

**Review of City of Atlantic City's Supplement to
the Five-Year Recovery Plan Pursuant to the
Municipal Stabilization and Recovery Act**



**Department of Community Affairs
Charles Richman, Commissioner**

November 7, 2016

I. Introduction

On October 25, 2016, the City of Atlantic City (the “City”) delivered to me a Five-Year Recovery Plan (the “Plan”), pursuant to the Municipal Stabilization and Recovery Act (the “Act”), N.J.S.A. 52:27BBBB-1, *et seq.* The Act required that the Plan cover a five-year period commencing as of January 1, 2017, and contain detailed processes “sufficient to effectuate the financial stability of the municipality.” N.J.S.A. 52:27BBBB-4(b). The Act also required that the City’s Plan “establish processes and identify specific actions undertaken by the municipality following the determination that it is a municipality in need of stabilization and recovery . . . and actions to be undertaken by the municipality if the recovery plan is approved” N.J.S.A. 52:27BBBB-4(b). The Act required me, as the Commissioner of the Department of Community Affairs, to decide “whether the recovery plan is likely or is not likely to achieve financial stability.” N.J.S.A. 52:27BBBB-4(c). On November 1, 2016, I issued a final agency decision entitled “Review of City of Atlantic City’s Recovery Plan Pursuant to the Municipal Stabilization and Recovery Act” (the “Final Decision”).¹ That 47-page (plus exhibits) Final Decision provided a detailed analysis of the City’s Plan and concluded that the Plan was not likely to achieve financial stability.

On November 3, 2016, I received a Supplement to the Five-Year Recovery Plan (the “Supplement”). That Supplement requested that I “reconsider that determination in view of the information provided herein that addresses the issues raised” in my Final Decision.

There is no provision in the Act that entitles the City to supplement its Plan after I have rendered my Final Decision. Nor does the Act provide for or require me to consider an application for reconsideration of a final decision. Nonetheless, since the Act does not expressly bar me from reconsidering my Final Decision, I have reviewed the City’s Supplement, using the full resources of the Department again in consultation with Acacia Financial Group, Inc. and Nassau Capital Advisors, LLC, and am addressing the issues raised therein. See In re Application of Trantino, 89 N.J. 347, 364 (1982).

For the reasons articulated below, I find that the information provided in the City’s Supplement does not justify reversing my Final Decision.

¹ Terms defined in the Final Decision are incorporated herein.

II. Review and Analysis of the City's Supplement

In various places in my Final Decision, I noted the absence of supporting documentation. In its Supplement, the City attempted to be responsive. While this effort is appreciated, some information duplicates what is already in the City's Plan and some simply confirms the assumptions that formed the basis for my Final Decision.

Specifically, in its Supplement, the City makes 49 separate comments regarding my Final Decision. Those comments were grouped into four main categories: Revenue Projections, Expense Projections, issues related to Debt and Bader Field, and Miscellaneous. Accordingly, the sections below are generally organized to correspond to each of those four categories. Although I reviewed the entirety of the City's Supplement, the four sections below contain my responses to the comments that were material to my Final Decision. The remaining comments in the Supplement did not raise issues germane to the ultimate decision to reject the Plan or were already addressed in detail in my Final Decision.

A. Revenues

1. Property Tax Revenues

As explained in the Final Decision, my finding that the City's taxable base will continue to decline, at gradually smaller rates, over the forecast period is based on the report prepared by Nassau Capital Advisors. Nassau's opinion is informed by a detailed qualitative examination of trends in demographic and economic indicators that impact property values in the City, as well as by a quantitative analysis of the effect that recent tax appeals have had on the City's ratable base. The City does not challenge Nassau's report. In addition, Nassau reviewed the Supplement and determined that nothing therein altered its conclusions.

