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# The Proposed Constitutional Amendments to the Local Finance Article: A Critical Analysis

## **Cover Page Footnote**

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# THE PROPOSED CONSTITUTIONAL AMENDMENTS TO THE LOCAL FINANCE ARTICLE: A CRITICAL ANALYSIS

*Richard L. Sigal\**

## I. Introduction

This paper will examine some of the recent proposals of the Committee on Municipal Affairs of the Association of the Bar of the City of New York to amend Article VIII of the New York State Constitution.<sup>1</sup> The amendments would modify the powers of local governments to raise and spend money.

In examining the Committee's proposals, due consideration must be given to philosophical, political and judicial theories of local finance. First, a fundamental idea in our political theory is that the power possessed by government comes from the governed. Thus:

The people of the Union created a national constitution, and conferred upon it powers of sovereignty over certain subjects, and the people of each State created a State government, to exercise the remaining powers of sovereignty so far as they were disposed to allow them to be exercised at all. By the constitution which they establish, they not only tie up the hands of their official agencies, but their own hands as well; and neither the officers of the

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1. The proposed amendments are a result of the Local Finance Project of the Association of the Bar of the City of New York's Committee on Municipal Affairs. The proposals and the Committee's report thereon were published in 1979. Committee on Municipal Affairs of the Association of the Bar of the City of New York, *Proposals to Strengthen Local Finance Laws in New York State*, 34 THE RECORD 58 (Jan., Feb. 1979, No. 1/2) [hereinafter cited as *Proposals*]. The text of the proposed constitutional amendments and legislation is reproduced in Appendix A.

This Article will not discuss the Bar's proposal for a constitutional provision requiring a balanced budget. Proposed Local Finance Article, §5, *Proposals, supra* at 113 (Reprinted in Appendix A). This provision is designed to be enforced by the State Comptroller in the Proposed Fiscal Monitoring Legislation. See, Elliot, *Proposed Fiscal Monitoring Legislation in New York: A Comparative Analysis, infra* at 109.

State, nor the whole people as an aggregate body, are at liberty to take action in opposition to this fundamental law.<sup>2</sup>

This theory embraces the notion that there is an inherent limitation upon the power of the legislature. For example, although the general power of the legislature to tax cannot now be questioned,<sup>3</sup> certain judge-made restraints derived from fundamental law limit legislative power. These restraints look neither to the object nor the amount of the tax, but to the purpose to which the revenue derived from taxation is put.

Every mind must be able to conceive of some legislative attempt to exercise this great and extensive power, which would fail to find warrant either in our written Constitution or in any inherent governmental authority, and which the owner of property subjected to it would have a right to resist. To use the not uncommon illustration, it must be far beyond the reach of real legislative authority to take the property of A, or of A and some, many, or all others, and give it to B, when there is no legal, equitable, just or moral obligation to render unto B one farthing. But to tax A and the others to raise money to pay over to B, is only a way of taking their property for that purpose.<sup>4</sup>

Second, the New York State Constitution is generally thought of as a limitation on municipal government. The state legislature is empowered to establish a municipal government and to authorize its powers. The legislature and municipal government, however, are limited in the powers they may exercise by the express provisions of the constitution,<sup>5</sup> including its home rule provision.<sup>6</sup>

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2. 1 T. COOLEY, TREATISE ON THE CONSTITUTIONAL LIMITATIONS WHICH REST UPON THE LEGISLATIVE POWERS OF THE STATES OF THE AMERICAN UNION 81 (8th ed. 1927).

3. *Weismer v. Village of Douglas*, 64 N.Y. 91, 97-98 (1876); *Town of Guilford v. Board of Supervisors*, 13 N.Y. 143 (1855).

The reliance of the people against excessive taxation, unjust in the application of it to the thing taxed, must be in the character of their legislative representatives, and their remedy when that reliance fails must be found in the power to displace and change them at recurring intervals.

*Weismer v. Village of Douglas*, 64 N.Y. 91, 98 (1876).

4. *Weismer v. Village of Douglas*, 64 N.Y. 91, 98-99. The *Weismer* court noted that "the legislature is the primary authority which is to inquire, what is a proper purpose for the application of money to be raised by taxation, and the necessity of taxation to subserve it . . ." *Id.* at 99. Still, courts will exercise their constitutional right to review legislative acts. *Id.* See note 13 *infra* and accompanying text.

