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**MEETING WITH
CONGRESSMAN JOE WAGGONER**

Wednesday, November 12, 1975

10:30 A. M.

THE PRESIDENT HAS SEEN....

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THE WHITE HOUSE

WASHINGTON

November 11, 1975

MEETING WITH CONGRESSMAN JOE WAGGONNER (D-La.)

Wednesday, November 12, 1975

10:30 A.M.

Oval Office

From: Max L. Friedersdorf *m.l.f.*

I. PURPOSE

To discuss the New York City financial situation and pending Congressional legislation.

II. BACKGROUND, PARTICIPANTS, AND PRESS PLAN

- A. Background: This meeting is in response to a request from Congressman Waggonner for him to meet with you to explain his views on New York City. A copy of a memorandum on New York City previously sent to you is attached.

An analysis of bills to provide financial assistance to New York City which have been favorably reported by both the Senate (S.2615) and House (H.R. 10481) Banking Committees is found at Tab A of the attached memorandum. The House bill has been referred to the Ways and Means Committee. Floor action in the House was initially scheduled for November 11th. Reports suggest that in light of the AFL-CIO opposition, House floor action will be delayed. Senate Banking Committee sources indicate that no attempt will be made to bring the bill to the Senate floor until there is some indication of what the House will do.

A review of the legislative status of the Administration's proposed amendment of the Federal Bankruptcy Act is found at Tab B of the attached memorandum. In short, the Senate bill gives us almost all of what we want; the House bill very little.

- B. Participants: Congressman Joe Waggoner
Jack Marsh
Bill Seidman
Alan Greenspan
Max Friedersdorf

- C. Press Plan: White House Press Corps photo opportunity

III. TALKING POINTS

- A. New York City's problems have received a great deal of my attention in recent weeks and I have been closely monitoring developments there, as I am sure you have.
- B. I continue to believe that a responsible and adequate solution to New York City's problems is possible. I have made my specific views on New York City quite clear and am interested today in having the benefit of your thinking on this problem.

THE WHITE HOUSE
WASHINGTON

November 8, 1975

MEMORANDUM FOR THE PRESIDENT

FROM: L. WILLIAM SEIDMAN

SUBJECT: New York City

This memorandum contains a set of materials designed to provide you with an analysis of legislation pending in Congress to provide financial assistance to New York City, the legislative status of your proposed amendment to the Federal Bankruptcy Act, a review of New York State's financial condition, possible ways of providing financial assistance under existing legislation for the New York Housing Finance Agency, the current condition of the municipal bond market, the impact of a New York City default on the national economy, and draft legislation to authorize Federal guarantee of debt certificates issued to fund essential services in event of a New York City default.

The specific papers, prepared in coordination with the Departments of Treasury and Justice and the Council of Economic Advisers, are as follows:

1. Pending Legislation to Provide Financial Assistance to New York City (Tab A)
2. Legislative Status of the Administration's Proposed Amendment to the Federal Bankruptcy Act (Tab B)
3. New York State's Financial Condition (Tab C)
4. Assistance to the New York State Housing Finance Agency (Tab D)
5. Impact of a New York City Default on the National Economy (Tab E)
6. Condition of the Municipal Bond Market (Tab F)
7. Draft Legislation on Provision of Essential Services (Tab G)
8. Questions and Answers on New York (Tab H)

Pending Legislation to Provide Financial Assistance to New York City

Bills to provide financial assistance to New York City have been favorably reported by both the Senate (S.2615) and House (H.R. 10481) Banking Committees. The House Bill has been referred to Ways and Means. Floor action in the House was initially scheduled for November 11. Reports suggest that in light of the AFL-CIO opposition, House floor action will be delayed. Senate Banking Committee sources indicate that no attempt will be made to bring the bill to the Senate Floor until there is some indication of what the House will do.

Summary of Bills

Both bills authorize the Federal Government to guarantee local obligations to prevent default and also confer authority to provide assistance after a default. Authority under both bills is delegated to a Board chaired by the Secretary of the Treasury

The fundamental difference between the two bills is in the amount of flexibility given to the Board. The Senate bill is highly restrictive: the Board cannot authorize a guarantee unless stringent pre-conditions are met. The House bill gives the Board substantially more flexibility, in recognition of the possibility that the City may not be able to meet very stringent guidelines between enactment and the time a guarantee would be necessary to avert default.

