

New York's Public Authorities: Promoting Accountability and Taming Debt



Citizens
Budget
Commission

September 2006

INTRODUCTION

Five Problems With New York's Authorities

Authorities, sometimes known as public benefit corporations, play a major role in delivering public services. They are used at all levels of government – federal, state and local – and play a vital role in a wide range of activities including delivering mail, providing electric power, creating and maintaining bridges and highways, running railroads and mass transit systems, building and operating housing, financing higher education, and providing medical care. However, New York State's extensive reliance on authorities has given rise to five significant problems.

These problems relate to two key areas: transparency and governance, and the use of authorities to take on debt.

PROBLEMS OF TRANSPARENCY AND GOVERNANCE:

- ▶ **Problem 1: Insufficient reporting to support accountability**
- ▶ **Problem 2: Insufficient independence in governance**

PROBLEMS WITH DEBT:

- ▶ **Problem 3: Misuse of the power to incur government-backed debt**
- ▶ **Problem 4: Insufficient oversight and coordination of project revenue debt**
- ▶ **Problem 5: Ineffective use of private conduit debt**

These are serious problems that should be addressed in order for New Yorkers to enjoy the full potential benefits of authorities. The remainder of this document is devoted to explaining the issues more fully and presenting recommendations for improvement.

Founded in 1932, the Citizens Budget Commission (CBC) is a nonpartisan, nonprofit civic organization committed to influencing constructive change in the finances and services of New York State and New York City governments.

This document is a summary of a report, *Public Authorities in New York State*. The report was prepared under the auspices of the CBC's Authority Reform Committee, co-chaired by Steven Polan and Emanuel Stern. It was prepared by Charles Brecher, Research Director and Jo Brill, Director of State Studies, with research assistance by Alexandra Simon, Eric Friedman, and Janine Murphy. Alexandra Simon prepared a draft of this summary. For details on source information, see the original report available on the web at http://www.cbcny.org/Authority_Reform_CBC.pdf.

Understanding Authorities

UNDERSTANDING AUTHORITIES

► Purpose: What Do Authorities Do?

Public authorities supplement the work of direct government agencies in three ways:

- Provide a business-like organizational structure for public services that are financed primarily by user fees and whose capital investments are self-financed through bonds supported by user fees.
- Provide a stewardship for major capital assets and make long-run investment decisions with some isolation from pressures of the electoral cycle.
- Provide a mechanism for taking advantage of federal tax benefits for economic development and other purposes that otherwise would be treated as private activities.

Table 1 describes the 583 authorities in New York by purpose and source of accountability. The two functions with the greatest number of authorities are housing (192) and economic development (173). Transportation, the area in which authorities were first used, now has 54 different entities.

Table 1
Public Authorities in New York State by Purpose and Accountability, 2005

PURPOSE	ACCOUNTABILITY			TOTAL
	STATE	LOCAL	MIXED	
Housing		192		192
Economic Development	3	168	2	173
Industrial Development		116		116
Other	3	52	2	57
Education Foundations and Auxiliaries	44			44
Transportation	10	41	3	54
Highways and Bridges	2	2	2	6
Parking		34		34
Other	8	5	1	14
Parks, Culture, Recreation	14	15		29
Water and Sewer	1	28		29
Solid Waste		18		18
Facilities Financing, Construction & Operation	9	3		12
Health	9	3		12
Energy	3	2		5
Fiscal Stability	6	2		8
Other	5	2		7
TOTAL	104	474	5	583

Source: CBC staff analysis based on data composed by the Office of the State Comptroller. For details, see the CBC's report, located at http://www.cbcny.org/Authority_Reform_CBC.pdf

► **Accountability:
To Whom Are Authorities Accountable?**

Total number of
public authorities
including subsidiaries

740

Number of
public authorities
when not counting
subsidiaries separately

583

Number of
public authorities
which have boards appointed
mostly by State officials

104

Number of
public authorities
which have boards appointed
mostly by local officials

474

Number of
public authorities
which are accountable
to the City of New York

17

Number of
public authorities
whose boards are appointed
by officials of more than
one government

5

Authorities are intended to be “public” in the sense that they are ultimately accountable to some electorate and “independent” in the sense that their governing boards are not directly elected. This balance is generally struck by having authorities governed by board members who are appointed by elected officials, and having those boards be accountable to State elected officials, officials of a specific local government, or some mix of officials from multiple jurisdictions.

Unlike heads of direct government agencies, governing boards of authorities are expected to be more independent of those who appoint them, to make difficult and unpopular decisions outside the arena of elected politics, and to be accountable to the public indirectly through reporting, transparency in decision-making and long-run performance.

The best indicator of the source of accountability for authority boards is the nature of the elected officials who appoint the board members. However, additional factors are relevant, including control of the office of board chair, and the reliance on a specific government for operating or capital subsidies.

Among New York’s 583 authorities, the most numerous (474) are those accountable to local governments. Another 104 are accountable to state officials, and 5 authorities have mixed accountability.

▶ **Scale:**
How Big Are Public Authorities?

The diversity of authorities is evident in the scale of their operations as well as their multiple purposes. Among authorities with state accountability, this is illustrated by the following examples:

- ▶ The Metropolitan Transportation Authority, including its six major subsidiaries, had annual operating expenses of nearly \$8.8 billion in fiscal year 2004.
- ▶ The Industrial Exhibit Authority (IEA), which puts on the State Fair each year, had annual operating expenses of \$4.5 million in fiscal year 2004.