5. *E.g.*, N.Y. CONST. art. VIII, § 1 (the "gift and loan" provision, *inter alia*, bars the grant of aid or credit by a city to a public authority); N.Y. CONST. art. VIII, § 10 (real estate taxes for local purposes may not exceed specified levels of the average full valuation of taxable real estate in the taxing municipality).

6. N.Y. CONST. art. IX. The "home-rule" authority delegated in article IX grants to local

Third, the New York Court of Appeals has responded with great deference to legislative acts respecting fiscal matters when those acts have been challenged under the state constitution. Programs that fit within the letter of the law will be upheld. This reluctance to find constitutional abuse in a variety of novel financing arrangements<sup>7</sup> has abetted government choices to issue debt to finance public projects. In *Comereski v. City of Elmira*,<sup>8</sup> the court faced a challenge to the legality of a parking authority organized to develop and operate parking garages. The authority was empowered to issue bonds to finance the facilities. If revenues received in operating the facilities were insufficient in any year to meet debt service, the city agreed to apply a certain amount of surplus revenue derived from its parking meters to the deficit. Plaintiffs argued that the statute violated the constitutional proscription against the loan of city credit to a public corporation.<sup>9</sup> The court characterized the appropriation as a permissible gift of money and upheld the statute.<sup>10</sup> This construction was approved recently in *Wein v. City of New York*.<sup>11</sup>

Where . . . the statutory scheme stays within the letter of the Constitution . . . we should heed Judge Desmond's statement in *Comereski* . . . , that we should not strain ourselves to find illegality in such programs. The problems of a modern city can never be solved unless arrangements like these . . . are upheld, unless they are patently illegal. Surely such devices, no longer novel, are not more suspect now than they were twenty years ago when, in *Robertson v. Zimmerman*, . . . we rejected a charge that . . . [a public

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governments extensive authority over the affairs within their jurisdiction. See, e.g., N.Y. CONST. art. IX, §§ 1,2.

7. *Hotel Dorset Co. v. Trust for Cultural Resources*, 46 N.Y.2d 358, 385 N.E.2d 1284, 413 N.Y.S.2d 357 (1978) (tax abatement for condominium owners, with corresponding tax equivalency payments made to a cultural institution, held constitutional as "general" legislation); *Quirk v. Municipal Assistance Corp.*, 41 N.Y.2d 644, 363 N.E.2d 549, 394 N.Y.S.2d 842 (1977) (diversion of city sales tax to Municipal Assistance Corporation, held no impairment of contract between city and its general obligation bondholders); *Wein v. City of New York*, 36 N.Y.2d 610, 331 N.E.2d 514, 370 N.Y.S.2d 550 (1975) (appropriation of city moneys to Stabilization Reserve Corporation found to be a gift of city money and, therefore, held no violation of constitutional restriction against loan of credit to a public corporation); *accord*, *Comereski v. City of Elmira*, 283 A.D. 556, 128 N.Y.S.2d 913 (3d Dep't 1954), *aff'd*, 308 N.Y. 248, 125 N.E.2d 241 (1955).

8. 283 A.D. 556, 128 N.Y.S.2d 913 (3d Dep't 1954), *aff'd*, 308 N.Y. 248, 125 N.E.2d 241 (1955).

9. N.Y. CONST. art. VIII, § 1.

10. 308 N.Y. at 252, 125 N.E.2d at 242-43 (1955).

11. *Wein v. City of New York*, 36 N.Y.2d 610, 331 N.E.2d 514, 370 N.Y.S.2d 550 (1975).

benefit corporation was] a mere invasion of constitutional debt limitations, etc. Our answer was this . . . : "Since the city cannot itself meet the requirements of the situation, the only alternative is for the State, in the exercise of its police power, to provide a method of constructing the improvements and of financing their cost."<sup>12</sup>

Indeed, "[t]here is a simple, but well-founded, presumption that an act of the legislature is constitutional and this presumption can be upset only by proof persuasive beyond a reasonable doubt . . . ."<sup>13</sup> Whether the court's reluctance to seek out the spirit of the constitutional limitations on public finance reflects sensitivity to the problems of financing public programs and services or merely follows from the presumption of a legislative act's constitutionality is unclear. The effect in either case is the same: amendments to the constitution respecting local finance must be clear and precise, otherwise, we will again see the creation of artifices designed to circumvent the restrictions.