Issue Analysis

1. Pre-Default Assistance

Senate

- authorizes \$4 billion in Federal guarantees of new 1-year State securities to prevent default;
- guarantee authority is phased out over 4-year period

House

- authorizes full or partial emergency guarantees of obligations of a State or State instrumentality to prevent default;

- authorized amounts: \$5 billion maximum outstanding until 1989; \$3 billion thereafter

Comment

The advantages of the Senate bill are (1) more control over the City is provided; since the guarantee is limited to one year there is the opportunity to terminate the program if the City is not complying with the guidelines; and (2) the program is shorter. The Senate program expires in 4 years; under House version, program could continue for 24 years.

The advantage of the House bill is that by authorizing a longer guarantee period, it eliminates the necessity for reapplications for assistance.

Suggested Improvements

Because of our position in opposition to any assistance to prevent default, no changes would make these provisions palatable.

2. Preconditions to Assistance

Senate

- voluntary restructuring of the City's debt:
- at least 65% of present MAC obligations must be exchanged for non-guaranteed bonds with longer maturities (at least 5 years) and lower interest rates
- at least 40% of the City's obligations maturing before June 30 must be exchanged for similar long-term, low interest bonds

- State must cover $\frac{1}{2}$ of City's operating deficit out of general tax revenues, over and above any assistance previously given
- Board must determine that neither City nor State can practically obtain credit from other source and that default is imminent
- Board may impose any other conditions deemed necessary
- City must balance budget by 1977, including reductions in cost of employee pension plans and maximum feasible participation by such funds in the restructuring of the City's debt
- State must assume control of City's fiscal affairs while Federal guarantee is outstanding
- guarantee must be satisfactorily secured, inter alia, by future revenue sharing payments to City and State
- City must open books to Federal audit and use accounting procedures prescribed by the Board
- State must pay guarantee fee of up to $3\frac{1}{2}\%$ of total obligations guaranteed if tax exempt, and up to 1% if made taxable by subsequent Act of Congress

House

- credit markets must be closed as a practical matter to both City and State
- City must submit and follow plan for fiscal solvency from recurring revenues
- State must have authority to control City's fiscal affairs during life of Federal guarantee. (New York's Emergency Financial Control Board is stipulated as satisfying this requirement.)

- State must supply additional aid up to 1/3 of City's deficit, as determined by Board
- allows for guarantee fee up to 3/4 of 1% per year in discretion of Board
- Board may require City to renegotiate outstanding obligations (e.g. by exchanges for longer maturity, lower interest paper) including outstanding contracts for services
- authorizes GAO audits of municipality and/or relevant State instrumentality

Comment

The flexibility issue is most squarely presented with respect to these provisions. While the exchange of debt, higher state tax and pension benefit renegotiation features of the Senate bill can be seen as forcing the City to take stringent measures, they may be so stringent as to make the guarantee authority unworkable. The House bill authorizes the Board to attach whatever condition it deems appropriate, but does not require the Board to deny assistance if extreme conditions are not met.

Suggested Improvements

None.

3. Post-Default Assistance

Senate

- guarantees up to \$500 million of 3-month City notes to meet City's short-term credit needs for continuing essential services
- obligations secured by a first lien on City's future revenues

House

- no separate authority. In a default situation, Board may issue guarantees and may, for a six month period, waive above preconditions in providing guarantees

Comment

House bill not specifically limited to essential services.

Suggested Improvements

If it is determined that we will carry out essential services pledge via guarantees, should limit guarantees to court-authorized debt certificates. Should also consider raising authorization to \$1 billion or \$1.5 billion.

4. Tax Status of Guaranteed Obligations

Senate

- to avoid necessity for Finance Committee action, does not require that guaranteed paper be taxable
- language presupposes that later legislation will require taxable feature.
- provides that Federal Financing Bank must purchase any tax-exempt guaranteed paper

House

- makes all guaranteed securities taxable

Comment

The Senate bill is needlessly cumbersome. Any guaranteed paper should be taxable.

Suggested Improvements

None

5. Governing Board

Senate

- 3-member Board consisting of Secretary of Treasury (Chairman), Chairman of Federal Reserve Board, and Secretary of Labor

House

- 5-member Board consisting of Secretary of Treasury (Chairman), Secretary of HUD, Chairman of Federal Reserve Board, and Chairman of SEC

Comment

None.

Suggested Improvements

If only post-default assistance will be provided, a full Board may be needlessly cumbersome.

B

LEGISLATIVE STATUS OF THE ADMINISTRATION'S PROPOSED
AMENDMENT OF THE FEDERAL BANKRUPTCY ACT

Statements comparing the Senate and House bills with the Administration's proposed amendment of the Federal Bankruptcy Act are attached.

H.R. 10624 has been approved by the Edwards Subcommittee and will receive the attention of the full House Judiciary Committee Monday, November 10, at 10:30 a.m. Minority Counsel for the Subcommittee expects the full Committee to ratify the action of the Subcommittee.