The authorities accountable to the City of New York show a similar range in scale:

- ▶ The Health and Hospitals Corporation had annual operating expenses of about \$4.8 billion in fiscal year 2005.
- ▶ New York City's Marketing Development Corporation had annual expenses of \$6.5 million in fiscal year 2005.

The authorities established by other local governments also vary widely in scale:

- ▶ The Westchester County Health Care Corporation, which operates the public hospital in Westchester County, had annual operating expenses of \$563 million in fiscal year 2004.
- ▶ The Yonkers Parking Authority spent less than \$4 million in fiscal year 2004.

The authorities with mixed accountability are also diverse in scale:

- ▶ By far, the largest is the Port Authority of New York and New Jersey with about \$2.8 billion in annual operating expenses in fiscal year 2004.
- ▶ The others had annual expenses ranging between \$14 million and \$22 million in fiscal year 2004.

► **Debt:
How and How Much
Do Authorities Borrow?**

Much of the importance of authorities stems from their ability to borrow for themselves, for state and local governments, and for private and nonprofit organizations. Debt of authorities can be divided into three types depending on the type of revenue pledged to repay the debt – government supported debt, project revenue backed debt, and private conduit debt.

- Government supported debt is repaid with the state or local government’s general revenues, primarily taxes.
- Project revenue debt is repaid with the revenues generated by the project that is financed with the borrowed capital; examples include toll bridges and airports.
- Private conduit debt is issued by an authority on behalf of a private individual or firm in order to take advantage of federal tax exemptions (often for economic development or for private housing); the debt is repaid by the private entity’s revenues and is not legally an obligation of the government.

Table 2
Estimated Combined Debt Outstanding of Governments and Authorities in New York State by Type of Issuer, 2004
(dollars in millions)

WHO ISSUES THE DEBT?	WHO PAYS?				
	TOTAL	GOVERNMENT SUPPORTED		PROJECT REVENUE	PRIVATE CONDUIT
		NYS FUNDED	LOCAL FUNDED		
Government Direct Debt	\$61,484	3,895	57,589		
State of New York	3,895	3,895			
City of New York	34,593		34,593		
Other General Governments	10,191		10,191		
Special Purpose Governments	12,805		12,805		
Authority Debt	165,937	40,987	28,811	55,783	40,356
Mixed Accountability	11,306			9,927	1,379
State Authorities	101,877	40,908	8,558	30,396	22,015
NYC Authorities	38,899	79	17,359	13,882	7,579
Industrial Development Authorities	9,681		298		9,383
Other Local Authorities	4,174		2,596	1,578	
TOTAL	\$227,421	\$44,882	\$86,400	\$55,783	\$40,356
Percent	100.0%	19.5%	37.6%	26.6%	16.2%

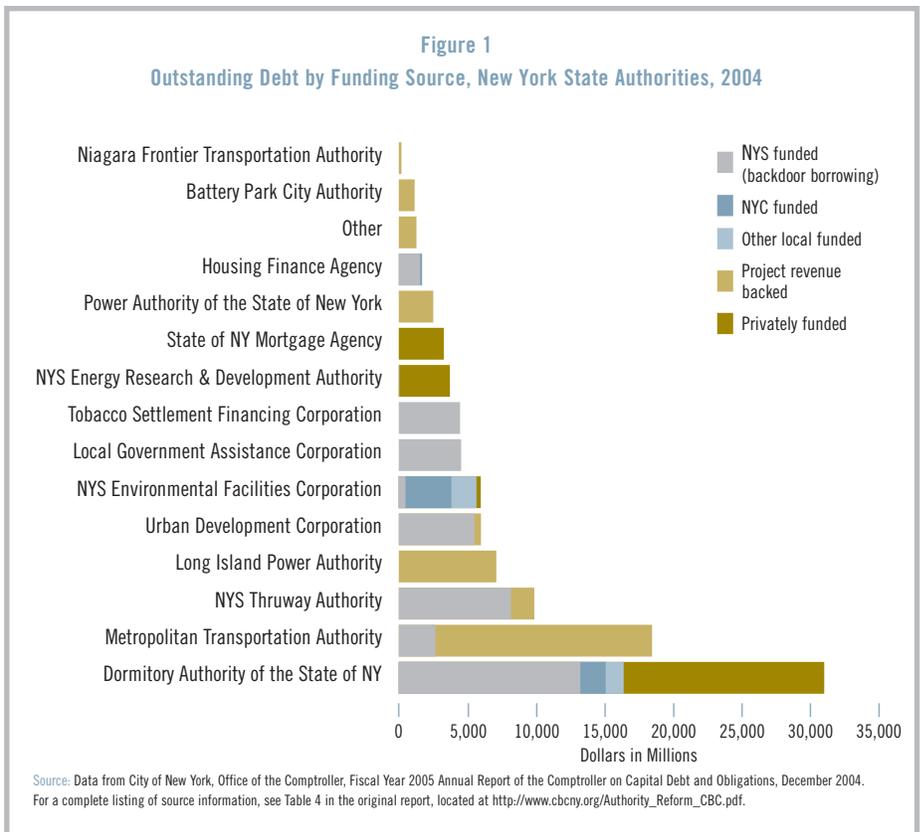
Source: Data from Office of the State Comptroller (OSC), Financial Data for Local Governments, http://www.osc.state.ny.us/localgov/datanstal/findata/index_choice.htm (February 16, 2006) as well as financial statements of individual authorities and local governments. For a complete listing of source information, see Tables 3-5 and Appendix B in the original report, located at http://www.cbny.org/Authority_Reform_CBC.pdf.

IN NEW YORK, STATE AND LOCAL GOVERNMENTS AND THEIR AUTHORITIES HAVE BORROWED AN ESTIMATED \$227 BILLION.

