OFFICE OF THE COMPTROLLER
THE CITY OF NEW YORK

I hope you will find this interesting.

Alan G. Hevesi
Comptroller

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ALAN G. HEVESI
COMPTROLLER

July 26, 1995

Honorable Rudolph W. Giuliani
Mayor of the City of New York
City Hall
New York, NY 10007

Re: Sale of New York City Water and Sewer System

Dear Rudy:

I appreciate the discussions we have had regarding the proposal to sell title to the New York City water and sewer system to the New York City Water Board, especially our meeting last Friday, July 21. The follow up communications from the Office of Management and Budget and Corporation Counsel have been interesting and useful. After fully considering all the relevant issues, I must reiterate my opposition to the sale of the City's water and sewer system. I will not approve the bond resolution authorizing the issuance of the bonds by the New York City Water Finance Authority necessary to finance this transaction. I am thoroughly convinced that the proposed sale is not in the best interests of the people of our City and their future well-being.

Let me outline my reasons.

First, although you have said that it is your intention to use the anticipated $1 billion in revenues from the proposed sale for the capital budget and that $200 million of this sum would go for the renovation of public school buildings, at our recent meeting, you indicated that you would not make a binding commitment to dedicate the entire $1 billion to the City's capital budget for fiscal years 1997 through 1999.

Furthermore, in my letter to you of June 8, 1995, I wrote, "To ensure that sale proceeds are firmly committed to use for such capital projects, I believe they should be processed in the same manner as proceeds from typical City general obligation debt issues. In the case of general obligation debt, bond proceeds are associated with specific capital projects and are deposited into restricted capital bond proceeds accounts administered by my Office." I also wrote that it would be appropriate to formalize any agreement that we would reach on this matter through a memorandum of understanding.

Yet, in Marc Shaw's letter to me of July 24, Mr. Shaw rejects my proposal for ensuring that the proceeds of the proposed sale are dedicated to the capital budget. He describes his intention to deposit the proceeds not in the City's restricted capital account, but instead in the City's general fund. If the proceeds are deposited in the general fund, there is no way to guarantee that they will not be used in this or a later fiscal year for the City's operating budget. The Water Authority was created to issue bonds for water projects, not to finance the City's own capital projects or its operating budget. The law does not permit proceeds of Water Authority bonds to be used for City expense purposes. To get around this problem and to accomplish the transfer of $1 billion raised at the expense of water ratepayers, the sale of the water assets is called a "water project". In fact, the purpose of the water asset sale, and therefore the purpose of the bonds sold to finance that sale, is solely to provide funds to the City.

Second, the proposed sale moves to the present revenues, in the form of lease payments from the Water Board, due to the City in the future. I do not support this.

Third, I remain profoundly concerned about the possibility that, with the transfer of ownership title of the water and sewer system to the Water Board, the State Legislature will pass a law that would expand membership on the Board to create domination by the State and interests from the watershed. Again, as I observed in my letter to you of June 8, my concern about this eventuality is particularly keen at a time when officials from the watershed area are strongly opposing some of the key elements of the City's filtration avoidance plan. Once the water system is owned not by the City but by a state-created entity, the Water Board, there is a dramatically greater possibility that the Governor and the Legislature may attempt to put their own representatives on the Board. As I testified before the Water Board on June 23, having spent more than 20 years in the State Legislature, experience tells me that giving a state body title to the water system sharply increases the chances that the Governor and Legislature will try to take control. Indeed, since he took office in January, Governor Pataki has already moved to substantially change one board. Legislation submitted by the Governor modifying the membership structure of the Long Island Power Authority was passed this year by both houses of the Legislature.

A report from Governor Pataki's transition group containing a section on the New York City watershed provides additional corroboration for this concern. The transition report suggests that a possible solution to the dispute between the City and the watershed communities is to create a <u>new authority</u> "to govern watershed protection". The report further states that, "To provide all parties with representation, control of the authority would be divided equally between the State, the City of New York and the watershed communities."

Further evidence of my understanding of how upstate views the proposed sale comes from a letter to me from State Assemblyman Richard Brodsky of Westchester, Chair of the Environmental Conservation Committee. In Assemblyman Brodsky's June 26 letter he writes, "I am concerned that the sale of the watershed assets to the Water Board could endanger the City's control of the watershed in the event that the law governing the board is amended. The provision in the draft acquisition and operating agreement allowing for a reinstatement of the lease in the event of changes in the board member appointment process is insufficient to address this concern."