Fourth, past practices by city and state officials to avoid, and if necessary, to amend constitutional and statutory limitations on public spending, indicate that no constitutional provision may succeed as an effective restraint on official action.<sup>14</sup> A typical attitude was displayed by Mayor Fernando Wood in 1846 when he remarked, "I shall not hesitate to exercise even doubtful powers when the

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12. *Id.* at 619-20, 331 N.E.2d at 519, 370 N.Y.S.2d at 557-58.

13. *Hotel Dorset Co. v. Trust for Cultural Resources*, 46 N.Y.2d 358, 370, 385 N.E.2d 1284, 1289, 413 N.Y.S.2d 357, 362 (1978)(citing *Montgomery v. Daniels*, 38 N.Y.2d 41, 340 N.E.2d 444, 378 N.Y.S.2d 1 (1975)); *In re Malpicaorsini*, 36 N.Y.2d 568, 331 N.E.2d 486, 370 N.Y.S.2d 511 (1975)). Chief Judge Breitel expressed a somewhat different view of such novel financing schemes in his dissenting opinion:

No constitutional provision was ever created nor is it ever to be interpreted without reading into it the effect of its violation. Constitutional provisions reflect a history of experience and mistrust of transient action dictated by transient necessities which may, as in the past, engender ultimate destruction for the society it is supposed to protect.

46 N.Y.2d at 380, 385 N.E.2d at 1296, 413 N.Y.S.2d at 369 (Breitel, Ch. J., dissenting).

14. See generally Macchiarola, *Local Finance Under The New York State Constitution With an Emphasis on New York City*, 35 FORDHAM L. REV. 263 (1967) [hereinafter cited as Macchiarola]. Mr. Macchiarola covers the historical treatment of the constitutional local finance law sections and their deleterious effect on New York City. The article substantiates, or at least makes a strong case for, the ineffectiveness of constitutional provisions restricting the operation of New York City. *Id.* at 278-85. See also Comment, *The Constitutional Debt Limit and New York City*, *infra*, at 185. Comment, *A Brief Constitutional History*, *infra*, at 135.

honor and the interest of the people are abused."<sup>15</sup> Similarly, notwithstanding a constitutional requirement for a state-wide referendum authorizing the issuance of tax-exempt debt instruments to finance a public project,<sup>16</sup> such projects have been built and financed by the state without voter approval.<sup>17</sup>

These considerations illustrate the ineffectual impact that constitutional debt limitations have had on controlling debt.<sup>18</sup> Constitutional silence, rather than express constitutional provisions purporting to limit debt, would be a more effective means toward limiting state and local debt, assuming elected officials, delegated the awesome responsibility to carry out their perceived mandate with public moneys without constitutional restraint, would respect the use of such moneys. Admittedly, any solution that suggests elimination of all constitutional restraint is probably unrealistic, and perhaps unwarranted, in the present fiscal environment. More thought, however, should be devoted to such a solution.<sup>19</sup> The city and state might respond well to the challenge. In any event, in addressing constitutional proposals, we should avoid naivete and maintain skepticism toward the concept that constitutional revision will as-

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15. Macchiarola, *supra* note 14, at 267 (citing ELLIS, FROST, SYRETT & CARMAN, A SHORT HISTORY OF NEW YORK STATE 231 (1957)). The city's commitment to offering generous services to its constituents has often led to credit negotiations in shotgun sessions with existing creditors. In 1932, a budgetary crisis resulted in an agreement between various banks and the City of New York whereby the banks imposed fiscal restrictions on the city. K. AULETTA, THE STREETS WERE PAVED WITH GOLD 204, 231 (1979).

16. N.Y. CONST. art. VII, § 11 reads, in pertinent part:

Except the debts specified in sections 9 and 10 of this article, no debt shall be hereafter contracted by or in behalf of the state, unless such debt shall be authorized by law, for some single work or purpose, to be distinctly specified therein. No such law shall take effect until it shall, at a general election, have been submitted to the people, and have received a majority of all the votes cast for and against it at such election nor shall it be submitted to be voted on within three months after its passage nor at any general election when any other law or any bill shall be submitted to be voted for or against.

