New York Law Journal

NEW YORK, MONDAY, NOVEMBER 26, 2012

MUNICIPAL LAW

BY JEFFREY D. FRIEDLANDER

Preserving New York City's Finances

Access to public credit markets and the ability to issue public debt is vital to New York City's operation. Within the Law Department, legal advice and assistance in these matters is provided by the four attorneys of the Municipal Finance Division, a small division with an outsized impact on the city. The origins of this division date back to the fiscal crisis of the 1970s, when the city nearly defaulted on its debt. As a consequence of that financial emergency, the city was temporarily shut out of the public credit markets until the adoption of federal and state legislation to enable the city to raise money for capital purposes. Over three decades later the Municipal Finance Division, working alongside the city's Office of Management and Budget, the Comptroller's Office and outside counsel, continues to represent the city and its related bond issuers in connection with the sale of approximately $10 billion of debt annually.

Today the city borrows money on a regular basis through three vehicles: general obligation bonds backed by the city's faith and credit; revenue-backed bonds issued by the New York City Transitional Finance Authority (TFA); and revenue-backed bonds issued by the New York City Municipal Water Finance Authority (Water Authority). In addition, the city enforces collection of real property taxes through the sale of tax liens to New York City Tax Lien Trusts, which issue asset-backed bonds secured by collections on the tax liens. State law, federal tax law, and federal securities law requirements vary among these types of debt.

General Obligation Bonds

General obligation bonds are issued directly by the city and are subject to Article VIII of the New York State Constitution, the New York State Local Finance Law (LFL) and the New York City Charter. General obligation bonds are issued to finance capital projects or to refund or refinance previously issued higher cost debt. Federal tax law exempts state and local government bonds from income taxation, to the extent their proceeds are used for a public purpose or given to a private entity with no repayment obligation. Pursuant to provisions of the LFL and the city charter, the mayor has authority to authorize the issuance of debt and to determine the amounts to be issued, while the city comptroller determines the nature and terms of the debt and arranges for its issuance.

Article VIII of the State Constitution provides that bonds of municipalities must be backed by the faith and credit of the issuing municipality. Article VIII also limits the amount of debt the city can issue to 10 percent of the average full valuation of taxable real estate in the city, and prohibits the use of municipal debt or municipal credit for non-public purposes. Other provisions of Article VIII as well as provisions of the LFL govern the amortization of municipal bonds, that is, the schedule by which principal must be repaid and interest paid. In general, municipal debt may not mature beyond the useful life established for a particular project, since this would burden future taxpayers with debt on a project from which they do not benefit.

The city generally sells its bonds to investment banks or underwriters which resell the bonds to retail or institutional investors through a public offering. The federal Securities and Exchange Commission (SEC), in order to prevent fraudulent sales practices, requires that underwriters provide a preliminary and final Official Statement regarding a municipal bond offering upon request by a potential customer. This is a set of documents that provides, among other things, information regarding terms of issuance and the financial situation of the issuing municipality. Both the underwriters and the city are liable for material misstatements or omissions in the preliminary and final Official Statement.

Money for Capital Program

The Transitional Finance Authority (TFA) is a public benefit corporation established in 1997 by the New York City Transitional Finance Authority Act (Public Authorities Law §2799aa et seq.) (TFA Act), to assist the city in raising money for its capital program. The TFA is headed by a board of five directors, all officers of the city. Although the TFA is not a municipality and is therefore not subject to some of the provisions of law that govern the city's general obligation bonds, the TFA Act provides that the mayor and the city comptroller jointly recommend arrangements for the offering of TFA bonds as well as certain terms and conditions of those offerings.

BY JEFFREY D. FRIEDLANDER

Preserving New York City's Finances

Other determinations of the TFA regarding the terms and conditions of its bonds must be approved by the mayor and the comptroller. Under federal law, the TFA is a "constituted authority," that is, an entity specifically authorized by state law to issue bonds on behalf of a political subdivision, and its bonds are therefore exempt from income taxation, to the extent their proceeds are used for a public purpose or given to a private entity with no repayment obligation.

The TFA issues several types of bonds, each backed by a particular source (or sources) of city revenue. Future Tax Secured Bonds are backed by city personal income taxes and, if projected annual income tax revenues are not sufficient to pay 150 percent of maximum annual debt service, by city sales taxes up to that amount. Building Aid Revenue Bonds, issued to finance city school construction, are backed by state education aid to the city. In 2001 and 2002, the TFA also issued Recovery Bonds, backed by city personal income and sales tax revenues, to finance costs relating to the attack on the World Trade Center. The TFA's bonds, like the city's general obligation bonds, are subject to the SEC requirement regarding the preparation of a preliminary and final Official Statement.