The City simply asserts that forecasters can reach different conclusions. It is for this reason that, to properly evaluate the City's Plan, I enlisted the help of a qualified expert. The City does not proffer any forecasts of its own from an expert in the Plan or the Supplement, relying instead on the Emergency Manager's Update Report and the opinion of its Tax Assessor. The Emergency Manager's forecasts, while more optimistic than Nassau's, are not current, are not the product of the detailed expert analysis of the issues that was conducted by Nassau, and depend on the execution of significant redevelopment initiatives in the City. Apart from the

Stockton University project, which is already included elsewhere in Plan revenues, and a passing reference to Gardner's Basin there is no mention of redevelopment initiatives in the Plan. I find Nassau's forecasts, prepared by an expert in this field and reached after considerable data analysis, to be more reliable than the assumptions related to property taxes contained in the City's Plan and Supplement.

Accordingly, as indicated in my Final Decision, I find no reason to alter my determination that the City overstated its projected property tax revenues by approximately \$20.5 million over the five-year forecast period.

2. PILOT Revenues

In my Final Decision, I pointed out that the City has not provided evidence of negotiated PILOT agreements with casino properties as required by the PILOT Act, thereby jeopardizing revenue collections during calendar year 2017 and beyond. In its Supplement, the City notes only that "The City does review this as a post plan approved action." The fact is that the PILOT Act requires these PILOT agreements to be negotiated, no matter whether the Plan is approved. The City offers no explanation as to why it has not been more proactive in negotiating these agreements with the casinos. I am quite concerned that the failure to execute such agreements could have a devastating impact on the City's cash flow.

The Casino Property Tax Stabilization Act, N.J.S.A. 52:27BBBB-18, *et seq.* (the "PILOT Act"), was enacted on May 27, 2016. Pursuant thereto, owners of casino gaming properties must pay the City specified payments in lieu of taxes ("PILOT") over a ten-year period, starting with \$120 million in 2017. N.J.S.A. 52:27BBBB-20. More specifically, the PILOT Act provides: "In exchange for the property tax exemption . . . , each owner of each casino gaming property shall sign a 10-year financial agreement with Atlantic City for each casino gaming property promising to make quarterly payments to the city of its allocated portion of the annual amount of the payment in lieu of taxes as determined by this section." N.J.S.A. 52:27BBBB-20(c)(1). Although the PILOT Act did not become operative until November 1, 2016, it was effective immediately (i.e. May 27, 2016). Thus, the City has known since at least May 27, 2016, of the need to draft, negotiate and execute those agreements. Critically, the City's failure to do so jeopardizes the amount and receipt of PILOT payments.

3. Investment Alternative Tax

I determined in my Final Decision that the City overstated IAT revenues by approximately \$31 million over the five-year forecast period because it failed to account for credits that casinos are eligible for under the PILOT Act. N.J.S.A. 52:27BBBB-20(c)(4). The City does not dispute that finding in the Supplement. Instead, the City states that it relied on forecasts provided by CRDA to estimate the portion of the IAT owed to the City. While CRDA's forecasts estimated IAT revenues and CRDA IATs for the five-year period, they did not include estimates for the Casino IATs or any credits to the casinos under the PILOT Act. Indeed, under the PILOT Act, it is the Local Finance Board ("LFB"), in consultation with the Division of Gaming Enforcement ("DGE"), that calculates Casino IATs, not CRDA. N.J.S.A. 52:27BBBB-20(c)(4). I understand that CRDA referred the City to DGE, but there is no evidence (and the Supplement does not indicate) that the City ever contacted DGE about the Casino IATs or any credits to the casinos under the PILOT Act, thus resulting in the overstatement. Moreover, it is incumbent upon the City to understand the operation of the PILOT Act.

4. Transitional Aid

In my Final Decision, I assumed for purposes of analyzing the City's Plan that Transitional Aid would remain constant at \$13 million in each year of the five-year forecast period. That number is consistent with the amount the City received in 2015 and also with the figure used by the Emergency Manager (whose findings the City relies throughout its Supplement) in his Update Report. By basing its projections instead on the \$26.2 million Transitional Aid award for 2016, the City continues to disregard the Director's clear instruction in his October 24, 2016 letter to the City, in which he advised that the \$26.2 million for 2016 was a one-time award that should not be relied upon going forward. The result of this misplaced reliance is a cumulative overstatement of approximately \$32.5 million over the five-year forecast period. The City should not have anticipated \$26.2 million in Transition Aid in 2017, particularly where this amount is much greater than awarded in prior years, is in contravention of the Director's October 24, 2016 letter, and is accompanied by no increases in the local property taxes throughout the duration of the Plan. There is nothing in the Supplement that causes me to alter this determination.

