance Corporation, a Public Benefit Corporation, is authorized
to issue up to $5.2 billion in bonds and notes in order to provide assistance to New York City.
Id.
Thus, the state has incurred millions of dollars of "debt," supported by its "moral obligation," apparently in direct conflict with article X, section 5 of the New York State Constitution.195

Due to the difficulties encountered by several authorities in both marketing bonds and meeting their obligations, and the resultant "obligation" by the state to take action to sustain investor confidence, legislation was adopted, effective in 1976, imposing limits on the amount of "moral obligation" bonds that an authority could issue.196 This "Capping Legislation"197 limited the amount of "moral obligation" indebtedness to the amount of bonds and notes already outstanding plus any additional bonds and notes necessary to finance projects already under construction.198 Special dollar limitations were also set.199 In many cases where no "moral obligation" bonds were outstanding, the "moral obligation" provisions were repealed.200

C. Other Methods of State Aid

In addition to lease-purchase and "moral obligation" financing, the State provides the larger State-wide public authorities with

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195. See note 158 supra; Quirk & Wein, supra note 133, at 569-70.
198. See note 196 supra. The total amount of bonds and notes necessary to finance projects in progress is determined by the New York State Authorities Control Board whose determination is conclusive. 1976 N.Y. Laws ch. 38.

In February 1976, the Build-Out Plan was formulated to facilitate re-entry of the Build-Out Authorities into the public securities market. There are four Build-Out Authorities: the Housing Finance Agency, the Environmental Facilities Corporation, the Dormitory Authority, and the Medical Care Facilities Finance Authority. The Plan provides for $2.59 billion in financial assistance to complete projects and to refinance bond anticipation notes through September, 1978. Financing needs as of October, 1978 were estimated to be $1.1 billion. 1978 Audit and Control Annual Report, supra note 136, at 35; Official Statement, supra note 146, at 24-27.
financial support in several ways which are within constitutional debt limitations. "Hard cash" appropriations are one such means of financial support. These appropriations are outright grants given by the state, derived from both tax revenues and full faith and credit bond funds. 201 Public authorities use these "hard cash" grants to provide initial working capital or to finance facilities. 202 In addition, the state has used "hard cash" appropriations to forgive authority debt resulting from unpaid state "first instance," loans. 203 "First instance" advances are interest-free loans provided by the state legislature to authorities in order to enable them to begin operation of facilities and programs. 204 The authorities are obligated to reimburse the state for the loans either from bond proceeds or operating revenues. 205 In order for an authority to make timely repayment of advances, it is essential that it be financially viable. However, many of the authorities were not fiscally sound and thus were unable to repay state loans. During 1964-1970, $88 million in advances was liquidated by state "hard cash" appropriations, 206 and during the next two years the state similarly forgave another $63.1 million in authority debt. 207 Despite early warnings that a large percentage of "first instance" advances were of doubtful collectibility, the state lent the public authorities a total of $46.8 million in "first instance" advances during the 1977-1978 fiscal year. 208

201. 1 N.Y. Dep't of Audit and Control, Statewide Public Authorities: A Fourth Branch of Government 10 (Study No. 1, 1972).
202. Id.
203. See note 204-05 infra and accompanying text.
204. 1 N.Y. Dep't of Audit and Control, Statewide Public Authorities: A Fourth Branch of Government 11 (Study No. 1, 1972).
205. Id.
207. Thus, during the 8 year period, $154.1 million in advances were "forgiven" by the State. 1 N.Y. Dep't of Audit and Control, Statewide Public Authorities: A Fourth Branch of Government 11 (Study No. 1, 1972). This constituted 37 percent of the "first instance" loans made by the state. In effect, the state writes the loans off as "bad debts" and appropriates "hard cash" and funds to liquidate these debts. 1 N.Y. Dep't of Audit and Control, Statewide Public Authorities: A Fourth Branch of Government 10-11 (Study No. 1, 1972); State of New York Office of the State Comptroller, Division of Audits and Accounts, Audit of New York State, New York City, and Public Authorities 54 (2 Year Period ended March 31, 1972).
As of March 31, 1978, the authorities owed the state $325 million for outstanding "first instance" advances.\textsuperscript{209}