Mr. Shaw's letter has not alleviated my concern about the possible legislative consequences of the proposed sale. Mr. Shaw claims that the legislation I have warned against would be prevented by the Public Authorities Law, the bond covenants and the Acquisition and Operating Agreement. I am not satisfied that this is the case. First, none of the above includes a specific prohibition against changes in the composition of the Board or the Authority. Rather, all three refer to changes in the Board's powers and authority. Second, I am not convinced that the legislation I have said might be enacted would be an unconstitutional impairment of contract, as discussed below. Finally, even assuming, which I do not, that the legislation I have warned against were an unconstitutional impairment of the bondholders' agreement with the Authority, the bondholders, not the City, would have the right to sue. Thus, the legislation could not be stricken unless bondholders, whose decisions are generally financially driven, brought suit to challenge it. Legislation changing the composition and/or powers of the Water Board could be carefully crafted so that it did not affect the property rights of bondholders, giving them no reason to challenge it. Nonetheless, such a change could have devastating political and policy consequences for the City.

The Law Department's legal memorandum, on which Mr. Shaw apparently bases his belief that the legislative action we fear would be unconstitutional, cites no cases directly addressing the concerns I have raised and omits a discussion of other legal authority more closely on point. Specifically, in two Louisiana cases, bondholders sued claiming that changes made in the composition of the New Orleans Water Board violated the federal Constitution. (Reppel v. Board of Liquidation, 11 F. Supp. 799 (D.C. La. 1935); State ex rel. Porterie v. Walmsley, 162 So. 2d 826 (La. 1935)). Both were rejected by the courts on the basis that the bondholders' interests were not directly affected. It appears unclear at best whether a change in the Board's or the Authority's composition that does not limit its ability to collect revenues (and which does not, therefore, impair the bondholders' security, i.e., their property rights) would be deemed an unconstitutional impairment of contract. Here in New York City, we have seen major changes in government structure that did not impair bondholders' rights and did not lead to bondholder suits. In 1989, the entire structure of City government was changed by a Charter revision that abolished the Board of Estimate, without objection from bondholders. We should not place the City's control of its water supply and sewer system in the hands of the Legislature, bondholders and the courts, parties whose interests and concerns are not necessarily the same as those of the City and ratepayers.

Mr. Shaw states that the reversionary right contained in the Acquisition and Operating Agreement would allow the City to retake the system should this legislation be enacted. The reverter clause is no protection. Under the Agreement, the City only has the right to take back the water system after it pays off all the Authority's outstanding bonds. After the sale, that debt would amount to about $7.8 billion and it grows by a minimum of about $750 million a year for the next six years. In the meantime, nothing would prevent a reconstituted Board or Authority from acting contrary to the City's and the ratepayers' interests. The Acquisition and Operating Agreement fails to allow the City to retake title to the system and subsequently refund the bonds pursuant to a repayment schedule. The Board is acquiring the system pursuant to a schedule that allows it to make payments over time; the City does not have that right under the Agreement. Also, the Agreement fails to specify that reversion would be automatic upon a change in the Board's composition.

In any event, the reverter clause only comes into play after the damage is already done, that is, after the Board's composition has been modified. This is analagous to plugging the hole in the dike after the flood.

Fourth, I am concerned that the State could use water system surpluses to close its own budget gaps. The Board, in exercising its specific mandated function to set water and sewer rates, will be in a position to set such rates to create a surplus. And since the Board is a state created entity, the State may find a way to gain control of such surpluses. The possibility of a surplus, whether planned or not, is more than hypothetical. In FY 92, there was a surplus of $208 million that had accumulated over the three previous years. In FY 93, there was a $6 million surplus and in FY 94, a $23 million surplus. These surpluses allowed the Board to freeze water and sewer rates until this June. Surely, New York City water and sewer rate payers should never be put at risk of such back door taxation by a State dominated Water Board.

Fifth, I believe the City has requested and not yet received bond counsel's opinion on the unresolved issue regarding the tax-free status for the refunding of existing outstanding bonds. Originally, the sale was supposed to include defeasance of $1.3 billion of water-related City general obligation debt. However, some of that debt has already been refunded so that under IRS rules another refunding would be taxable. I understand that the City is seeking permission to refund other City G.O. debt instead, since the loss of tax-exempt status for bonds to be issued as part of the sale would make it difficult, if not impossible, to sell them.

Finally, the impression has been created that if the water sale does not go through, the City will lose $400 million in capital funds for FY 96 and $200 million a year for the next three years. You have raised the loss of capital funds as a rationale to go forward with the sale. I do not accept that view. The sale either is a good or flawed proposal on its own. I believe it is seriously flawed and we should not go forward, even at the cost of the capital funds. But I also believe that there are alternative ways to fund urgent capital projects, especially the $207 million in school renovations that you and the City Council have identified as a priority.