5. Payments to the County

As noted in my Final Decision, if the City has to pay the County 13.5% of the PILOT revenues rather than the 10.3% contemplated by the Plan, then the PILOT revenues available to the City would be reduced by approximately \$20 million over the five-year forecast period. I find no basis on the facts before me to reconsider my determination that 13.5% is the correct figure because, as set forth in the Final Decision, it is the only number that has been agreed to by the County. Nonetheless, even if, as the City contends, the actual portion of the PILOT paid to the County winds up being less than 13.5%, the share due to the County almost certainly will be closer to 13.5% than to 10.3%, based on historical data.² That means the City's \$106 million shortfall would be reduced by only a few million dollars and, therefore, would not materially improve the financial outlook for the City.

For each of these reasons, my determination remains that there is a cumulative shortfall across the recovery period in excess of approximately \$106 million and, therefore, the Plan is not likely to achieve financial stability.

B. Debt and Bader Field

1. Municipal Qualified Bond Act

As discussed in my Final Decision, two of the three financial transactions that the City has proposed to address certain significant financial liabilities involve bonding under the MQBA. Specifically, the Plan proposes a \$105 million bond issue to fund tax appeal liabilities owed to the owners of the Borgata Hotel Casino & Spa, as well as a five year \$4 million annual capital improvement program, whereby short-term notes are issued and converted to longer-term bonds under the MQBA. I stand by my finding in the Final Decision that these bond financings do not seem achievable as presented because the assumptions made in the Plan and amplified in the Supplement reflect neither past nor present reality of the bond market for Atlantic City bonds.

² Over the past three years, the City has paid to the County a gross percentage (i.e., before tax refunds payable by the County are netted out) of 13.2% on average. Over a five-year horizon, that average is 13.1%.

To demonstrate how untenable the City’s interest rate assumptions regarding the proposed MQBA financings are, the Department compiled data on recent comparable MQBA issuances by other economically distressed municipalities. The table below depicts for each issuance the coverage factor – *i.e.*, the ratio of CMPTRA and ETR aid to annual debt service for each financing – as well as the relative “spread to MMD”³ – essentially the interest rate associated with the financing – both at the time of issuance and for recent secondary market trades.

Municipality	Date of Bond Issuance	Coverage Factor	Spread to MMD (at Issuance)	Secondary Market Spread to MMD (past few months)	Bond Insurance
Newark	9/21/2016	3.5x	30-100 bps	30-120 bps	Insured
Newark	6/01/2015	4-6x	170-250 bps	170-250 bps	Non-insured
Trenton	5/28/2015	2x	40-90 bps	25-100 bps	Insured
Camden	7/01/2014	100x	50-130 bps	30-75 bps	Insured
Paterson	5/01/2013	3.8x	100 bps	70-95 bps	Insured
Atlantic City	5/28/2015	3x	326-378 bps	290-340 bps	Non-insured

Two key observations are worth noting. *First*, the cost of the City’s MQBA bond issuance in 2015 fell well outside the norm both at issuance and in secondary trading. The relative spreads to MMD for insured MQBA issuances ranged in the neighborhood of 30 to 130 basis points (“bps”), both at the time of sale and in recent trades, and had coverages often well above 2.0x. The City of Newark’s non-insured issuance ranged in the neighborhood of 170 to 250 bps, both at the time of sale and in recent trades, and had a coverage of 4-6x. Meanwhile, the City’s spreads to MMD exceeded 300 bps at the time of issuance (the same sale date in 2015

³ MMD AAA is a yield curve published daily that shows rates on AAA-rated tax-exempt bonds with maturities ranging from one to forty years. It is common in the municipal bond industry to compare the yields on tax-exempt bonds of various credit ratings by reference to a “spread to MMD.” The lesser this spread, the lower the relative interest rate the issuer must pay.

as the Trenton issuance) and in recent secondary market trades, and its coverage was only at 3.0x. *Second*, all but one of the comparable issuances carried the benefit of municipal bond insurance as an extra layer of protection to buyers of the debt – something the Supplement suggests may only be available to the City up to \$20 million (if at all).