The constitution permits the state, without a public of referendum to guarantee unconditionally the debt of three types of authorities: highway authorities,\textsuperscript{210} port authorities,\textsuperscript{211} and authorities created to construct industrial or manufacturing plants designed to improve employment opportunities.\textsuperscript{212} As of September 30, 1978, the state has used this authority to guarantee unconditionally, by its full faith and credit, the debt of three public benefit corporations.\textsuperscript{213} The debt of these authorities has made the state contingently liable as a guarantor for $521 million of bonds and notes issued.\textsuperscript{214} There is little danger that an authority which generates revenues greater than its debt service and operating expenses will ever be a drain on the treasury of the state. Strong authorities, such as the Port Authority of New York and New Jersey or the Triborough Bridge and Tunnel Authority, produce excess revenues which are then reinvested into larger and usually more successful revenue-producing projects.\textsuperscript{215}

Beginning in 1960, however, authorities have become involved in public developments, such as hospitals,\textsuperscript{216} educational facilities,\textsuperscript{217}

\begin{itemize}
\item \textsuperscript{209} Official Statement, supra note 146, at 27.
\item \textsuperscript{210} N.Y. CONST. art. X, § 6.
\item \textsuperscript{211} Id. art. X, § 7.
\item \textsuperscript{212} Id. [sic][so numbered by the Legislature, should be § 8].
\item \textsuperscript{213} Specifically, the state has committed itself to make payments on certain borrowings of the New York State Thruway Authority, N.Y. PUB. AUTH. LAW §§ 350-75 (McKinney 1970), the Job Development Authority, id. §§ 1800-1834, and the Port Authority of New York and New Jersey, N.Y. UNCONSOL. LAWS §§ 6401-7171 (McKinney 1979); 1978 AUDIT AND CONTROL ANNUAL REPORT, supra note 136, at 35.
\item \textsuperscript{214} Official Statement, supra note 146, at 12.
\item \textsuperscript{215} The Port Authority of New York and New Jersey, N.Y. UNCONSOL. LAWS §§ 6401-7171 (McKinney 1979), the first Authority, created in 1921, was originally authorized to settle problems in connection with the harbor. XI NEW YORK STATE CONSTITUTIONAL CONVENTION COMM. REPORT: PROBLEMS RELATING TO HOME RULE AND LOCAL Gov'T. 238-40 (1938). Today the Authority has over 8000 employees and its annual operating budget is larger than the operating budget of the New York State Department of Transportation. Port Authority facilities now include the $575 million World Trade Center, three major airports and two minor ones, eight marine terminals, four bridges, two tunnel complexes, a multistate transportation center, a rapid transit line, and trade development offices in nine cities. A. WALSH, THE PUBLIC'S BUSINESS 89-103 (1978).
\item \textsuperscript{216} E.g., New York State Medical Care Facilities Finance Agency Act, N.Y. UNCONSOL. LAWS §§ 7411-7431 (McKinney 1979).
\item \textsuperscript{217} E.g., State University Construction Fund, N.Y. EDUC. LAW §§ 370-84 (McKinney
and dormitories,\textsuperscript{218} which traditionally have not been self-supporting.\textsuperscript{219} Authorities venturing into these types of arrangements would thus have difficulty financing their operations and meeting their debt service. Consequently, it is up to the state to back these "weak" authorities. This is necessary in order to sustain investor confidence in both the authorities and the state. Since it is unconstitutional to guarantee such debt, "moral obligation" financing was formulated to serve the dual purpose of assisting the authorities and avoiding constitutional strictures.\textsuperscript{220}

In the case of lease-purchase agreements, the state contracts with an authority to build a needed facility, agreeing to lease it when the facility is completed. The state, unable to build the facility itself since it would then incur debt beyond its constitutional debt limitation, agrees to make rental payments high enough to cover the authority's debt service. The state has managed to do indirectly what it cannot do directly. Thus, lease-purchase arrangements serve to circumvent constitutional debt limitations.\textsuperscript{221}

In sum, New York State has substantially more involvement with the financing of public benefit corporations than is strictly permitted by the constitution.