17. *E.g.*, N.Y. UNCONSOL. LAWS §§ 6251-6285 (McKinney 1979).

18. At the time the Municipal Assistance Corporation was formed to restructure the city's existing debt, the total debt outstanding was \$2,624 million. A. OTT & J. YOO, NEW YORK CITY'S FISCAL CRISIS 4 (1975).

19. This notion of "zero-based" review of constitutional provisions should not be considered a radical solution, particularly if we insist on real public hearings and public disclosure of borrowings and expenditures, thereby assuring procedural safeguards. Several other states, after serious study, have adopted this policy and the sky remains blue in those states. See ILL. CONST. of 1970, art. VIII, § 1; PA. CONST. art. IX., § 9; MICH. CONST. art. VII, § 26.

sure good credit, because recurrences of fiscal crisis in the city and state are almost as persistent as constitutional conventions. Our mission in reviewing constitutional proposals should be to achieve clarity of purpose while maintaining a discreet distinction between possibility and probability of the provision fulfilling its purpose.

## II. City Bar Association Proposal: Remove Prohibition Against Loan and Guarantee of Loan to Private Corporations.

No local government shall give or loan its money, property or credit, except as authorized by law for a public purpose, including provision of assistance necessary to promote the betterment of a local government or its economy.<sup>20</sup>

In New York, the case law substantially supports the proposition that no money may be expended, no taxes levied and accordingly, no general obligation debt issued except for a public purpose.<sup>21</sup> The basis for this proposition is a case decided more than one hundred years ago, *Weismer v. Village of Douglas*.<sup>22</sup> *Weismer* held, without reliance upon or the existence of any express constitutional provision, that the state legislature had no power to authorize a municipal corporation to issue its obligations for the purpose of raising money to pay for a subscription to the capital stock of a private corporation and to provide for the payment of such obligations by taxation. "It is a general rule that the legitimate object of raising money by taxation is for public purpose and the proper needs for government, general and local, state and municipal."<sup>23</sup>

The Committee's proposal, however, fails to recognize that this proposition derives not from a specific provision of the constitution but from a fundamental notion of common law covering the conduct of elected municipal officials.<sup>24</sup> Therefore, there is no need in New

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20. For the full text of the Bar's proposals see Appendix A. The present provision reads, in pertinent part:

No county, city, town, village or school district shall give or loan any money or property to or in aid of any individual, or private corporation or association, or private undertaking, or become directly or indirectly the owner of stock in, or bonds of, any private corporation or association; nor shall any county, city, town, village or school district give or loan its credit to or in aid of any individual, or public or private corporation or association, or private undertaking.

N.Y. CONST. art. VIII, § 1.

21. *Weismer v. Village of Douglas*, 64 N.Y. 91, 98-100 (1876).

22. *Id.*

23. *Id.*

24. *Id.*



York for a constitutional provision restraining the city, either through its Mayor, its City Council or Board of Estimate, from spending, appropriating, contracting or incurring debt for a private emolument. Elected officials by the very nature of their offices operate only for the public good and cannot be arbitrary, discriminatory or capricious in any respect. Under *Weismer*, simply repealing article VIII, section 1, in its entirety would achieve the objectives of the Committee.<sup>25</sup> The clear "public purpose" test of *Weismer*, would permit the extension of city aid or credit to projects and services beneficial to the public without restricting the manner in which it may be accomplished.

Under article VIII, section 1, notwithstanding the existence of a public purpose, an expenditure of public funds may be invalid if there is a violation of the "gift or loan" provision.<sup>26</sup> Such a prohibition thereby provides an additional restraint. In *People v. Westchester County National Bank*,<sup>27</sup> the New York Court of Appeals considered a challenge to chapter 872 of the Laws of 1920<sup>28</sup> which provided for a bonus to be paid to residents of the State who were in military service during World War I. The bonus was to be financed by a \$45 million bond issue.<sup>29</sup> The sole question presented in the case was the validity of the bonus act. The bonus was not aid to the wounded; it was to be paid regardless of a person's physical condition. In the case of those who died in World War I, the bonus was to be paid to relatives of the deceased.<sup>30</sup>

The Court of Appeals began its analysis with a basic premise: a tax may only be imposed if its purpose or the use of its proceeds is public. The court said:

At the basis of our ideas as to the relation of the Citizen to the state is one outstanding principle of taxation. Whether or not the legislature is curbed by any constitutional formula no tax may be imposed except it be for a public purpose. Otherwise, however, unless for some constitutional restriction the taxing power is plenary. Except for such restriction the legislature may ap-

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25. The Bar argues that its proposal would substitute for the existing constitutional provision a broad "public purpose" standard. *Proposals, supra* note 1, at 82-87.