These comparable issuances cast even more doubt on the City's belief, reiterated in the Supplement, that it can access the bond market at interest rates anywhere close to a 115-189 bps spread to MMD.⁴ This is exacerbated by the fact that the coverage factor associated with the proposed MQBA bond issuance would be below 1.5x, as noted in my Final Decision.⁵

Finally, as I noted in my Final Decision, and based on the foregoing, the City understated the level of debt service expense associated with the proposed MQBA financings by (i) underestimating the interest rate the City will likely have to pay on these bonds and (ii) neglecting to account for \$30 million in new debt the City may have to issue to cover additional outstanding tax appeals. I understand from an analysis performed by Nassau that the City potentially needs more than \$100 million to pay or settle its outstanding tax appeals above and beyond the Borgata tax appeals and the MGM settlement that are assumed to be resolved by the Plan. Yet the City only has approximately \$70 million of this \$100 million – namely, the \$35.75 million “reserve for tax appeals/other one-time costs” created from the sale of Bader of Field plus the \$34 million of reserves for tax appeals available on the City's balance sheet after the Borgata settlement. That approximately \$30 million difference has been added to the City's total debt load in order to estimate the required annual debt service on unbonded tax appeals. I also note that remaining casino tax appeals likely will need to be resolved in the very near future, and not “over the next several years” as the City suggests, in light of the pending PILOT agreements.

⁴ I find the City's reliance in the Supplement on the State's \$2 billion Transportation Trust Fund Authority bond issue and on a small issuance of bonds for the benefit of a New Jersey liberal arts college to be unhelpful as these are of little comparative value in evaluating the City's proposed sale of MQBA bonds. MQBA bond issues for distressed municipal credits rely upon future years of interceptible CMPTRA and ETR being at least in amounts greater than the annual debt service on the MQBA bonds – a completely different type of bond security structure.

⁵ My Final Decision assumes \$26 million per year of CMPTRA and ETR aid versus nearly \$18 million of MQBA annual debt service, (including principal repayment and estimated unfunded liabilities) which generates a minimum 1.5x coverage of MQBA debt service in the years immediately following the five -year forecast period.

In sum, my Final Decision does not change with respect to the City's proposed bond issuances under the MQBA.

2. Bader Field

As expressed in my Final Decision, I have raised significant issues surrounding the proposed sale of Bader Field to the MUA. From a public policy perspective, I have grave concerns about the merits of a governmental authority purchasing property for a purpose that remains largely undefined and superfluous to the core function of the authority. Further, the inflated purchase price given known market conditions only exacerbates my misgivings. These policy concerns are in addition to the legal and practical issues surrounding this transaction. Such issues are notable. In particular, whether the MUA has the ability to finance this purchase, and, if it does, what future ramifications said financing could have on the City's financial stability, are open questions. So, too, are issues around the statutory approvals necessary to facilitate the sale and whether these approvals can be obtained in the short timeframe laid out in the Plan for consummating the transaction. The Supplement only reinforces these concerns.

Based on the exhibits submitted with the Supplement, the MUA intends to issue \$126 million of new debt to fund the purchase of Bader Field from the City, defease existing debt, and create a debt service reserve fund. These new bonds will have a 36-year maturity, a 4.5% interest rate, with ascending annual debt service beginning at \$5.7 million per year and rising to \$8.5 million per year, and debt service coverage of 1.2x. As collateral for the bonds, the MUA plans to raise rates across all customers by 25% in Year 1 and then to impose subsequent 3% increases each year thereafter. Finally, by defeasing and refunding all of its existing debt (in the amount of approximately \$14 million), the MUA intends to extinguish its existing debt covenants and terminate the service agreement with the City.