S. 2597, as amended, has been approved by the Subcommittee on Improvements in Judicial Machinery. In the Thursday meeting of the full Judiciary Committee, Senators Kennedy and Mathias argued that the legislation was not urgent. Senator Mathias exercised his personal privilege, thus putting over a vote on the bill until Thursday, November 13. Minority Counsel advises that there are sufficient votes to bring the bill out of Committee.

To summarize, the Senate bill gives us almost all of what we want; the House bill very little.

COMPARISON OF H.R. 10624 WITH THE ADMINISTRATION'S
BILL FOR BIG CITY BANKRUPTCIES

The House Bill, following the personal plea of Chairman Rodino before the Subcommittee, opts for a revision of the debt adjustment provisions of Chapter IX of the Bankruptcy Act rather than a new Chapter XVI to deal with major municipalities. The style of the bill, its arrangement and many of its particulars are different from the Administration's bill though much of the substance is similar.

Sec. 81 includes definitions of nine terms used in the bill, only three of which are the same terms defined in the Administration's bill--and even these three definitions are different. The changes are not substantial, and we have no objection.

Sec. 82(a) on jurisdiction is the same as the last sentence of Sec. 801(a) of the Administration's bill. Sec. 82(b)(1) of H.R. 10624 permits the petitioner to reject executory contracts and unexpired leases. The Administration's bill expressly permitted this only in conjunction with the consummation of the plan. We think, however, it would be permitted even without express provision, and so have no objection to the new language. Sec. 82(c), limiting interference by the court with the political and governmental powers of the city, omits the proviso contained in Sec. 805(e) of the Administration's bill specifically authorizing the court to enforce the conditions attached to certificates of

indebtedness and the provisions of the plan. We object to this change.

Sec. 84 would permit any political subdivision, public agency or instrumentality of a State, without regard to size, to file a petition for relief; the Administration's bill is limited to cities in excess of 1,000,000 population and certain subentities thereof. We object to the change strenuously, since its adoption will substantially lessen the possibility of including some of the substantive provisions we think necessary for New York. Sec. 84 would permit filing so long as the petitioner is "not prohibited by State law from filing a petition". The Administration's bill would require the specific approval by the State before a petition could be filed by a major municipality but subentities could file if not prohibited. We object to the change.

Sec. 85 would require any party in interest desiring to challenge the filing of a petition to do so within fifteen days. The Administration's bill would permit such challenges up to ten days before the hearing on confirmation of the plan, unless the judge imposed further restrictions. We object to the change, since it eliminates the possibility of dismissal for failure to submit a good faith, reasonably feasible plan. Sec. 85(a) permits a governing authority or board for certain special taxing or assessment districts to

file on behalf of such districts. No objection. Sec. 85(c) gives the city a wider choice of venue than does the Administration's bill. We think the opportunity to forum shop is undesirable. Sec. 85(d) uses different phraseology for the notice required as to the filing or dismissal of a petition and is specific as to use of publication. No objection. Sec. 84(f), unlike the Administration's bill, makes certain "bankruptcy" clauses in contracts and leases unenforceable if the petitioner cures prior defaults and provides adequate assurance of future performance. This is acceptable if a reasonable time limitation for curing defaults is added.

Sec. 88(b) uses somewhat different language than that used in the Administration's bill as to the classification of creditors. Sec. 88(c), unlike the Administration's bill, seeks to spell out the limits on damages for breach of an unexpired lease. No objection to these changes.

Sec. 90(a) permits the petitioner to file the plan with its petition or at such later time as the court may specify. The Administration's bill requires the filing of the plan with the petition together with a statement of present and projected revenues and expenditures sufficient to show that the budget of the petitioner will be in balance within a

reasonable time after adoption of the plan. H.R. 10624 does not call for a balanced budget as a requirement for confirmation of the plan, though the requirement that the plan be "feasible" may supply this requirement. We oppose these changes.

Sec. 92, governing the acceptance of a plan, uses language and arrangement that is different from that in the Administration's bill. However, voting is much the same except that the court could temporarily allow disputed claims for the purpose of voting. Both bills permit "cram down" as to nonassenting classes of creditors. H.R. 10624 follows the language of current Chapter IX and this would make it somewhat more difficult for the city to dispose of nonassenting classes of creditors by "cram down". No objection to these changes.

Sec. 93 allows the SEC to file a complaint objecting to a plan but SEC could not appeal. The Administration's bill provides for notice to the SEC but would not make it a formal party to the proceedings. Presumably it could file papers in the proceeding as amicus curiae with the same result as to appeal. We have no objection to the changes.