26. *People v. Westchester County Nat'l Bank*, 231 N.Y. 465, 132 N.E. 241 (1921).

27. *Id.*

28. 1920 N.Y. Laws ch. 872.

29. 231 N.Y. at 468, 132 N.E. at 241-42.

30. *Id.*

propriate public moneys for private corporations or for individuals if thereby the public welfare is promoted.<sup>31</sup>

The court defined public use or purpose as that which is sanctioned by time and the acquiescence of the people.<sup>32</sup> The court concluded that even if the argument could be made that payment of the bonus was not in the general interest, it would be hesitant to overturn the judgment of the legislature on those grounds.<sup>33</sup>

The court then turned its attention to the constitutional prohibition of gifts and loans of public money. The court stated that, notwithstanding the public purpose of a particular expenditure, public funding is unconstitutional if it violates the loan or credit provision of article VIII, section 1.

Whether the purpose is a public one, therefore, is no longer the sole test as to the proper use of the state's credit. Such a purpose may not be served in one particular way. However important, however useful the objects designed by the legislature, they may not be accomplished by a gift or a loan of credit to an individual or to a corporation. It will not do to say that the character of the act is to be judged by its main object—that because the purpose is public, the means adopted cannot be called a gift or a loan. To do so would be to make meaningless the provision adopted by the convention of 1846. Gifts of credit to railroads served an important public purpose. That purpose was distinctly before the legislatures that made them. Yet they were still gifts and were prohibited.<sup>34</sup>

In analyzing the nature of the transaction, the Court of Appeals determined that the payment of the bonus could not be justified as being in the nature of recognition of a moral or equitable claim.<sup>35</sup> No such claim existed because those who gained victory in World War I were not the servants of the state; the state, therefore, owed

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31. *Id.* at 470, 132 N.E. at 242.

32. *Id.* See also *Murphy v. Erie County*, 28 N.Y.2d 80, 88, 268 N.E.2d 771, 774, 320 N.Y.S.2d 29, 34-35 (1971); *Saratoga Ass'n v. Horse Breeding Fund*, 22 N.Y.2d 119, 238 N.E.2d 730, 291 N.Y.S.2d 335 (1969).

33. 231 N.Y. 465, 471, 132 N.E. 241, 243 (1921). See also *Wein v. State*, 39 N.Y.2d 136, 155-56, 347 N.E.2d 586, 596-97, 383 N.Y.S.2d 225, 235-36 (1977); *Hoyt v. County of Broome*, 285 N.Y. 402, 406, 34 N.E.2d 481, 482 (1941); *Kohn v. Bates*, 275 A.D. 431, 433, 90 N.Y.S.2d 391, 393 (4th Dep't 1949), *aff'd*, 300 N.Y. 722, 92 N.E.2d 60 (1950).

34. 231 N.Y. at 475, 132 N.E. at 244.

35. *Id.* at 476-77, 132 N.E. at 245. A moral or equitable claim is based on the receipt by the state of some direct benefit by the claimant or the suffering by the claimant of some direct injury where in fairness the state ought to respond. *Id.*

them no obligation, either legally or morally. The bonus was a mere gratuity, a gift, and thus, unconstitutional.<sup>36</sup>

There are numerous cases, at the local level of government, that are instructive on the point of the prohibition of gifts and loans of money, credit or property, and on the point of the limits of public purpose or use.<sup>37</sup> For example, in 1897, the issue was raised as to whether construction of a rapid transit system and its operation by a private enterprise under a long-term lease violated the gift or loan prohibition. The decision in *Sun Printing and Publishing Ass'n v. Mayor of New York*<sup>38</sup> concluded that no violation existed because the lease was not in perpetuity, was subject to review, adjustment and termination and the city was, therefore, not alienating its property.<sup>39</sup> Although *Sun Printing* predates *Westchester* by twenty-four years, it is interesting to note that the earlier court specifically recognized and permitted construction of a rapid transit system as a public purpose. By so doing, it effectively recognized a two-tier test for public expenditures as enunciated in *Westchester*:<sup>40</sup> first, there must be a public purpose; second, there must be no gift or loan of money, property or credit to a private person. The former test, again, derives from fundamental judge-made municipal law; the latter from positive constitutional law.