Of this total, fully \$166 billion or 73 percent was issued by authorities.

- ▶ New York State funds \$44.8 billion of this debt, or 20 percent of the total. Of this amount, \$41 billion or 91 percent was issued through authorities. When authorities rather than the State itself issue this type of debt, it is called “back-door” borrowing, because it circumvents the constitutional provisions that would otherwise require voter approval for the borrowing.
- ▶ Local governments fund \$86.4 billion or 38 percent of the total debt. Authorities borrowed \$28.8 billion or one-third of this subtotal.
- ▶ Project-backed debt totals \$55.8 billion or 25 percent of the total. It is issued exclusively by authorities for projects that generate revenue to repay the debt.
- ▶ Private conduit debt totals \$40.4 billion or 18 percent of all debt, and is issued exclusively by authorities on behalf of private individuals or firms.

Figure 1 shows the debt of the authorities accountable to New York State by funding source. The Dormitory Authority of New York has issued the largest amount of debt among these authorities – a total of over \$31 billion. This is comprised primarily of debt funded by New York State (about \$13.3 billion) and private conduit debt (approximately \$14.7 billion). The Metropolitan Transportation Authority is the second largest borrower with nearly \$18.6 billion in debt; the largest component is \$15.9 billion of project revenue debt backed by the agency’s tolls and fares.



PROBLEM 1

Insufficient Reporting To Support Accountability

Authorities differ from direct public agencies in the way in which they are held accountable. While elections are the primary mechanism of accountability for direct government, authority boards are intended to be somewhat independent of the elected officials who control direct agencies. Nevertheless, the authorities are expected to be accountable to the public. The primary mechanism for achieving this accountability is periodic reporting on their activities and status.

WHAT SHOULD AUTHORITIES REPORT?

At the minimum, authorities should regularly share with the public four types of information:

- ▶ Financial condition and recent financial results – this is the information traditionally presented in balance sheets and financial statements.
- ▶ Financial plans – this is typically information presented in an annual operating budget and in a multi-year financial plan.
- ▶ Capital assets – this includes information relating to the current condition of these assets, recent changes in their condition, recent and planned expenditures for maintenance and enhancements, and how these maintenance expenditures and capital investments will alter the condition of the assets.
- ▶ Activities and accomplishments – sometimes characterized as “performance measurement,” this information tells the public what services the entity has provided, how efficiently this has been done, and what the impact on customers has been.

Three important qualities of the information are that it be timely, accessible, and subject to audit or review. Timeliness suggests that reports be prepared with regular frequency and be made public within a reasonable time frame. The criterion of accessibility requires that information not only be maintained by the authority, but that it is easily available to the public. The reliability of information should be promoted by requiring that authority reports be audited or subject to outside review.

WHAT DO AUTHORITIES REPORT NOW?

Authorities' reporting practices have fallen far short of meeting the recommended standards. Among the four content areas, only one (financial condition and results) is in substantial compliance. The remaining shortcomings are substantial:

- ▶ The information currently available, relating primarily to financial condition and results, is sometimes not easily accessible and suffers from inconsistencies among reporting entities. Notable inconsistencies include differences in the time horizon used for multi-year financial plans, differences in the designation of the fiscal year, and differences in the method of disclosure for conduit debt.
- ▶ Major classes of information that ought to be publicly available are not. Typically there is little or no information reported on future financial plans, conditions of capital assets, and service efforts and accomplishments.
- ▶ No entity provides a "big picture" perspective on the finances and performance of the multiple state and local authorities. There is no one place to find information on all authorities.

An important recent development in State law is passage of the Public Authorities Accountability Act, effective in 2006. It closes a major gap in the content of available information by requiring that local authorities disclose to local officials the same information that state authorities must disclose to state officials. It also strengthens and standardizes the disclosure requirements with respect to real estate holdings and transactions. The law also addresses some of the previous qualitative shortcomings by enhancing audit standards for financial reports, establishing new requirements for making certain information available on the Internet, and creating a new Authority Budget Office to receive, and make publicly available, information about local authorities. Because the new law's requirements apply only to local authorities and the new office's independence is not firmly established, it remains to be seen how effective it will be.

PROBLEM 2

Insufficient Independence In Governance

The structure of authorities is designed to strike a balance between political accountability and independence. When the mix of accountability and independence becomes unbalanced, the potential benefits of an authority structure are eroded. Accountability can be diminished if sufficient information is not made available to the public. An equally important risk is that the authority board does not function with sufficient independence. Insufficient independence can lead to three types of deficiencies in authority performance:

- ▶ **Patronage-like decisions.** The official making the appointment may seek more direct accountability than is appropriate and may give undue weight to personal or partisan loyalty as a criterion in making the selection; at the same time, the person selected may believe it is his or her obligation to reflect the preferences of the appointing official rather than to exercise independent judgment.
- ▶ **Erosion of professionalism among senior staff.** There is a concern among knowledgeable observers that in some authorities an increased concern for political accountability among board members has led to the departure of some highly competent staff and their replacement with individuals with less impressive and relevant credentials. Some board members of state and local authorities acknowledge informally that senior staff appointments are expected to be cleared with elected officials appointing the board members.
- ▶ **Inappropriate time frames for strategic decisions.** Perhaps the most harmful consequences of insufficient independence flow from the poor policy decisions it can produce. If authorities are intended to help insulate long-run decisions from shorter-term political pressures, then this benefit will be lost by undermining the board's independence. Whether it is the amount and timing of a mass transit fare increase, the location of a power plant or transmission line, or the value of a subsidy necessary to retain or recruit a large employer, the decision should be separated from the electoral cycle and based on longer-run considerations than the impact on voter decisions in the next election.