Sec. 94(b), setting forth the conditions for confirmation of a plan, omits the Administration's requirement that

petitioner's current and projected revenues and expenditures forecast a balanced budget within a reasonable time after adoption of the plan. The language of the Administration's provision also calls for the dismissal of the proceeding if these conditions are not met. As indicated earlier, we object to this change.

Sec. 95, dealing with the effect of confirmation, is the same as in the Administration's bill except for specific language that the plan and the discharge will not be binding on certain creditors who did not have timely notice or actual knowledge of the petition or plan. We have no strong objection to this change, though it may produce considerable litigation. Sec. 95(b) spells out conditions for discharge of debts which are implicit in the Administration's bill but not spelled out.

Sec. 96(a), dealing with the deposit of cash or securities, is not spelled out in the Administration's bill though its substance is covered by the requirement that the petitioner comply with the plan. Sec. 96(f), making a certified copy of any order or decree evidence of the jurisdiction of the court and effective to impart notice when recorded, is not found in the Administration's bill and seems unnecessary. No objection to these changes.

Sec 97, covering the effect of the exchange of debt

securities before the date of the petition, is not found in the Administration's bill and seems of little utility. We have, however, no objection.

The Subcommittee draft did not have a dismissal provision initially. Sec. 98 now contains five discretionary bases for dismissal, though couched in language which is different from that in Sec. 806(b) of the Administration's bill. Dismissal for default in any of the terms of the approved plan is an issue we are studying further. Otherwise we have no objection.

COMPARISON OF S. 2597 WITH THE ADMINISTRATION'S BILL
FOR BIG CITY BANKRUPTCIES

As amended to date the Senate Bill follows the Administration's bill in most particulars, including arrangement and identical language in a number of sections. The following changes have been made in the Administration's draft:

Sec. 801 includes authority for the court to permit the rejection of executory contracts even before the approval of a plan of composition or extension, whereas the Administration's bill authorized rejection of executory contracts and unexpired leases in the city's plan (Sec. 813). We do not object. Sec. 801(c) of S. 2597 would require the chief judge of the district court to notify the chief judge of the circuit court of the filing of the city's petition. The later would then designate the judge who would conduct the proceedings. The Administration's bill did not have this provision. We support the change.

Sec. 802 defines "claim" and "creditor" a bit differently than the Administration's bill and adds definitions of "plan" and "person". We do not object.

Sec. 803(a) still limits eligibility to municipalities of 1,000,000 or more population and requires specific State authorization for the city to file. An amendment adopted on Senator Scott's motion modifies the latter provision to permit the chief executive, the legislature or

such other governmental officer or organization as is empowered under State law to authorize the filing. This would presumably allow the Control Board now overseeing the city's finances to provide the necessary State consent-- which is probably not enough for our purposes.

Sec. 804 drops the Administration's jurisdictional requirement that the city submit a good faith plan with its petition together with a statement of current and projected revenues and expenditures adequate to establish that the budget will be in balance within a reasonable time after adoption of the plan. However, that requirement is still retained as condition for confirmation of the plan. Sec. 817(c). We prefer the original Administration proposal, but realistically think it has little chance of survival. Sec. 804(b) gives the city a choice of the district in which the petition can be filed. The Administration's bill would deny this choice; the change is acceptable, however, if Sec. 801(c), discussed above is adopted.

Sec. 805, dealing with stays, goes beyond the Administration's bill in denying recognition or enforcement of setoffs occurring within three months before the filing of the petition. We think this goes too far.

Sec. 806 would require any creditor wishing to challenge the petition to do so within thirty days of its filing and

an interlocutory appeal could not be taken from the court's finding of jurisdiction. This is intended to increase the marketability of debt certificates. We oppose the interlocutory appeal provision.

Sec. 807, dealing with notices, is much the same as the Administration's provision except for an express requirement for publication of the notice. Throughout the bill provision is made for notices to be given by the petitioning city or such other person as the court designates rather than by the court clerk as in the Administration's bill. We do not object to these changes.

In Sec. 812, the second priority accorded claims for services or materials furnished shortly before the filing of the petition is limited to claims arising within two months of the filing rather than to claims arising within four months of filing as in the Administration's bill. No objection.

Sec. 813 permits the petitioner to file a plan either with the petition or at such later time as is set by the court. Sec. 804(b) of the Administration's bill required that the plan be filed with the petition. We prefer the Administration's proposal, but realistically think it has little chance of acceptance.