D. The New York City Stabilization Reserve Corporation and Municipal Assistance Corporation

City funds were necessary to provide essential services to its inhabitants and to pay its debt to holders of outstanding securities. In order to meet these obligations, New York City depended on its ability to market new securities. However, this source of funds is viable only where investors remain confident in the newly-issued securities. In the first months of 1975, the city, forced to meet its previous short-term borrowing obligations, was barely able to market its debt. Consequently, serious short-term debt and cash flow problems were encountered.\textsuperscript{222}

In 1974, the Legislature created the Stabilization Reserve Corpor-

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\textsuperscript{219} See Quirk & Wein, supra note 133, at 597.

\textsuperscript{220} See notes 180-200 supra and accompanying text.

\textsuperscript{221} See notes 160-79 supra and accompanying text.

\textsuperscript{222} See note 242 infra.
ration ("SRC") in order to raise funds for the city through the sale of the corporation's bonds. The stated purpose of the SRC was to "assist [the] city to enable it to provide . . . essential services . . . ." In short, by selling its own bonds, the SRC was to generate sufficient capital to meet its own debt service costs and, at the same time, provide much needed relief to New York by contributing to the city's general fund.

The SRC's debt service was to be paid out of a capital reserve fund which was to be supplied by the sale of corporate notes or bonds, city appropriations, and "any other monies which may be made available to the corporation . . . from any other source." However, the statute expressly absolved the city from any mandatory obligation to make contributions. The Legislature had provided that the state, by channelling sums otherwise going directly to the city, would contribute an amount sufficient to meet the fund's current debt service costs. Although the provisions for contributions existed, the statute expressly stated that "neither the state nor the city shall be liable" on the obligations, since the debts were solely those of the SRC.

Despite its good intentions, the SRC was unable to market its securities. Investors were reluctant to buy the SRC's bonds because the city could not become indebted on the obligations. Although the SRC was ineffective, as a practical matter, it did survive a constitutional challenge, and in doing so helped pave the way for

224. Id. § 2533.
225. Id. § 2538.
226. Id. § 2537.
227. Id.
228. E.g., the city's share of the stock transfer tax; federal and state aid appropriated for the city. Id. § 2540.
229. Id. The statute defines the requisite level of the capital reserve fund in terms of that amount needed to meet interest and principal due and sinking fund payments due on corporate bonds. Id. § 2531(10).
230. Id. § 2542.
231. Wein v. City of New York, 36 N.Y.2d 610, 331 N.E.2d 514, 370 N.Y.S.2d 550 (1975). In Wein, the court would not accept the argument that the SRC was an unconstitutional avoidance of the full faith and credit provision of the state constitution. (N.Y. CONST. art. VIII, § 2, para. 2.). 36 N.Y.2d at 617, 331 N.E.2d at 518, 370 N.Y.S.2d at 555. The court distinguished between the loaning of credit and the appropriation of a gift of money for a public purpose. SRC contributions were characterized as a gift of money. 36 N.Y.2d at 619, 331 N.E.2d at 519, 370 N.Y.S.2d at 557. As such, they were held constitutional and not city debt obligations.
the creation of the New York City Municipal Assistance Corporation ("MAC").