If the purpose of the Committee Proposals is to eliminate the restraint on gifts or loans of credit,<sup>41</sup> in light of these cases interpreting the existing provision the proposed amendment should simply repeal the entire "gift and loan" provision. Alternatively, if the

36. *Id.* at 483, 132 N.E. at 247.

37. *Sun Printing and Publishing Ass'n v. Mayor of New York*, 152 N.Y. 257, 46 N.E. 499 (1897); *County of Nassau v. South Farmingdale Water Dist.*, 62 A.D.2d 380, 405 N.Y.S.2d 742 (2d Dep't), *aff'd*, 46 N.Y.2d 794, 386 N.E.2d 832, 413 N.Y.S.2d 921 (1978); *Kearney v. City of Schenectady*, 37 A.D.2d 896, 325 N.Y.S.2d 278 (3d Dep't 1971); *County of Niagara v. Levitt*, 97 Misc. 2d 421, 411 N.Y.S.2d 810 (Sup. Ct. 1978).

38. 52 N.Y. 257, 46 N.E. 499 (1897).

39. *Id.* at 271, 46 N.E. at 502.

40. *Id.* at 265, 46 N.E. at 500. The public purpose must be for the general welfare of the people, sanctioned by the citizens, public in character and authorized by the legislature. *Id.* Similar issues were raised in 1912 in *Admiral Realty Co. v. City of New York*, 206 N.Y. 110, 99 N.E. 24 (1912) (action to enjoin subway construction based upon the claim that the Rapid Transit Act, under which construction was authorized, violated the provisions of the constitution against the gift by a city of money in aid of any individual, association or corporation), and were disposed of in a similar fashion.

41. *Proposals*, *supra* note 1, at 84.

purpose of the proposals is to elaborate and to provide a constitutional foundation for certain types of economic development activities, a direct approach is recommended: the proposed amendment should repeal the existing "gift and loan" provision and in addition grant direct authorization for spending public moneys on economic development.

Precedent for the latter approach may be found in article XVIII,<sup>42</sup> which provides that the legislature may authorize municipalities to contract indebtedness for low income housing.<sup>43</sup> Because the delegates to the 1938 Constitutional Convention recognized that government assistance for housing might violate article VIII, section 1, a constitutional provision was added authorizing such government assistance for this purpose. Along these lines, I believe that the best way to authorize municipalities to issue general obligation bonds for the purpose of financing economic development, assuming, *arguendo*, that this is a desirable policy, is to adopt a concise constitutional provision establishing this as a valid public purpose. This provision should set forth clear standards and requirements so that it may be cited as unambiguously overruling *Weismer* in this area.

It is arguable that in the light of recent decisions of the Court of Appeals, it is unclear whether *Weismer's* restrictive interpretation of valid state and local financial assistance efforts is still controlling. *Weismer* recognized that any enterprise "tends indirectly to the benefit of every citizen by the increase of general business activity, greater facility of obtaining employment, the consequent increase of population, the enhancement in value of real estate and its readier sale, and the multiplication of conveniences."<sup>44</sup> However, that court stated that these are not direct and immediate public uses and purposes to which money taken by tax may be directed. If this rule remains good law, government assistance for economic development would likely be found unconstitutional as an expenditure of public funds for a private purpose. If the rule is not controlling, there would be no need to specifically authorize governmental assistance for economic development in the absence of the "gift and loan" provision.

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42. N.Y. CONST. art. XVIII.

43. *Id.* § 4.

44. *Weismer v. Douglas*, 64 N.Y. 91, 103 (1876).