Sec. 814 changes voting requirements to further protect small creditors. Thus the petitioner must obtain approvals

from two-thirds in amount and 51 per cent in number of each class of creditors, unless other provision is made for their claims. The Administration's bill required approvals only from two-thirds in amount. Both bills permit the majorities to be counted on the basis of those eligible to vote who actually vote. We think the change is undesirable.

Sec. 814(c) of S. 2597 covering the division of creditors into classes, is somewhat more flexible than the Administration's provision. No objection.

Sec. 816 includes Senator Abourezk's amendment which would let the court allow a labor organization's or employee's association representative to be heard on the economic soundness of the plan. No provision is made for voting or appeals by such representatives. No objection.

Sec. 817 omits the requirement found in the Administration's bill at Sec. 816(a) that the court make written findings in connection with the confirmation of the plan. We think this change is undesirable. The balanced budget concept is retained as a condition for approval of the plan.

Sec. 820 uses somewhat different language from that contained in Sec. 806(b) of the Administration's bill in stating the grounds for dismissal of the proceeding and adds as a mandatory ground for dismissal the fact that an adopted plan has not been consummated. Dismissal is important as this is one of the few levers the court has to force

the city to move forward and come up with a balanced budget. We think, however, that this provision requires further analysis, which we are now conducting.

Sec. 823, on conversion of a pending Chapter IX proceeding to one under this new chapter, is new, as is Sec. 824 on effective date. No objection.

C

NEW YORK STATE'S FINANCIAL CONDITION

Fundamentally, New York State is in reasonably sound financial condition on the basis of underlying factors. It does have difficulties, attributable to (1) its own deficit for the fiscal year ending March 31, 1976, now officially estimated to be \$611 million; (2) substantial short term borrowing to aid New York City; and (3) the unsound financial condition of some of the agencies of the State, particularly the Housing Finance Agency.

The State must act to remedy these difficulties by establishing new revenue sources to cut the deficit and by taking the steps proposed by the Financial Community to strengthen the Housing Finance Agency. However, these difficulties will not result in an immediate crisis for the State, even if a default by New York City were to trigger an adverse psychological reaction. While the State does have note maturities in December and January, its cash flow, according to State estimates, is adequate until late March, when it must borrow to refund notes issued to raise the funds loaned to the City and to fund its own deficit.

In the April-June period (the first three months of the following fiscal year), the State typically borrows \$4-5 billion (State estimate) against revenues to be received later in the year. The proceeds of this borrowing are used primarily to provide assistance payments to local governments and school districts. The State's ability to borrow such funds will depend in part on what steps it takes with respect to the problems outlined above.

D

ASSISTANCE TO THE NEW YORK STATE
HOUSING FINANCE AGENCY

There are four mechanisms which could be employed to provide assistance to the New York State Housing Finance Agency (HFA):

1. Facilitate HFA borrowing by Federal guarantees and subsidies for taxable HFA bonds under Section 802 of the 1974 Housing Act.
2. Reduce HFA borrowing needs and provide cash by GNMA purchase of unfunded mortgages owned by HFA.
3. Strengthen backing of HFA's bonds by FHA insurance and subsidies on mortgages owned by HFA.
4. Federal Reserve loan to HFA.

I. Section 802 Guarantee

Section 802 of the 1974 Housing Act authorizes HUD to guarantee an aggregate amount of \$500 million of taxable state housing agency debt and to provide a 33-1/3 percent interest subsidy on the bonds. None of this guarantee authority has been used. Such a guarantee would make HFA debt fully marketable at low rates. This approach has the dual advantage of being the easiest to implement and providing the most substantial benefit.

II. GNMA Purchase

We estimate that HFA owns approximately \$200 million in marketable mortgages; that is, mortgages on viable projects which have not been fully or partially funded by HFA bonds. We believe GNMA has the legal authority to purchase these mortgages.

A sale of mortgages to GNMA would lessen HFA's funding (and thus borrowing) requirements and would also provide cash which HFA could use to meet other commitments.

III. FHA Insurance and Subsidies

FHA could provide mortgage insurance and interest reduction subsidies under its Section 223(f) and Section 8 programs. This would require unraveling the original mortgage arrangements

between HFA and the private project owners and the issuance of a new mortgage at current rates. The interest reduction subsidy notwithstanding, HUD believes that few project owners would agree to give up their 5, 6 and 7 percent mortgages for a new market rate loan. We understand that HFA and HUD staff have discussed this approach, but have not reached conclusions as to its viability.

IV. Federal Reserve Loan

Under its emergency lending authority, the Federal Reserve could lend HFA whatever amounts are required. Governor Carey has requested a \$576 million, 90 day loan. Paul Volcker, President of the Federal Reserve Bank of New York, has not closed the door but has indicated that the request was "incomplete" in terms of the information provided.