The Public Authorities Accountability Act, effective in 2006, creates new governance standards for authorities. It requires separating the board chair and chief executive roles in several authorities where this is not the case, specifies the role and responsibilities of board members, requires training for board members, and require boards to have audit and governance committees. While these are helpful measures, it does not solve all the governance problems mentioned above.

Misuse of the Power to Incur Government-backed Debt

PROBLEM 3

Debt is an important tool in public finance, most valuable as a way to finance large capital projects that have a long lifespan. Borrowing long-term to pay for such projects makes good sense; multiple generations of taxpayers who enjoy the benefits of an investment such as building a sewer system or a road network should also share the burden of paying for it.

But debt is also a great temptation for elected officials. They can spend in the short-run on projects for which they get credit from the electorate, while passing most of the costs on to future taxpayers who have no say in the decision. In order to strike a balance between debt as a temptation and debt as a useful instrument, the State constitution sets limits on the debt of the State and its localities.

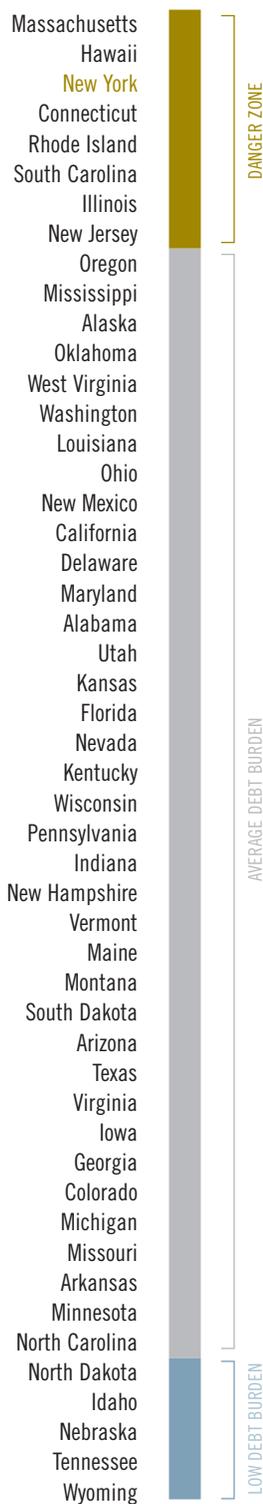
The limit for State government is procedural; general obligation debt of the State must be approved by the voters in a referendum on a bond issue that is for a specific amount and a designated purpose.

- ▶ Since 1946 the voters have been asked to approve 34 different bond proposals; 22 passed and 12 failed.
- ▶ Of the six considered since 1990, four have failed.

The State Constitution also limits local governments' debt. These limits are not procedural, but are amounts set by formulas relating permissible debt to real estate values in the community.

State officials have used authorities extensively to circumvent the constitutional limits. Officials of the City of New York, with the cooperation of the Governor and State Legislature, also use authorities extensively to avoid their constitutional debt limit. Other local officials generally do not use authorities to bypass debt limits.

Figure 2
Danger Zone Analysis Results



Source: See Citizen's Budget Commission, *New York's Endangered Future: Debt Beyond Our Means* (Citizens Budget Commission, September, 2005).

▶ **New York State and Its Authorities: Extensive Misuse of Debt Powers**

The total debt funded by New York State and authorities accountable to New York State at the end of fiscal year 2005 was \$44.8 billion.

Nearly \$41 billion or 91 percent of this amount was issued by authorities on behalf of the State and otherwise would have required voter approval.

HOW MUCH DEBT IS “TOO MUCH” DEBT?

How does one determine how much debt is “too much” for a state or other jurisdiction? The Citizens Budget Commission developed a method in 2000 that seeks to define an “affordable” level of debt for a jurisdiction based on the criteria that repayment of the debt:

- ▶ Should not require tax increases or service cutbacks that make a place less attractive than its competitors;
- ▶ Should be gauged according to the level of resources available to repay it; wealthier places can afford to carry more debt than poorer ones.

A six-step method is used to apply this standard to New York and other states.

1. Identify the relevant (state-funded) debt outstanding for each state.
2. Account for pension obligations, another long-term liability for a state.
3. Determine the resources (tax base) available to repay debt.
4. Adjust available resources to reflect the division of responsibility between a state and its local governments.
5. Include a safety margin for an economic downturn; a rapid downturn should not jeopardize debt repayment.
6. Compute the ratio of debt to resources for each state; a state far above its competitors (more than one standard deviation above the average) is in the “danger zone” and has a debt level that can be judged as too high.

In 2005 this method was applied in an analysis using data from fiscal year 2003, the most recent comprehensive data available. It indicated that:

- ▶ New York was one of eight states in the danger zone;
- ▶ Its debt ratio had risen to third highest, compared to the fifth highest in 2000;

- ▶ Its level of debt exceeded the danger zone threshold by nearly \$10 billion.
- ▶ Particularly troubling about “backdoor” debt is that a significant amount has been used to cover the State’s operating expenses rather than for capital investments. For example:
 - ▷ The proceeds of the Local Government Assistance Corporation’s debt (now \$4.6 billion) were used to make aid payments to school districts and localities, effectively converting the State’s annual short-term borrowing for these aid payments into long-term debt.
 - ▷ The proceeds of the Tobacco Settlement Financing Corporation’s borrowing (\$4.5 billion) were used to help cover deficits in the State’s fiscal year 2003, 2004 and 2005 operating budgets.
 - ▷ Some borrowing by the Urban Development Corporation was used to “purchase” assets from the State, the proceeds of which were applied to the State’s operating budget; for example, in the early 1990s over \$300 million was raised with the “sale” of Attica prison to the UDC, certain roadways to the Thruway Authority, and the parking lot at the Aqueduct Racetrack to the Port Authority.