MAC, a public benefit corporation created in June, 1975 by the New York State Municipal Corporation Act, was specifically designed to administer to the City financial assistance during its emergency period. The state legislature declared a dual statutory purpose for MAC: "to assist the City of New York in providing essential services to its inhabitants without interruption and [to create] investor confidence in the soundness of the obligations of such city so that it may retain its ability to sell its obligations to the public." In furtherance of this purpose MAC is empowered to market its own bonds and notes, the proceeds of which may be loaned or given to the city. MAC does not have the power to levy taxes, nor is its debt covered by the general obligations of the state or city. Hence, neither the state nor city is required to appropriate the funds to meet MAC debt service. However, all MAC debt is supported by the state's "moral obligation" to repay the bonds if necessary. In order to restore investor confidence, the city agreed to take steps to balance its budget process by introducing a better accounting system and phasing out its practice of capitalizing oper-


233. See notes 131-223 supra and accompanying text.


235. Id. § 3031. The consequences of a failure of the city to meet its obligations was seen as resulting in an end to the city as a viable governmental entity; endangering the health, safety and welfare of its inhabitants; shaking the status of the city as the financial capital of the nation and the world; and causing a great exodus from the city of corporate and individual taxpayers, imposing an even greater burden on those remaining. Municipal Assistance Corporation of New York, Financial Plan and Legislative Program, § 1, at 31, 32 (September, 1975).

236. N.Y. Pub. Auth. Law § 3031 (McKinney Supp. 1978). MAC has nine voting directors chosen by the governor, four of which are recommended by the mayor. In addition, six non-voting members are appointed by agreement of the four political leaders of the Legislature, the city's Board of Estimate and the vice chairman of the City Council. Id. § 3034.

237. Id. § 3033.

238. Id. § 3016. Section 3012(c) provides that every note and bond issued is a general obligation of the corporation.

239. See notes 182-202 supra and accompanying text.

MAC bonds have been issued under two general bond resolutions: First General Resolution Bonds and Second General Resolution Bonds. First General Resolution Bonds are general obligations of the corporation. Two special funds, the Debt Service Fund and the Capital Reserve Fund, have been established for the service of the First General Resolution Bonds. The revenues of MAC pledged to the payment of the First General Resolution Bonds are derived principally from the sales tax and, secondly, from the stock transfer tax. Revenues from the sales tax consist of collections within the city of the state sales tax and compensating use taxes which, hitherto, were imposed by New York City itself. Revenues from the stock transfer tax are derived from the state's tax on sales and transfers of certain securities. These revenues are diverted from the city to MAC. They are not available to the city or any agency other than MAC until the current requirements of the corporation, including debt service on the bonds, have been satisfied. Additionally, MAC revenues not otherwise pledged are available for the payment of the First General Resolution Bonds.

Second General Resolution Bonds also are general obligations of MAC. These bonds are payable from any available revenues of the corporation not otherwise pledged. Two special funds have also been established for these bonds: The Bond Service Fund and the Capital Reserve Fund. The principal sources of revenue to MAC for the

242. Id. § 3012(c).
243. The Debt Service Fund is used to pay interest on principal and redemption of MAC's bonds and notes. Id. § 3036(1) (McKinney Supp. 1978).
244. The capital reserve fund is used to pay the principal on the corporation's bonds. Id. § 3036(3).
246. Id. § 270 (McKinney 1966).
247. Id. §§ 1107, 1108 (McKinney Supp. 1978).
248. Id. § 270 (McKinney 1966).
250. Id. § 3036(3). The sources of these funds are the proceeds from sales of MAC bonds or notes, state appropriations, and any income or interest earned as a result of investment of the amounts deposited in those funds.
251. Id. § 3012(c).
252. Id. § 3036-a(1).
253. Id. § 3036-a(2).
Second General Resolution Bonds are per capita aid,254 the sales tax255 and the stock transfer tax.256 Revenues from the sales tax and the stock transfer tax are pledged to the payment of Second General Resolution Bonds only to the extent those revenues are not pledged to pay debt service on obligations issued under the corporation's First General Bond Resolution.257

The state has agreed to appropriate sums only to the corporation,258 but there is no constitutional guarantee that the taxes from which the funds are supplied will continue to exist. This possibility does pose a risk to investors, though it is unlikely these taxes would be eliminated.