IMPACT OF A NEW YORK CITY DEFAULT ON THE NATIONAL ECONOMY

Several studies have claimed that a New York City default would have a severe negative impact on the national economy. An analysis of these studies by the Council of Economic Advisers concludes that the studies are deficient in several respects.

The studies generally assume that default will lead state and local governments to rapidly balance their operating budgets by raising taxes and lowering expenditures. But state and local governments have already made substantial adjustments to their budgets and little or no further adjustment is likely. With no further steps we believe that the combined operating and capital account deficit of state and local governments will be eliminated by the fourth quarter of 1976. A moderation in the growth of state and local expenditures has, therefore, been long anticipated and has been taken into account in our recommendations concerning national tax and expenditure policy.

The various studies also assume that default would mean a lower rate of money supply growth, even though some of them assume that the Federal Reserve would intervene to prevent disruption to financial markets. We do not believe that if default were to occur that the Fed would pursue a more restrictive monetary policy. Consequently, part of the impact which some of the studies ascribe to default is in reality the impact of a more restrictive monetary policy assumption.

We also do not see as sharp an increase in interest rates resulting from a New York City default as is assumed in some of the studies. Yields on municipals have already risen some, and while it is impossible to foresee future changes with confidence, we believe that most of the impact of a possible default is already reflected in current rates.

In summary, therefore, while we acknowledge a number of unknowns in the current outlook, we do not believe that the impact of a New York City default, should it occur, would have a significant impact on the developing economic recovery. Clearly there are some risks in the current situation. But there are no Federal policies which can eliminate those risks without creating others.

F

CONDITION OF THE MUNICIPAL BOND MARKET

The municipal bond market has performed extremely well over the past year. In the first nine months of 1975, state and local governments have raised approximately \$45 billion in bonds and notes. Moreover, such funds have been raised at a cost not disproportionate to historical levels.

As a general rule, we expect interest rates on tax-exempt instruments to be 70 percent of the rates on taxable instruments of comparable quality. In October, rates on prime and medium grade municipals were exactly 70 percent of the rates on AAA and A utility bonds.

What has taken place is a shift in the quality preferences of investors: a tendency to prefer higher grade instruments. This change -- in market parlance a "flight to quality" -- has resulted in lower costs for better quality borrowers and relatively higher costs for the lower grade issues.

The excellent performance of the market notwithstanding, certain improvements can be made. In recent years the growth rate in demand for funds by state and local governments has exceeded the growth rate in the supply of funds from traditional institutional purchasers of tax-exempts: commercial banks and fire and casualty insurance companies.

These entities have had reduced needs for tax-exempt income as a consequence of underwriting losses in the case of fire and casualty companies and loan losses, leasing activities and foreign tax credits in the case of banks.

Accordingly, to broaden the market and reduce borrowing costs, it would be desirable to afford state and local governments the option of issuing debt on a taxable basis, with an automatic interest subsidy from the Federal Government. Such an option would in effect open the market to new classes of lenders which do not need tax-exempt income -- e.g., pension funds, charitable foundations, etc.

Secondly, partially in recognition of the fact that there is greater individual investor participation in the market, state and local issuers of substantial amounts of debt should be required, under Federal law, to report their financial condition on a current, accurate and comparable basis.

DRAFT LEGISLATION ON
PROVISION OF ESSENTIAL SERVICES

A proposal to authorize the Secretary of the Treasury to guarantee debt certificates issued to fund essential services is attached.

The draft language does not define essential services nor does it resolve the question of whether assistance should be in the form of a guarantee or a loan.

As drafted, the Secretary of the Treasury would have sole discretion to determine what constitutes an essential service.

*Draft Legislation

(1) In connection with a proceeding under Chapter XVI of the Bankruptcy laws, upon application of petitioner, the Secretary of the Treasury may guarantee, in whole or in part, payments of principal, of interest, or both, on certificates of indebtedness issued pursuant to Section 811 of said Chapter XVI for the purpose of providing funds for the maintenance of essential services.

(2) The provision of such guarantees shall be on such terms and conditions as may be established by the Secretary of the Treasury in his sole discretion.

(3) Any decision, rule or other determination by the Secretary of the Treasury pursuant to the authority conferred under this section shall not be subject to judicial review by any means.

(4) The aggregate amount of guarantees outstanding at any time under this section shall not exceed [\$1, 500, 000, 000].

(5) No petitioner shall be eligible for guarantees under this section unless such petitioner shall have first made application under this section on or before January 31, 1976.

* It would be possible to redraft this language to give the President authority to delegate these powers to such officers as he desires.