Over the last five years, the City has always ended the year with at least $200 million in unspent capital proceeds, as shown in the table below. This surplus is then rolled into the next year's capital program and a new surplus is left at the end of that year. Thus, $429 million of funds not spent in FY 94 were rolled into FY 95 and $203 million of funds not spent in FY 95 were rolled into FY 96. By improving the efficiency of its capital planning and administration, the City could spend an additional $200 million.

Fiscal Year	Surplus In Capital Proceeds Account
1995	$202,861,000
1994	429,251,000
1993	360,605,000
1992	1,506,455,000
1991	609,054,000
1990	352,151,000

In FY 95, the unspent proceeds would have been more than $400 million, instead of $203 million, if the City had not cancelled the approximately $200 million competitive bond sale planned for last May. It is not unusual for the City to borrow less than planned and available because agencies cannot use all the planned capital funds. Thus in FY 95, If the City had borrowed and used all the capital proceeds planned, the City would have at least another $200 million for capital expenditures, in addition to the $203 million surplus. If this situation recurs in FY 96, as is likely based on the experience for at least the last six years, the City would have a total of $400 million in additional capital funds, equal to the amount of capital that the sale of the water system would provide that year.

Funds could also be found by delaying some specific projects now in the Capital Budget. I am not suggesting that these projects are not worthy, but in times of fiscal stress, some projects may have to be postponed by you and the Council to make way for those that are essential. For example, the Five Year Capital Plan includes $1.06 billion for housing programs. If that program were delayed for one year, an additional $200 million would be available in FY 96. Alternatively, $100 million of the project could be delayed this year. Or, the entire program could be spread over seven years instead of five, freeing up $60 million a year. These alternatives would provide from $60 million to $200 million in FY 96.

Other capital projects could be delayed until a future fiscal year. For example, the enclosed Department of Sanitation barge unloader - $38 million; Duke Ellington Statue - $.2 million; Corrections Department laundry refurbishment - $1.18 million; NY 2000 economic development study - $1 million; Brooklyn Amateur Sports Complex - $7 million; HPD office space renovation - $6.6 million; Foley Square Park - $8 million; Police Department precincts parking lots $3.06 million. Together these illustrative options add up to $65.04 million.

In sum, experience from FY 95 indicates that at least $400 million more would have been available in that year if capital borrowing and spending had achieved planned levels. It is very likely that at least the same amount will be available in FY 96. When added to the $265 million in possible savings from postponing projects, a total of at least $665 million could be available for capital purposes this year. There are undoubtedly other reasonable alternatives besides those in this menu of capital funding sources.

I strongly recommend that you and the Council begin the process of exploring these alternative sources of capital funding so that we can avoid both the difficulties that would flow from the sale of the water system and those that would come from cancelling vital capital projects such as school renovation.

Sincerely,

Alan G. Hevesi

AGH/nea

CC: Hon. Peter Vallone
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Newsday 6/29/95 Page A-38

Waterlogged

Scrap or redo waterworks deal


Giuliani

Mayor Rudolph Giuliani and City Council Speaker Peter Vallone doth protest a tad too much. Neither one should be in a lather over City Comptroller Alan Hevesi's sound decision to do everything in his power to block the $2.3-billion sale of the city's waterworks to the Water Board. What sane person would sell the family jewels (or major appliances) to pay June's AmEx bill? Or bust up the furniture to toss more wood on the fire?

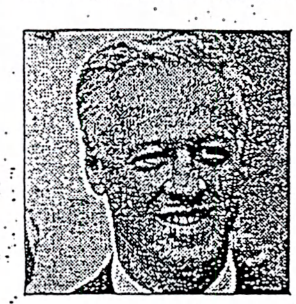
Giuliani and Vallone should spare us jawboning over whether Hevesi has the power to block the bond deal. Instead, they should ditch this fiscal gimmick. They should get back to stitching together a bona fide budget for fiscal 1996, which begins Saturday. As we've noted, what Rudy and Peter call a $31.1-billion budget really isn't; it's just a draft deal full of risky assumptions and revenue holes.

Our low-key comptroller's qualms about selling title to the waterworks do make sense.