Water Authority Bonds

The renovation and improvement of the city's water and sewer system are separately financed by bonds issued by the New York City Municipal Water Finance Authority. Established by the New York City Municipal Water Finance Authority Act, Public Authorities Law §1045-a et seq. (Water Authority Act), the Water Finance Authority is a public benefit corporation headed by a seven-member board of directors, consisting of three officers of the city, one officer of the state and three public members, two appointed by the mayor and one by the governor.

The Water Authority acts in conjunction with the New York City Water Board (Water Board), another public benefit corporation established by the Water Authority Act, which fixes and collects rates, fees and charges for use of the city's water and sewer system and is headed by seven members appointed by the mayor. The Water Board has leased the water and sewer system from the city and has further entered into a financing agreement with the Water Authority and the city for the financing of capital improvements to the system through the issuance of bonds by the Water Authority. These bonds are special obligations payable from and secured by a pledge of the rates, fees and charges established by the Water Board. Pursuant to the Water Authority Act, the mayor and the city comptroller jointly recommend arrangements for the offering of Water Authority bonds and approve the terms and conditions of the bonds after their issuance is authorized by the Water Authority's directors.

Like the TFA, the Water Authority is a "constituted authority," and its bonds are therefore exempt from income taxation subject to the private activity rules applicable to the city's general obligation and the TFA's bonds. Also like the city's general obligation and the TFA's bonds, the bonds of the Water Authority are subject to the SEC requirement regarding the preparation of a preliminary and final Official Statement.

Tax Lien Collateralized Bonds

In order to enforce the payment of real property taxes or water and sewer charges, the city, pursuant to §11-301 of the Administrative Code of the City of New York, has a lien on all properties for which these taxes or charges are due and unpaid. These tax liens may be foreclosed in the same manner as a mortgage on real property. Pursuant to Administrative Code §11-319, the Commissioner of Finance may sell tax liens which have remained unpaid for certain periods of time (depending on the type of property) to one or more purchasers, at a price he or she determines to be in the best interests of the city.

Beginning in 1996, the city, acting under Delaware law, has established each year a tax lien trust, also called an Issuer Trust, to which it sells all tax liens available for sale during that year under §11-319. On the basis of these liens, the Issuer Trust issues and sells Tax Lien Collateralized Bonds, proceeds from the sale of which are paid to the city as consideration for the sale of the tax liens. These proceeds go to the city's general fund for expense budget purposes and to the city's water and sewer system.

Each Issuer Trust hires servicers to collect the largest amounts possible on the tax liens it has purchased, which are pledged to the repayment of its bonds. However, delinquent property owners must be notified of the impending sale pursuant to notice requirements of the Administrative Code, and many pay their past due taxes before the applicable sale date. In fact, the tax lien sale program is the city's primary means of enforcing the payment of delinquent property taxes.

Bonds of the Issuer Trusts are offered and sold pursuant to an offering document similar to an Official Statement, called a Private Placement Memorandum (PPM), which, like an Official Statement, is required by the SEC to prevent fraudulent sales practices. As the bond seller is liable for any material misstatement or omission in the Official Statement, so the Issuer Trust is liable for any such shortcoming in the PPM. Issuer Trusts are not "constituted authorities" under federal law, and their bonds are therefore not tax-exempt.

BY JEFFREY D. FRIEDLANDER

Preserving New York City's Finances

Municipal Finance Division

The Municipal Finance Division, along with the Office of Management and Budget, the Comptroller's Office, prospective underwriters, and outside counsel, works to ensure the legality of the city's bond offerings and to maintain the confidence of investors in the integrity of the process. The role of the division in the structuring, negotiation and preparation of transaction documents for each of the types of bond offerings discussed here is substantially similar.

Due to the city's joint liability with the bond seller for any material misstatements or omissions in the Official Statement, the preparation and review of these documents is an important part of the work of the division. Division attorneys also participate with other city agencies, outside bond counsel and the underwriters (or Issuer Trusts) in due diligence inquiries to ensure that all portions of the offering documents are accurate and up to date. Division attorneys periodically contact other lawyers in the office to compile and update the Litigation Section of the Official Statement, which informs potential purchasers of litigation against the city which may be material, and, for the city's general obligation bonds, prepare an Opinion of the Corporation Counsel affirming the accuracy of that portion of the Official Statement. Opinions of the Corporation Counsel are initially reviewed and approved by this office's opinion committee comprised of senior office attorneys.

Finally, division attorneys arrange for the closing of the city's general obligation and TFA bonds. This includes drafting legal documents which are executed at the bond closing, such as Certificates of the Mayor and the City Comptroller, documents relating to the proper application of proceeds for capital purposes, and documents evidencing the proper payment for and delivery of the bonds.

Jeffrey D. Friedlander *is first assistant corporation counsel of the City of New York.* ***Albert Moncure****, chief of the municipal finance division of the law department, and* ***Kathy Blyn****, senior counsel in the division, assisted in the preparation of this article.*