The principal purpose of MAC is to refinance a substantial share of the short-term debt of New York City. This is to be accomplished by replacing more than $3 billion of this debt with long-term obligations of the corporation secured by the taxes discussed above.259 Since city debt is then cancelled, liability for such debt is actually shifted from the city to MAC.260 Further, upon certification by the Mayor of New York City to MAC of the amounts necessary to pay the city's operating expenses or debt service, MAC may pay such amount to the city or, alternatively, buy city obligations up to the amount of the city's certified requirement.261

MAC's initial public offering of July 10, 1975 of $1 billion in bonds was less than completely successful; the public market absorbed only $550 million thereof, with the balance being taken by underwriters.262 The public lacked confidence in the city's ability to regain solvency.263 The corporation realized that more stringent management and financial controls on the city were required in order to

254. N.Y. STATE FIN. LAW § 54 (McKinney 1974).
256. Id. § 270 (McKinney 1966).
257. Id.
260. N.Y. PUB. AUTH. LAW § 3035 (McKinney Supp. 1978). Such cancellation does not apply to BANs. If MAC receives these notes and delivers them to the city, the city must pay the accrued interest and principal or pay the accrued interest and exchange city BANs of equal principal and interest rate. Id.
262. [1976] MAC REPORT, supra note 1, at 11. The underwriters are the large lenders, the banks and the brokerage houses.
263. Id. at 12.
make investors more willing to purchase MAC obligations.\textsuperscript{264} Despite several efforts towards reform, the corporation was hard-pressed to meet the city's August, 1975 cash requirements.\textsuperscript{265}

As a response to imminent financial collapse in September, 1975, and in an effort to gain the support of the state and federal governments, the state legislature passed the Financial Emergency Act for the City of New York on September 5, 1975.\textsuperscript{266} This legislation created the Emergency Financial Control Board\textsuperscript{267} and directed the city to prepare a three year financial plan.\textsuperscript{268} The plan was to be reviewed by the Board. In addition, the release of city revenues and all major city expenditures and contracts were subject to the Board’s review.\textsuperscript{269}

At present, then, New York City's financial plans are controlled by MAC and the Emergency Financial Control Board. MAC has the power to issue its own debt and the right to specified tax proceeds. The Emergency Financial Control Board, separately from MAC, overseas the city's financial plans.

There are three groups of major creditors involved in the New York City recovery effort:\textsuperscript{270} the city's past lenders (i.e., the banks and brokerage houses), the city pension funds (who agreed to buy a large amount of MAC bonds after substantial negotiations), and the federal government (which introduced a seasonal loan program to begin in fiscal year 1976 and end in fiscal year 1978).\textsuperscript{271} The latter two creditors were included when the private lenders became unwilling "to continue playing the game alone."\textsuperscript{272} These three groups have spent the past three years negotiating with MAC and the city over the deferral, exchange, stretch-out, and general rearranging of city debt.\textsuperscript{273} This has been accomplished through a maze of arrange-

\begin{itemize}
\item \textsuperscript{264} Id.
\item \textsuperscript{265} Id.
\item \textsuperscript{266} 1975 N.Y. Laws chs. 868, 869, 870.
\item \textsuperscript{267} Id. ch. 868 § 5.
\item \textsuperscript{268} Id. § 8.
\item \textsuperscript{269} Id. § 7.
\item \textsuperscript{270} The Fiscal Observer, supra note 240, at 9.
\item \textsuperscript{271} Id.
\item \textsuperscript{272} Id.
\item \textsuperscript{273} MAC discusses the general features of its history and publishes its audited financial statements in its 1976 Annual Report (Sept. 30, 1976), 1977 Annual Report (Nov. 14, 1977) and 1978 Annual Report (Sept. 28, 1978). MAC distributes free of charge its annual reports and quarterly financial statements as well as the official statement for its most recent bond
\end{itemize}
ments and devices for refinancing. Simply stated, "MAC [has] managed to provide the city with cash proceeds from financing while holding off cash outlays that without MAC would have gone to pay off old creditors."275