FISCAL NO-NO. Despite some questions about the deal's assumptions, Hevesi told Giuliani in early June that he might support it if the mayor signed an memorandum of understanding. The MOU would guarantee that bond proceeds left over after debt service could only be used for pay-as-you-go capital projects. Giuliani didn't bite. His refusal is a signal that he might one day divert this dough to the city's cash-starved operating budget. That's one of those bad habits that led to the '75 fiscal crisis — shades of the Beame Shuffle.

HIGH-STAKES GAME. The city's Water Board, an authority, exists to finance our water and sewer system. Shifting the waterworks' title from the city to the board, Hevesi legitimately fears, would whet the appetite of upstate watershed towns and Gov. George Pataki to take over the state-created board. Pataki & Co. could back a bill that ends the city's control and spreads it out among the guv, upstate towns and the city.

Does this power-sharing model sound painfully familiar? Does the Metropolitan Transportation Authority, especially the subway system, get a fair shake in Albany? Nope. Does the city get its fair share of state school aid from suburban-dominated Albany? Nope.


Hevesi

Though the city would retain operational control of the waterworks and eminent-domain power in the watershed, a title sale could leave the city with a weakened hand at Albany's poker table. Legislative horse-trading (and bluffing) is the coin of the realm. The city shouldn't dilute its power while it's trying to win state and federal approval to use watershed protection, not a multi-billion dollar filtration plant, to protect our water supply.

JEWEL IN THE CROWN. Our system of reservoirs and water tunnels is one of the seven wonders of the universe we call New York. This imbroglio over it is just more evidence of Giuliani's stubborn refusal to make budget cuts in a thorough way and to raise revenue from underutlilized sources, including user fees and undertaxed homeowners. New York still needs shared sacrifice and a 24- to 36-month plan for overhauling services and bringing spending in line with revenues.

How long will Giuliani continue to rely on that fiscal-gimmick factory otherwise known as the Office of Management and Budget? Probably as long as it can pull tricks out of its hat. His use of OMB is really no different from his predecessors'. If he won't take OMB out of the gimmick-making biz, at least he should rename it the Office of Magic and Bullfeathers.

New York Times 6/29/95 Page A-20

Mr. Hevesi's Timely Warning

Selling New York City's vast water system for an infusion of budget funds was always an unsettling proposal. But Mayor Rudolph Giuliani and Council President Peter Vallone made a sincere and forceful case that the transfer of ownership of the city's network of reservoirs, pipelines and sewers to another government entity was a risk-free step to raise a billion dollars for much-needed capital improvements. We initially supported their approach, with certain reservations about how the money was spent and about the general wisdom of ownership transfers. But now the City Comptroller, Alan Hevesi, has raised more searching, fundamental questions about the sale that need to be addressed.

Under the Mayor's proposal, the water system, with its network of upstate reservoirs, would be sold to an independent agency, the New York City Water Board, which was created years ago by the State Legislature. Mr. Hevesi believes that the system is a core asset that should not be sold off, especially for a $400 million boost to the capital budget. In the long run, he believes it is better to let the capital budget decline from $4.2 billion to $3.8 billion, even though half of the lost revenue was targeted on school repair.

Mr. Giuliani and Mr. Vallone can rightfully argue that the city's need for this extra money is acute. While its bridges, schools and buildings are crumbling, the city has been forced to cut its capital spending program because it is bumping up against a constitutional ceiling on its debt.

Our initial reservation was that the proceeds of the sale might be seized as a one-shot revenue to meet current expenses, and not as promised for long-term capital projects. That remains a serious problem in view of the Mayor's reluctance to guarantee that he won't divert the money to help close the gap in the operating budget in future years.

But the real issue runs deeper. Outright city ownership of the water system, including the irreplaceable upstate reservoirs, is the best insurance for protection of the watershed.

This is a time of growing threat to that watershed from developers and pollution. Governor George Pataki is sympathetic to upstate interests that would like to see more development around the reservoirs. The Giuliani administration has set aside the funds to upgrade sewage treatment plants and septic systems, reduce pollution and acquire land upstate. But its actual right to carry out these plans is being challenged by local property owners and developers.

Mr. Hevesi and environmentalists warn that selling the water system to the Water Board would weaken the city's ability to combat such pressures in Albany. A further danger lies in the Legislature's ability to change the composition, and thus the priorities, of the Water Board at some future date.

Certainly, the Mayor and Mr. Vallone are not acting in bad faith in this matter. They are moving to try to address Mr. Hevesi's questions. Supporters of the sale in the Mayor's office and the City Council have come up with some interesting proposals that Mr. Hevesi has an obligation to discuss with them. One might be to cut back the sale, letting the Water Board take over the facilities inside the city and leaving the actual watershed property and reservoirs under outright city ownership. Another would be to write provisions into the deed of transfer and bond resolutions causing ownership of the water system to revert to the city if the composition of the Water Board is changed by the Legislature so that the Mayor of New York loses control of it.