DEFINITION OF ESSENTIAL SERVICES

- Q. In your address to the National Press Club you indicated that the Federal Government would work with the Court to assure the provision of services essential to the protection of life and property. What specific services were you referring to?
- A. It would not be desirable to speculate at this time as to each and every item on such a list. In the context of an orderly proceeding to reorganize the City's debt, to the extent our participation is required, we will work with the Court, in cooperation with the parties, in identifying the needs which do exist.

November 8, 1975

FEDERAL ASSISTANCE FOR ESSENTIAL SERVICES

- Q. How does the Federal Government intend to insure essential services for the citizens of New York City in the event of a default?

Alternative 1

The resources to meet the needs of the citizens of the City remain available at the State and local level. Any action by the Federal Government now could interfere with the processes which I now understand are taking place at those levels to deal with these possibilities. If State and local officials abdicate their responsibilities to meet these critical needs, then we will take the necessary action.

Alternative 2

I will propose legislation authorizing the Secretary of the Treasury to guarantee or purchase debt certificates to meet essential services.

Such a guarantee would be available only after default, in limited amounts and for a limited period of time to insure that only essential services were covered.

November 8, 1975

AVOIDING A NEW YORK CITY DEFAULT

Q. You have indicated that New York City can avoid a default if they take the necessary steps. What are those steps?

A. I have often said that it would be improper for me to get into the business of dictating what actions should be taken at the State or local level. But let me give you some possibilities.

First, the plan announced by MAC last week could be pursued. That plan calls for institutional holders of City notes to exchange their notes for long term City bonds; individual City noteholders to exchange their notes for MAC bonds; and for the banking and pension systems to provide new loans during the period in which the City is balancing its budget.

Second, the State could enact a temporary and emergency tax -- perhaps an increase in the sales tax or an income tax surcharge -- to provide revenues to bridge the gap. When the City returns to a balanced budget, such taxes could be repaid through refunds or other forms of tax reductions.

Third, the nearly \$20 billion in State and City employee pension fund assets could be used to collateralize bridge loans to the City.

As I said, these are only a few examples of what could be done. They clearly belie the erroneous suggestion that all State and local resources have been exhausted.

November 8, 1975

STATE OF MUNICIPAL BOND MARKET

Q. Hasn't the municipal bond market deteriorated in the past two weeks? How do you account for this?

A. After its strongest and most sustained rally of the year, prices in the municipal market have shown a slight decline in the past two weeks; that is, interest rates have risen slightly. Such a price decline is neither surprising nor disturbing. After all, the municipal bond market, like any other market, is subject to fluctuations for a wide range of reasons. Profit-taking, minor changes in demand for tax-exempt income, a relatively heavy volume of new borrowing, have all been factors. These events must be viewed in perspective. The health of the municipal market is best reflected by how it has performed recently: in the third quarter alone, states and cities raised some \$13.7 billion.

November 8, 1975

CONTAINING NEW YORK CITY'S PROBLEMS

Q. How can you be sure that New York City's problems won't spread to New York State and to other cities and states throughout the country?

A. New York City's problems have been caused by a consistent pattern of failing to bring spending into line with revenues, resulting in massive cumulative deficits. No other major city has engaged in such practices and thus no city faces the burdens New York faces. Indeed, one way to insure that such problems will spread is if the Federal Government signifies -- by adoption of an assistance program -- that it stands ready to finance the spending mistakes of America's cities.

November 8, 1975

CONGRESSIONAL LEGISLATION ON NEW YORK

- Q. The House is expected to take up soon a bill to provide loan guarantees for New York City, tied to a municipal bankruptcy bill similar to what you requested. Would you consider signing this legislation?
- A. As I have indicated, I shall veto any bill which requires the Federal Government to provide financial assistance to prevent default. If Congress sends me a bill containing that requirement, I will not sign it.

November 8, 1975

NEW YORK CITY

Q. How will you prevent riots in New York City if paychecks and welfare checks stop because of a default?

A. The legislation which I have proposed to handle a New York City default would permit the maintenance of services essential to the protection of life and property. Furthermore, I have indicated that the Federal Government will work with the court, in the event of a default, to ensure that such services are provided. There is no reason why New York City's financial difficulties cannot be resolved in an orderly manner, and there is no justification for concern over social disorders or disruptions..