The most recent financing package was developed in November, 1978.276 The city expects $4.5 billion in financing before fiscal 1983 and MAC will provide at least $2.8 billion of this amount.277 City pension funds and local financial institutions are committed to buy $1.8 billion of these MAC bonds under the November plan.278 The remaining $1 billion is to be met by sales to the public, hopefully by 1981.279 The city, in addition, hopes to market $950 million of its own unguaranteed bonds to the public in 1981 and 1982.280 However, if this offering is unsuccessful, MAC will substitute its own securities for up to $900 million in public sales.281

The outlook for MAC's debt issuing operations after 1982 is uncertain. As part of the agreement with the municipal pension funds and financial institutions to buy the $1.8 billion in MAC bonds issuable under the plan, MAC promised it would never have more than $8.8 billion in First and Second Resolution Bonds outstanding.282 Assuming MAC substitutes all city bond issues by 1984, the $8.8 billion limit will have been reached if the city fails to achieve access to the market on its own.283 In that event, without a waiver of the restriction or the authorization of a Third Resolution Bond by the state legislature, MAC would be foreclosed from issuing more debt.284 Importantly, MAC has promised not to issue Third Resolution Bonds unless it buys city bonds with an investment grade rating in

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274. See id. for specific information sources.
276. Id. at 2.
277. Id. at 1-2.
278. Id. at 2. As of February 22, 1979, of the $1.8 billion, MAC has sold $401 million in private placements. Id.
279. Id. As of February 22, 1979, one-quarter of the one billion figure was sold. Id.
280. Id.
281. Id.
282. Id. at 4.
283. Id. at 4-5.
284. Id. at 5.
Furthermore, the city must have balanced its previous year's budget according to generally accepted accounting principles. As a recent report pointed out:

If the city could meet all these conditions, it would have market access on its own in 1984—and theoretically would not need MAC anymore. But MAC cannot issue more debt unless all these conditions are met. In effect, if existing agreements are not changed and if MAC has not restored the city's fiscal credibility by 1984, MAC will be written out of all future scripts for financing New York City.

IV. Conclusion

Despite its good intentions, the New York Legislature's piecemeal revision of the New York Constitution's Local Finance Article resulted in New York City's exclusion of significant amounts of actual debt from its financial reports. Thus able to "overspend" its available resources, New York City used fiscal practices which underscore the inexorable conclusion that constitutional debt ceilings were, and continue to be, phantom regulations of municipal debt incurrence.

The need for thorough and decisive reform is clear. Absent such action, municipalities will be free to repeat New York City's difficult choice between providing adequate public services and financial collapse. Cognizant of the need for reform and the realities of political expediency, the proposed Local Finance Article advanced by the Association of the Bar of the City of New York goes far in

285. Id. City bonds would not be able to receive an investment grade rating (i.e. credit rating) without having regained sufficient fiscal stability so that it could achieve some market access for its own obligations.

286. Id.

287. Id. New York City's future in the market is uncertain. Despite the successful sale of $275 million in short-term notes in early 1979, most analysts are wary of the fact that the notes were state guaranteed. In addition, Moody's Investors Service has refused to rate New York City bonds higher than "undesirable [and] speculative." As justification for its position, Moody's cites "the lack of any meaningful long-term remedial measures" to improve the city's fiscal position. Since investment-grade ratings are crucial to N.Y. City's ability to reenter the long-term debt market, its funding future appears bleak, particularly for the scheduled public sale of $300 million in bonds in 1981, followed by $650 million in 1982. As well, federal loan guarantees and private loans expire in 1982. Finally, the city's spending has not decreased significantly. Wall St. J., Sept. 14, 1979, at 1, col. 1.
striking a balance between the need for municipal funding and the ability of cities and towns to generate massive debt almost at will.

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