But Mr. Hevesi is fundamentally right to worry about the risks of unloading a priceless part of the city's life-support system, over which it should exercise unquestioned control. The gut instincts of many knowledgeable politicians and civic leaders say it is better to find another way altogether than undertake an ownership swap that might cause problems down the road. It would be tragic if New Yorkers woke up one day and realized the value of one of their cherished possessions only after it was lost.

New York Times 7/28/95
Page A-26

Keep the Water System

After weeks of haggling, Mayor Rudolph Giuliani has failed to persuade the City Comptroller, Alan Hevesi, to approve the sale of New York City's water system for an infusion of budget funds. Now Mr. Giuliani says he will take Mr. Hevesi to court. The legal issues are complicated and subject to differing interpretations. But we continue to believe that it would be unwise public policy for the city to sell a vast and valuable asset to pay for construction projects over the next four years.

As originally proposed in Mr. Giuliani's budget, the city would transfer ownership of its network of reservoirs, pipelines and sewers to another government entity, the New York City Water Board. Part of the proceeds from the sale would be used to retire existing city debt, and $1 billion would pay for capital improvements, including $200 million this year for schools alone.

In these stringent times, the city certainly needs any extra money it can get to keep its infrastructure in good shape. But the immediate financial gain seems modest compared with the long-term risks of disrupting a water system that has taken years to build up and has served the city well. The sale poses a potential threat to the upstate reservoirs once control of all or part of the system passes from New York City. Mr. Hevesi has joined with many environmental groups in warning that, with the upstate watershed under threat from developers and pollution, Gov. George Pataki and the Legislature might well change the composition of the Water Board and weaken the city's authority. The Governor has already shown that he is sympathetic to developers upstate.

The Mayor argues that a network of legal protections can be put in the deed of transfer and Water Board bond resolutions to protect the city's control of the watershed. But no one can guarantee that those protections will be adequate, or that they would be enforced in time to avert destruction of the watershed. It is not prudent to risk the loss of such a precious city asset when there are so many parties that would like to get their hands on it.

Instead of going to court and challenging Mr. Hevesi's motivation as political, the Mayor should devote his energies to finding alternative resources for the city's capital budget. The Mayor and the City Council are right to have singled out school repairs as a major priority. To address the problem, money might be diverted in the next few years from housing and other projects in the $4 billion capital budget. Years from now, New Yorkers will very likely be grateful that alternatives were found to selling a priceless possession for short-term gain.

Newsday 7/28/95 page A-34

Hevesi Pours Cold Water on a Dangerous Scheme

Thanks to City Comptroller Alan Hevesi, another get-rich-quick scheme just bit the dust. The city may not pocket a quick $1 billion by selling its water system to the city Water Board, Hevesi wisely decided this week.

It's the kind of decision that an outsider might expect Mayor Rudolph Giuliani to like. After all, Giuliani promotes himself as Mr. Austerity — a straight-shooting bottom-liner with little patience for fiscal gimmickery. But in fact, this gimmick was hatched not by tired old Democratic pols trying to avoid tough choices, but by Giuliani's own people. And now the administration and its allies are livid. They say Hevesi is playing politics — *politics?* oh, whatta shock! — and that he exceeded his authority. They say they'll see him in court.

Here's hoping Hevesi wins.

Under the proposal, the city Water Finance Authority would issue bonds for purchase of the city's water system. Giuliani promises that the windfall would be used for urgent capital projects such as school repairs and bridge renovation. That sounds reasonable. But as Hevesi noted, not all of the $1 billion was assigned. Which means it could be used for operating expenses as well as capital costs. The city learned in the 1970s that borrowing money to pay day-to-day bills is a quick way into financial quicksand. Hevesi conveniently removed any temptation to do that.

Another pitfall: The city Water Board is a state entity. Once it owns the water delivery system, what's to stop the State Legislature from enlarging the board and giving control to upstate politicians? If that happens, the board could decide to filter city water — at a huge cost to city taxpayers — and open the way for lucrative development in the upstate watersheds. Council Speaker Peter Vallone, who supports the mayor's plan, says there are safeguards against such a disaster. Hevesi — a veteran of the Legislature — says there aren't.

Trust Hevesi on this one. The schools and bridges desperately need work. But there are other ways to raise the money — from user fees to a fairer allocation of tax burdens. This cockamamie scheme richly deserves to die.