Porter
November 7, 1975

NEW YORK CITY

Q. Why is Chancellor Schmidt so concerned about New York City?

A. Chancellor Schmidt is the most appropriate and able person to comment on his views. I might say that in a general sense many concerns abroad regarding New York City are based on psychological fears about a general disruption in financial markets that could occur. As you know, I have proposed legislation in the event of a New York City default, which we all surely hope will not occur, that would provide for an orderly procedure to handle the situation. Under this legislation there need not be any major disruptions in the financial markets in New York or anywhere else. Moreover, there are strong indications that the markets have already made adjustments and discounted for the possibility of a New York City default. In short, the situation is manageable.

Porter
November 7, 1975

GOVERNOR CAREY LETTER ON AID FOR N.Y. AGENCIES

Q. Will you support Governor Carey's request to the Federal Reserve for a 90 day, \$575 million loan for four agencies of New York State?

A. I have received a letter from Governor Carey advising me of his request to the Federal Reserve but, as you know, the Federal Reserve Board is an independent body and the Administration does not participate in or direct its decisions. I have no control over whatever action the Federal Reserve might take.

Background

For over a month, Governor Carey has had a detailed and carefully thought-out plan presented to him by the financial community in New York to strengthen the credit of the New York State Housing Finance Agency which would receive the great bulk of the loan the Governor has requested. The plan is specifically designed to put the Housing Finance Agency in the kind of fiscal condition necessary to restore market access. Press reports of the Governor's request to the Fed indicate that he does not intend to ask the Legislature to act on the plan until after the State receives a loan from the Fed.

The financial community plan consists of the following:

1. Creation by State appropriation of an insurance fund in an amount equal to 20% of annual debt service -- cost: approximately \$60 million.
2. Provide funding, by general fund appropriation, of the smaller programs of the Agency -- \$30 million.
3. Fund the \$30 million shortage in the operating and maintenance reserves of the component projects.
4. Finance the deficit in the Co-op City Project's debt service -- \$12.5 million.
5. Agree to fund deficits in other projects as a line item in the state budget.
6. Effect improvements in accounting methods and management controls.

There is, of course, no assurance that adoption of this program would enable HFA to re-enter the market. As a practical matter, however, the financial community could well be locked in: having had their proposal adopted, they could not argue that financial factors precluded their underwriting HFA securities.

Porter

November 6, 1975

November 4, 1975

MEMORANDUM: EMERGENCY MUNICIPAL REORGANIZATION ACT

The Democratic Policy Committee met to consider legislative options dealing with the crisis in our cities with particular regard to New York City and New York State. Senator Proxmire and Senator Stevenson were invited to the Policy Committee to explain the range of options previously addressed by the Senate Banking Committee. Both Senator Proxmire and Senator Stevenson opposed a federal bailout of New York City as was suggested by some when the crisis first arose. It was noted in the Policy Meeting that the President had announced publicly that "he was prepared to veto any measure" to bail out New York City.

It was reported that a bill dealing with the New York situation has been approved by the Senate Banking Committee. It was prepared in cooperation with the Federal Reserve and Treasury Department staff people and in effect it mandates the type of reorganization of New York City's financial structure that would otherwise only be provided after a technical default and a declaration of bankruptcy by that City. Senator Proxmire and Senator Stevenson are prepared to present a detailed delineation of the stringent provisions that would be imposed on New York under the terms of this bill that has been recommended for consideration by the full Senate. In effect, what their bill provides is a rigid program of austerity to be undertaken by the State as well as by the City of New York including the refinancing of existing municipal bonds and City obligations on a voluntary basis triggering a guarantee by the federal government of this indebtedness. In effect, the bill recommends a reorganization of the City in return for the most stringent conditions of financing.

It was the unanimous recommendation of the Senate Democratic Policy Committee to seek a meeting with the President to convey our sense of urgency and the range of options other than a direct federal bailout which have been considered in the Senate. What has emerged from the consideration of the issue is the structure of the bill I have outlined. It is a short-term four-year bill. Hopefully and with a great degree of probability, we do not think it would cost the federal government any money; in fact, it would yield a benefit to the federal government through the guarantee fees. What it would do essentially is to mandate a dramatic reorganization of the services and financing of the City and State to put them on a sound level. It would avoid the technical default of the Bankruptcy Act but provide the remedies of reorganization established by an even updated bankruptcy law.

In view of the opposition of the President to any federal funds bailing out New York City without assuring restructuring in return, it seems to us that the proposal of the Senate Banking Committee would meet the objections raised by the President to a great extent. It would undertake to reorganize City and State finances without setting off a potential ripple effect on every other municipality in the country that might occur with a technical default under the existing bankruptcy law. It was the hope that in a meeting with the President and his consideration of the details of the bill presented by Senators Proxmire and Stevenson that together we might accomplish what is best for the nation, least costly to the federal taxpayer and in the best interest of all municipalities including New York City and all states including New York State.