The closest cases by which we might attempt to determine whether or not we need a constitutional provision validating the public purpose of a municipality providing economic assistance are the recently decided *Commodore Hotel*<sup>45</sup> and the *Hotel Dorset*<sup>46</sup> cases. Both cases involved the provision of the constitution restricting real estate tax exemptions.<sup>47</sup> In the *Commodore Hotel* case,<sup>48</sup> the court sustained the use of the Urban Development Corporation ("UDC") as the technical owner of the hotel because, in effect, the UDC could only have chosen to participate in a project designed to combat urban blight. The extent of actual or substantial participation in the project by the UDC was of no constitutional importance.<sup>49</sup> Property held even technically by a public agency, primarily for a public use, does not lose immunity from taxation merely because the state agency or a private person incidentally or generally derives income from the property. While it was clear that the private developer was the substantive owner of and derived benefit from the hotel, there was no constitutional issue relating to its real estate tax exemption so long as the renovation was designed to combat urban blight.

*Hotel Dorset* developed the concept further.<sup>50</sup> In this case the

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45. *Wein v. Beame*, 43 N.Y.2d 326, 372 N.E.2d 300, 401 N.Y.S.2d 458 (1977).

46. *Hotel Dorset Co. v. Trust for Cultural Resources*, 46 N.Y.2d 358, 385 N.E.2d 1284, 413 N.Y.S.2d 357 (1978).

47. N.Y. CONST. art. XVI, § 1 reads:

The power of taxation shall never be surrendered, suspended or contracted away, except as to securities issued for public purposes pursuant to law. Any laws which delegate the taxing power shall specify the types of taxes which may be imposed thereunder and provide for their review.

Exemptions from taxation may be granted only by general laws. Exemptions may be altered or repealed except those exempting real or personal property used exclusively for religious, educational or charitable purposes as defined by law and owned by any corporation or association organized or conducted exclusively for one or more of such purposes and not operating for profit.

48. In *Wein v. Beame*, 43 N.Y.2d 326, 372 N.E.2d 300, 401 N.Y.S.2d 458 (1977), plaintiff challenged the constitutionality of the plan by the City of New York and the Urban Development Corporation (UDC) to provide for the renovation of the dilapidated, midtown Commodore Hotel by granting tax exemptions to a private developer. These exemptions were created by operation of law when the UDC bought the hotel and then leased it back to the private developer, as the government was the nominal owner of the land. The court held that the UDC's voluntary participation in the plan to combat urban blight was in accordance with its benign legislative purpose. *Id.* at 332, 372 N.E.2d at 303, 401 N.Y.S.2d at 462.

49. *Id.* at 331, 372 N.E.2d at 302, 401 N.Y.S.2d at 460-61.

50. In *Hotel Dorset Co. v. Trust for Cultural Resources*, 46 N.Y.2d 358, 385 N.E.2d 1284,

court considered a statute which authorized the expansion of a museum, together with the construction of revenue producing apartments, financed by the issuance of public tax-exempt debt. The bonds were to be secured by a pledge of the revenues derived from the entire project. The Court of Appeals permitted the construction of condominiums and their exemption from taxation on the condition that the moneys that otherwise would have been used for taxes would be diverted to pay debt service on the bonds issued to finance the addition to the museum. The preservation of cultural institutions was deemed to be a public purpose.<sup>51</sup>

Both *Commodore Hotel* and *Hotel Dorset* exemplify the types of financing that have become necessary to renovate many urban areas. Throughout the country, tax abatement has been a useful tool in urban renewal programs<sup>52</sup> and it is clear that the New York Court of Appeals will accept a theory of public purpose premised on concepts such as preservation of cultural institutions and combating urban blight.<sup>53</sup>

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413 N.Y.S.2d 357 (1978), plaintiff challenged the constitutionality of the New York State and New York City Cultural Resources Act which provided support, through real estate tax exemptions, for financially troubled cultural institutions in the state. The court ruled that the Acts were constitutional because the state legislature was furthering a public purpose and, additionally, the tax exemption applied to a rationally defined class of institutions. *Id.* at 358, 385 N.E.2d at 1290-92, 413 N.Y.S.2d at 362-64.