I find these assumptions unrealistic, and indeed troubling, for the following reasons:

First, the idea that the MUA, whose credit rating is "B-" on Creditwatch from S&P and "B3" with Negative Outlook from Moody's, will be able to sell \$126 million of long-term bonds in the market at an interest rate of 4.5% is dubious at best. Even if the MUA's ratings are driven in part by the City's current financial crisis, they also reflect the endemic characteristics of the MUA's user base – relatively low median household income, high unemployment, and reliance

on a limited and concentrated industry (the casinos) – that are not likely to change materially in the near term. Simply removing the “linkage” between the City and the MUA by terminating the service agreement is therefore unlikely to jump the MUA’s credit rating six to eight notches to an investment grade rating (the range of credit improvement required to achieve the lowest possible investment grade rating) by March 2017, as anticipated in the Supplement.

Second, in light of the MUA’s anticipated 25% across-the-board rate increase, the City and the MUA appear to have overlooked the risk of a reduction in the rate-paying base, caused by existing ratepayers seeking alternative sources of water⁶ and/or further closures of casinos and commercial property exodus. Any losses in the rate-paying base will reduce the collateral available for the bonds, assuming rates are not increased even further.

Third, the MUA’s issuance of \$126 million of new debt represents a seven-fold increase in its debt portfolio and will add approximately \$6-\$8 million of annual debt service. Thus, not only will the MUA have a non-core, non-revenue-producing asset in Bader Field, but the MUA’s capacity to issue bonds in the future to fund investments in its aging infrastructure for the purpose of advancing its core mission will be diminished. I am advised that traditional revenue-backed bond purchasers who seek comfort in municipal utilities issuing debt for reasons closer to their core purpose may be reluctant to purchase the MUA bonds envisioned by the Plan and the Supplement.

Indeed, in a report dated October 31, 2016, S&P Global Ratings articulated similar concerns about the MUA’s purchase of Bader Field from the City: “The ‘B-’ rating primarily reflects our [S&P] opinion that the ACMUA’s ability to support its financial obligations could be severely weakened depending upon the structure and security on water revenue bonds recently authorized by ACMUA for the purchase of Bader Field. Another source of uncertainty regarding creditworthiness is that it appears these water revenue bonds are being issued for a purpose unrelated to the mission of the MUA. I am advised, that this has the potential to greatly increase operating risk.

⁶ For instance, New Jersey American Water Company accounts for approximately \$2.1 million, or 13%, of the MUA’s yearly revenues, based on information contained in the MUA’s financial statements for 2015. If New Jersey American Water were no longer an MUA customer, those revenues would not be available to support the bonding.

In short, the substantial uncertainty that surrounds the sale of Bader Field – the “cornerstone of the Plan,” according to the Supplement – bears out my determination in the Final Decision that the Bader Field sale is unlikely to achieve financial stability for the City. I also note that the City’s Supplement does not satisfactorily address the potential revenue and cost benefits of dissolving the MUA and running the water utility as part of the City.

C. Expense Projections

Throughout my Final Decision, I identified further actions the City could have taken to reduce costs. In the Supplement, in a section entitled “Expense Projections,” the City questions twelve different comments I made regarding the City’s efforts to reduce costs in its Plan. Putting aside for a moment the City’s failure to account for an additional \$30 million in tax appeals, which is addressed above, I find that none of the issues raised in the City’s response to my comments was pertinent to my decision that the Plan is not likely to lead to the financial stability of the City. It is the totality of the Plan that resulted in my rejection. That said, I disagree with a number of the claimed errors the City asserts.

I do note that the City concedes that in many respects, it failed to provide various pieces of information and/or backup in its Plan concerning its proposed cost cutting measures. To some extent the City has provided that information. However, I also noted that the proposed measures were not sufficient and in my Final Decision I noted examples of further steps the City could have taken to reduce costs. The City’s Supplement does not address this concern and, as a result, it does not alter my decision to reject the Plan.

D. Miscellaneous Comments

1. Steps Taken During the 150-Day Period

In my Final Decision, I observed that the City’s Plan identified a number of future actions that the City hoped to undertake but that many faced significant practical and legal obstacles. I suggested that the City should have, but did not, provide evidence of demonstrable and completed steps in support of its stated objectives. I gave ten different examples.