In sum, New York has used its authorities to borrow for the wrong reasons and to incur too much debt, with the situation getting worse over time. This puts the State in a danger zone and contributes to an uncompetitive tax burden.

▶ **New York City and Its Authorities: Circumvention of An Unreasonable Debt Limit**

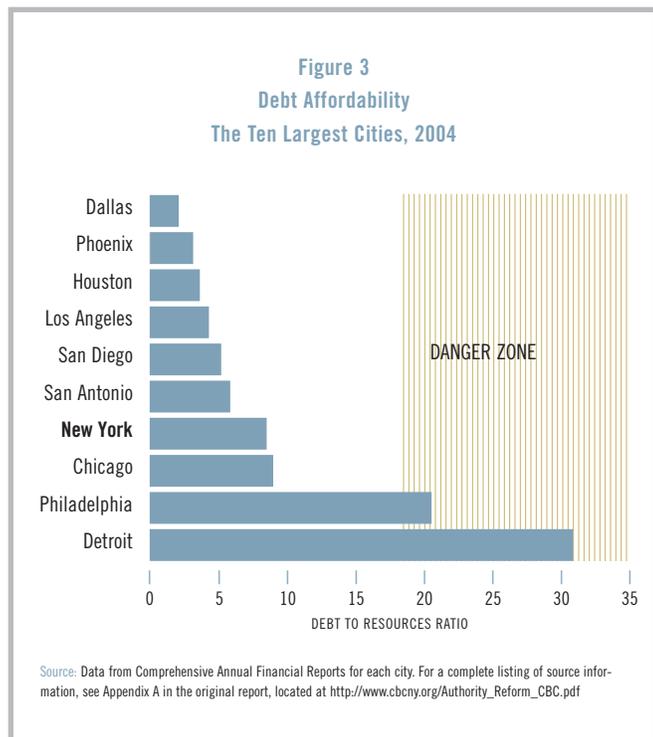
The total debt outstanding of New York City and its authorities was \$78.2 billion at the end of fiscal year 2005.

Of this total, fully \$53.5 billion is funded by New York City.

- ▶ Of the amount funded by New York City, \$34.6 billion or 65 percent is issued directly by the City, primarily in the form of general obligation debt.
- ▶ Nearly \$18.8 billion or 37 percent of this total is authority borrowing, and is outside the City's constitutional debt limit.

Unlike State debt, however, the analysis by CBC of the ten largest cities showed New York City debt to be within the affordable range, suggesting the constitutional limit may be unreasonable. As shown in Figure 3, New York City ranked fourth among the cities and was not in the danger zone.

Figure 4 shows the debt issued by authorities accountable to the City of New York by source of funding. The combined total is nearly \$43.6 billion. The largest issuers are the Transitional Finance Authority and the Water Finance Authority, each with outstanding debt of \$13.4 billion.



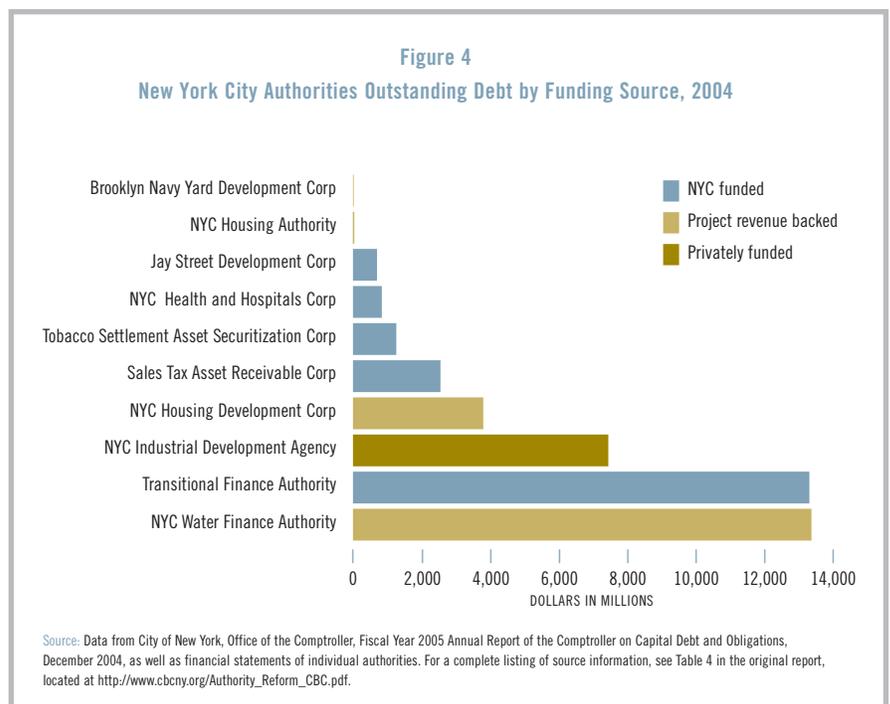
- ▶ Of the total, \$18.8 billion is funded by the City of New York and might otherwise be subject to the constitutional limit.
- ▶ Another \$17.2 billion is backed by project revenues. The largest component is \$13.4 billion issued by the Water Finance Authority and supported by water and sewer fees imposed by a separate Water Board.
- ▶ Another \$7.5 billion is private conduit debt. This debt has been issued by the City's Industrial Development Authority on behalf of private firms and is backed by contracts with these organizations.

▶ Local Governments and Their Authorities: Limited Use of Authorities for Borrowing

Most of New York's 583 authorities are creatures of local governments other than the City of New York. The total debt issued by other local governments and their authorities at the end of fiscal year 2005 was \$36.9 billion.

- ▶ Of this total, \$23 billion or 62 percent is issued directly by local governments and \$13.9 billion by authorities.
- ▶ Of the debt issued by authorities, fully \$10.9 billion is project revenue backed or private conduit debt; less than \$3 billion is government supported.

Outside New York City, government backed debt by local authorities is accounted for largely by local authorities established in counties facing fiscal challenges, such as Nassau and Erie.



▶ **Authorities with
Mixed Accountability:
No Use of Tax-backed Debt**

The total debt issued by authorities with mixed accountability is \$11.3 billion.

- ▶ The Port Authority of New York and New Jersey accounts for nearly \$11 billion of this total.
 - ▷ Of this total, \$9.6 billion is backed by project revenues
 - ▷ About \$1.4 billion of private conduit debt has been issued on behalf of airlines building terminals at regional airports.
- ▶ Four other authorities have debt ranging from \$45 million to \$130 million, all of which is backed by project revenues.

These authorities have no tax-backed debt and are not mechanisms for avoiding state or local debt limits.

Insufficient Oversight and Coordination of Project Revenue Backed Debt

Although authorities are misused to borrow on behalf on the State in order to avoid debt limits, it is desirable for authorities to borrow for other reasons. Debt supported by revenues generated by authority investments, such as water systems, bridges, and housing, is a legitimate and vital use of authorities powers and capacities. In New York, authorities have borrowed about \$56 billion in the form of project revenue backed debt. As shown in Figure 5, more than half the total is by State authorities, about one-quarter by New York City authorities, and nearly one-fifth by mixed authorities.

While this is generally an appropriate and desirable form of authority borrowing, project revenue backed debt raises two important issues:

LIMITED COORDINATION WITH STATE CAPITAL PLANNING

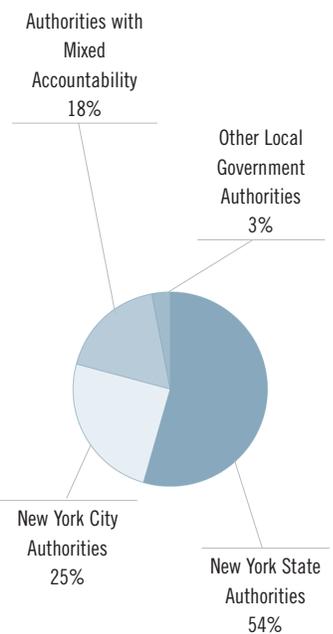
Investments financed by project revenue borrowing are not coordinated with the State's capital plan for its direct agencies, leading to fragmentation of capital planning. State capital plans are prepared by the Governor on a rolling, five-year basis, and are reviewed and authorized by the Legislature. An example of successful coordination between the State government and an authority is State legislation which requires that the Metropolitan Transportation Authority (MTA) prepare a five-year capital plan, and that the plan be subject to approval by a Capital Program Review Board. Authorities other than the MTA are not required to prepare multi-year capital plans and their capital plans are not subject to review by the Governor's Division of the Budget or by the Legislature. Each State authority develops its own procedure for capital planning, and the plan is reviewed only by the authority's board. Yet several State authorities control large-scale capital assets and make substantial annual capital investments financed with their independent revenues. State authorities with capital assets valued at more than \$1 billion include the Thruway Authority, the Long Island Power Authority, and the New York Power Authority.

INADEQUATE ADVANCE REVIEW

Neither project revenue nor private conduit borrowing is subject to sufficient advance review to protect the State or the relevant local general government from an authority taking on a project that might not be financially viable. The existing Public Authority Control Board (PACB), established in 1975 to review and approve some State authority borrowing, suffers from three limitations:

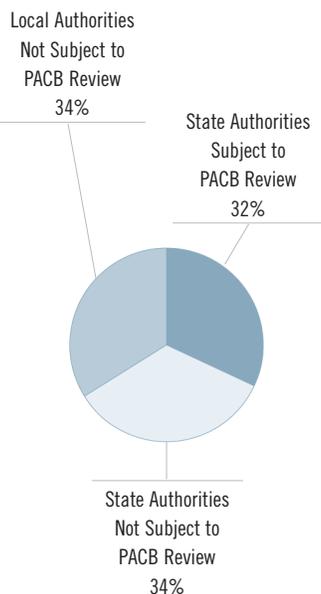
- ▶ Much authority borrowing is exempt from PACB review, including large borrowers such as the New York State Power Authority, the Metropolitan Transportation Authority, and the Thruway Authority. In addition, all the local authorities are exempt. As shown in Figure 6, less than one-third the \$98.1 billion of private conduit and project revenue backed debt is subject to PACB review.

Figure 5
Project Revenue Debt by Issuer, 2004
Total \$55.7 billion



Source: Data from Office of the State Comptroller (OSC), Financial Data for Local Governments, http://www.osc.state.ny.us/localgov/datanstat/findata/index_choice.htm (February 16, 2006) as well as financial statements of individual authorities. For a complete listing of source information, see Tables 6 in the original report, located at http://www.cbny.org/Authority_Reform_CBC.pdf.