In its Supplement, the City took issue with many of the examples listed in the Final Decision, arguing that it could complete these steps in the future. That may be true for some of

the steps. But, the City is missing the point. The Act required the City's Plan to "identify specific actions undertaken by the municipality following the determination that it is a municipality in need of stabilization and recovery" N.J.S.A. 52:27BBBB-4(b). In other words, the City was required to identify specific actions it took during the 150-day period between my decision that the City was a "municipality in need of stabilization and recovery" and the deadline for submitting its recovery plan. The City failed to do so. Certainly the City *could* complete some of the steps in the future. But the City's inability to do so at any point prior to now, and in many instances failing to specify how it will accomplish its goals in its Plan, weighs against assuming it will do so.

By way of example, the City did not address the Green Acres issue on the Bader Field proposal, stating in the Supplement that it is more appropriate to address this in the future. Indeed, the City states that if the Green Acres portion becomes "too cumbersome" to deal with, the City can subdivide and retain the land. There is no discussion as to how this may affect the proposed sale or bond issuance. Contrary to the City's assertions, this is an issue that the City should have addressed beyond simply saying that it will deal with it during the process, especially since the Bader Field proposal is admittedly the cornerstone of the City's Plan. Further, the City contends it will execute a settlement agreement with the owners of the Borgata at some point in the future. However, the City previously executed a settlement agreement with the Borgata – and then defaulted. Even if the Borgata has agreed in principle to settle at a specific number, presumably the terms and conditions of that agreement will have to be negotiated and the agreement itself will have to be executed. It would be unrealistic for me to assume that those steps are likely to occur within the timeframe assumed by the City.

As a final point, the City did little on its own to affirmatively reduce its expenses in the last 150 days. This failure not only unnecessarily created issues with the adoption of the City's CY 2016 budget, but it also means that the City's Plan starts, on the expense side, with unnecessary expenses. The City did not utilize the 150-day period to meaningfully reduce its expenses and the City's Plan does not include steps necessary to reduce them in the future.

2. Preparation of a Budget

The City conceded that it did not complete a 2017 Budget in accordance with the Local Budget Law as required by the Act. I note that as part of its Supplement the City provided a 2017 Budget that appears to comply with the Act's requirements but that the City continues to erroneously rely on a \$26 million figure for Transitional Aid. Putting that issue aside, I find that the inclusion of the 2017 Budget in the Supplement, while helpful, does not change my decision that the Plan is not likely to achieve financial stability.

III. Conclusion

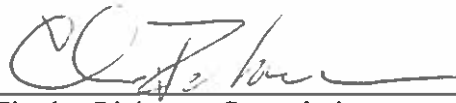
In its Supplement, the City acknowledges that I am "limited to an evaluation of whether the Plan is likely to achieve financial stability." Nevertheless, it criticizes the State for not offering a better Plan and for not considering the "financial instability that would be created" if the State did not form "a partnership to advance the Plan." It also takes the Department to task for not making staff available to advise on the Plan's development.

The Act plainly does not direct me to propose an alternative plan or to commit the State to invest in the City's Plan. The Act only empowers me to evaluate the City's Plan based on actions taken and proposed by the City itself—again, not on actions undertaken in partnership with the State and not on any actions the State might subsequently take to assist the City.

Yet the Supplement is rife with references to the Plan achieving financial stability through a State partnership, which appears to consist of an overreliance on State aid. The extent to which the City minimizes the Plan's weaknesses by invoking the value of a partnership to propel the Plan forward is, to me, confirmation that the Plan does not stand on its own.

Further, I do not concur that the sale of Bader Field to the ACMUA is good public policy and will not consider a partnership bound by a plan to which I do not subscribe.

I have concluded, therefore, that although the Supplement offered greater visibility into the research and assumptions underpinning the Plan, it does not persuade me to alter my Final Decision.

A handwritten signature in black ink, appearing to read "Charles Richman", written over a horizontal line.

Charles Richman, Commissioner
Department of Community Affairs