Figure 6
Project Revenue and
Private Conduit Debt, 2004
Total \$96.1 billion



Source: Data from Office of the State Comptroller (OSC), Financial Data for Local Governments, http://www.osc.state.ny.us/localgov/datanstat/findata/index_choice.htm (February 16, 2006) as well as financial statements of individual authorities. For a complete listing of source information, see Tables 6 in the original report, located at http://www.cbcny.org/Authority_Reform_CBC.pdf.

- ▶ The review of covered borrowings is not sufficiently rigorous or transparent. When the PACB reviews a proposed borrowing, the analysis behind its decision is not presented in public documents. An authority prepares an application for the PACB, and the PACB adopts a formal resolution of approval for the projects it accepts. However, the documents typically contain data relating only to the sources and uses of funds; they do not analyze whether the cost estimates are reasonable, whether the future revenue stream will make repayment of the debt likely, or whether the project has long-run financial viability.
- ▶ The timing of the review is typically a “last step” in the planned borrowing that can delay transactions and limit the flexibility of authorities in taking advantage of market conditions for low cost borrowing.

Ineffective Use of Private Conduit Debt

PROBLEM 5

Authorities are the mechanism by which states can bestow federal tax benefits on private organizations. By borrowing on behalf of a private party, the government entity can gain a federal tax exemption for the interest paid on the debt. In competitive capital markets, this lowers the interest rate that the borrower must pay. Thus, in effect, by borrowing on behalf of a private party, a public authority gives that party a subsidy at the expense of the federal government. In New York, the State also grants exemptions to state and local income taxes, increasing the value of the subsidy.

The total amount of private conduit debt issued by authorities in New York is about \$40 billion. As shown in Figure 7, State authorities (principally the Dormitory Authority) account for more than half this total, the New York City Industrial Development Agency nearly one-fifth, and other local IDAs more than one-fifth.

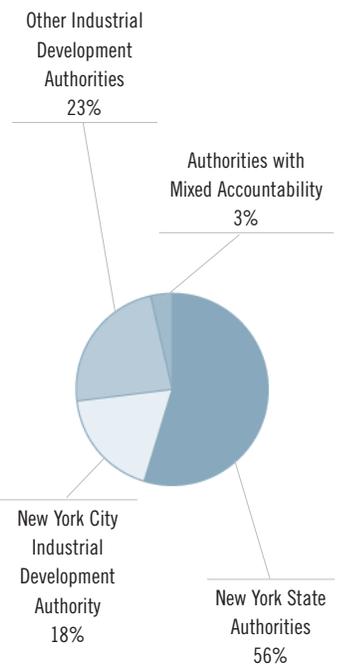
LIMITED GUIDELINES FOR AND COORDINATION OF CONDUIT DEBT

While desirable and appropriate in certain situations, this type of borrowing poses a significant problem. The allocation of the benefits of tax-exempt borrowing among private parties is not guided by a set of strategic priorities that maximize the social return and avoid counter-productive competition among multiple authorities.

Federal laws set the rules for what types of projects are eligible for private conduit borrowing and, for some purposes, cap the amount that can be issued. The State Legislature determines the broad allocation of the state's cap annually. Generally, the Legislature divides the statewide cap into thirds. One-third is allocated to local governments, another one-third is allocated to state agencies, including state authorities, and the last one-third is set aside for a "statewide reserve" and is jointly administered by the Department of Economic Development and DOB.

Some of the conduit debt the State issues is not subject to the cap. This is primarily borrowing for health care and higher education institutions. Such borrowing has little strategic guidance from state officials, which in some cases has led to sub-optimal use. One result, evident in the hospital sector, is a surplus of facilities that is now being addressed by a gubernatorial commission that is seeking to identify hospitals that can be closed, with some of the candidates having financed projects with conduit borrowing by the Dormitory Authority. New subsidies are being considered to retire that debt with the expectation that future operating savings will justify the needed additional subsidy.

Figure 7
Private Conduit Debt by Issuer, 2004
Total \$40.4 billion



Source: Data from Office of the State Comptroller (OSC), Financial Data for Local Governments, http://www.osc.state.ny.us/localgov/datanstat/finddata/index_choice.htm (February 16, 2006) as well as financial statements of individual authorities. For a complete listing of source information, see Tables 6 in the original report, located at http://www.cbny.org/Authority_Reform_CBBC.pdf.

SOLUTIONS

Solving the Problems

The problems described above can be solved. The five strategies presented below would better enable authorities to realize their potential contribution to more effective and efficient services for New Yorkers.

SOLUTIONS TO PROBLEMS OF GOVERNANCE AND TRANSPARENCY

1. Improved Accountability with Better Reporting

Authorities can become more accountable through more complete and accessible reporting of financial and other information. Four strategies should be pursued:

- ▶ The new, more comprehensive standards for the content of publicly reported information promulgated in the new laws and regulations effective in 2006 should be implemented effectively by individual authorities with strict oversight by the State Comptroller and the Authority Budget Office. Entities should report regularly on their budgets and financial plans, the condition of and plans for capital assets under their control, and their service efforts and accomplishments.
- ▶ One or more public officials should be given responsibility for providing the Legislature and the public with a “big picture” perspective on the activities of authorities. Given the current division of responsibilities between the Office of the State Comptroller and the Authority Budget Office, preparation of a “big picture” perspective on all authorities will require that the two organizations cooperate. Each has access to the reports submitted to the other by authorities, and the responsible officials have indicated a willingness to cooperate. A mechanism for cooperation should be formalized with either or both offices responsible for preparing the “big picture” report to the public.
- ▶ The accessibility of mandated reports should be improved by having the individual authorities, the new Authority Budget Office and the State Comptroller make them available on the Internet.
- ▶ Inconsistencies in current financial reporting practices should be addressed through guidelines established by the State Comptroller and, as necessary, by statutory standards. The State Comptroller and the Division of the Budget should work together to develop standards for reporting that overcome problems created by the use of different fiscal years by different entities; if necessary, the Legislature should require more uniform fiscal years for the multiple authorities.

2. Better Governance through Greater Independence and Professionalism among Board Members

Greater independence and professionalism among board members will enhance the governance of authorities. Currently, the greatest threat to the desired governance arrangements for authorities is that many elected officials and their appointees to authority boards share an expectation that the appointees will defer to the judgment of the person who appointed them on important board decisions including staff hiring. This culture should be changed to one in which board members consult the officials who appointed them and other elected leaders, but their final decisions should be based on their own judgments about how to best promote the agency's mission. While appropriate deference might be given to the views of elected officials, the final judgment should be that of the board member and not the appointing official.

Measures that are likely to bring progress towards this goal include:

- ▶ **Screening.** There should be a standard screening process for proposed board appointees, which discloses information about their qualifications and potential conflicts of interest.
- ▶ **Formal Orientation.** New appointees should be required to participate in brief sessions which provide information about the organization and its procedures, and familiarize the member with issues involved in striking an appropriate balance between political accountability and independence.
- ▶ **Staggered Terms.** It is appropriate for a board chair to serve a term that coincides with that of the appointing official, promoting an appropriate degree of political accountability. However, other board members should serve staggered terms to help ensure continuity for organizational policy and facilitate independence among board members.
- ▶ **End "Hold Over" Appointments.** Currently board members may continue to serve when their fixed term expires, effectively making them subject to dismissal by the appointing official like an individual serving at the pleasure of that appointing official. Such "hold over" appointments should be eliminated by obliging board members to leave office shortly (perhaps 30 days) after their term expires if they are not re-appointed to a fixed term.

The State Commission on Public Authority Reform, established by Governor Pataki and chaired by Ira Millstein, released a report in May 2006 which made recommendations for improving the governance, operations, and disclosure of the State's public authorities. These recommendations would enhance governance of authorities by authorizing legislation to increase the power and independence of

the Authorities Budget Office (ABO), allowing the ABO to set standards for board fiduciary duties, reporting and disclosure, monitoring performance, and enforcing compliance.

SOLUTIONS TO PROBLEMS ASSOCIATED WITH DEBT

3. New Constitutional Limits on Debt

Setting comprehensive constitutional limits on the amounts of State-supported and City-supported debt that can be issued by the State of New York and the City of New York will eliminate the misuse of authorities' debt powers. The current constitutional debt limits should be replaced with an approach based on the concept of affordability developed by the CBC. Instead of having a procedural limit requiring voter approval, an independent board should conduct periodic analyses to arrive at a debt limit based on a comparative approach to affordability. Their charge would be to set rolling, multi-year limits for debt based on analysis that takes into account trends in the resources of the City and State and in the patterns of debt issuance by other competitive jurisdictions. These limits should be binding on the City and the State.

The sole safety valve or exception to the limit set by an independent board based on analysis of affordability should be the will of the electorate. If the voters opt to approve debt for a specific purpose, then such debt should be permitted above the limit set by the independent board. The will of the voters should be supreme, but it should be guided by information on the affordability of debt. The voters should be empowered to go beyond that limit, when and if they are convinced it serves an important public purpose.

4. Improved Oversight of Authority Project Debt and Conduit Debt

Eliminating the PACB review process and replacing it with more comprehensive capital planning and project feasibility studies subject to professional, transparent review will improve the oversight of non-government-supported authority debt. The primary responsibility for assessing the merits of specific project borrowing should remain with the authority boards. However, two requirements should be subject to external enforcement.

- ▶ First, authority borrowing backed by the entity's project revenues should be limited to projects that are part of a long-run, capital plan reviewed and approved by the relevant elected officials. For state authorities, their capital investments should be integrated with the State's capital plan developed by the Governor and approved by the Legislature. For local authorities, integration with local government's capital planning should follow a model similar to that in place in New York City. The authorities' proposed capital investments should be considered as part of the general government's capital budget process and approval of the

relevant chief executive should be required before the project is initiated. Most private purpose conduit borrowing need not be subject to a public capital planning process.

- ▶ Second, both project-revenue backed and private conduit borrowings should be subject to professional review of a feasibility study in order to avoid undue risks. It should be the responsibility of the authority board to prepare (or have prepared) a feasibility study. For State authorities this study should be subject to review by the Division of the Budget. For local authorities, the review should be conducted by the local government's chief financial officer or the newly created State Authority Budget Office. In all cases the initial study and the reviewers' comments should be part of an easily accessible, public record.

5. More Effective Allocation of Private Conduit Debt

Requiring more explicit advance allocation of its purposes and more competition among private entities for its benefits will improve the effective use of tax-exempt conduit debt. Allocations of private-purpose debt should be based on elected officials' political judgments about the relative importance of the permissible functions, and decisions should be based on evidence submitted by the issuing agency. The appropriate legislative committee should conduct public hearings and prepare an annual report based on reliable data and sound evaluation methods to support a recommended allocation. At the next stage, the authorities given an allocation of tax-exempt debt should select among entities seeking the benefit based on criteria established in advance and in response to competitive proposals.

H. Dale Hemmerdinger, Chairman
Diana Fortuna, President
Charles Brecher, Executive Vice President

Citizens Budget Commission
One Penn Plaza, Suite 640
New York NY 10119
tel 212.279.2605 *fax* 212.868.4745
web www.cbcny.org *email* info@cbcny.org