51. *Id.* at 372, 385 N.E.2d at 1290, 413 N.Y.S.2d at 362-63. The court of appeals decision in *Hotel Dorset* may indicate judicial approval of yet another imaginative financial device, tax allocation financing. Tax allocation financing is a scheme which allows a governmental entity to borrow money to finance urban renewal or housing construction with the increase in real property taxes resulting from the project. Tax assessments within the project area are frozen as of a particular date, with all the taxes on the frozen base accruing as usual to the taxing agency which hitherto had received the tax payments. Those property revenues above the frozen base generated by the project are used to pay off the bonds issued to finance the project. Upon retirement of the bonds the taxing agency receives all the tax revenues levied against the entire property tax base.

The tax-equivalency payments scheme upheld by the court of appeals is very similar in nature and effect to tax allocation financing. New York courts have yet to face the issue of tax allocation financing because no statutory authority presently exists permitting it. Two other courts have addressed the issue. *Richards v. City of Muscatine*, 237 N.W.2d 481 (Iowa 1975); *Tribe v. Salt Lake City Corp.*, 540 P.2d 4491 (Utah 1975). See Bass, *Tax Allocation and Housing*, 6 LAWYERS IN HOUSING 31 (Special Issue 1976).

52. See Gupta & Rea, *The Investment Decision In The Central City: A Consideration of a Property Tax Abatement Law*, 7 FORDHAM URB. L.J. 253 (1978-79), for discussion of the efficacy of a property tax abatement program as an incentive for investment in depressed urban residential communities.

53. *Proposals*, *supra* note 1, at 71-82, 84. The court cites *Wein v. City of New York*, 36

Notwithstanding such cases as *Hotel Dorset* and *Commodore Hotel*, it is probably sounder practice to counsel that a constitutional amendment is necessary to give the legislature the power to provide the means, the terms and the conditions pursuant to which municipalities may finance economic development projects by the issuance of general obligation bonds. The question then becomes whether or not it is wise to eliminate the "gift and loan" provision and validate the public purpose of issuing general obligation bonds for economic development.

On this question, the rationale offered by the Committee for its proposal does not seem to correspond with the proposal itself. The Committee asserts<sup>54</sup> that existing law failed to prevent the financial collapse of the City of New York, citing debt limit abuses and the complexity of constitutional restraint, among other factors.<sup>55</sup> One of the practices that has not been cited, however, is the use of tax moneys for gifts, loans or the guarantee of a debt for a private purpose or corporation. This practice is, after all, the subject of the restriction found in article VIII, section 1. The fact is that the constitution's restraints in the area of economic development appear to have worked as intended, the closest example of abuse being the programs at issue in *Commodore Hotel* and *Hotel Dorset*. Thus, the Committee is incorrect when it concludes that the "gift and loan" provision has been circumvented primarily through the creation of authorities.<sup>56</sup> The thrust of the city's efforts in using ancillary authority financing prior to the fiscal crisis was as means to expand its taxing power and its debt limit. This was done to raise tax moneys for its current expenses under economic circumstances

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N.Y.2d 610, 331 N.E.2d 514, 370 N.Y.S.2d 550 (1975), to support its position that the gift and loan provision has been abused. See *Proposals*, *supra* note 1, at 84. In *Wein*, plaintiff taxpayer brought an action for a judgment declaring the New York Stabilization Reserve Corporation Act invalid as violative of the state constitution in that the Act illegally allowed the city to obtain additional operating revenues through the sale of bonds of its legislatively created corporation, which thereby extended the city's debt obligations beyond the limit set by the constitution. The court ruled that any claim of excessive indebtedness was refuted by the statutory provision that does not permit the city to become indebted on the Stabilization Reserve Corporation's bonds and that the loan of city credit to aid a public corporation was a legally and constitutionally proper gift. The clear purpose of the statute was to evade the debt limits, not the restriction of the "gift and loan" provision.

54. *Proposals*, *supra* note 1, at 84.

55. See notes 45-53 *supra* and accompanying text.

56. *Proposals*, *supra* note 1, at 84.

where its revenues were not sufficient therefore.<sup>57</sup> Article VIII, section 1 should not be amended upon the assumption that it did not work. The provision has worked generally as its draftsmen intended it to work.

Practically, it is also questionable to assume that the elimination of the "gift and loan" provision will permit municipalities to embark on programs of direct aid to private corporations. It must be remembered that even the UDC, with minor exceptions, did not issue industrial development bonds backed by the so-called "moral obligation" to finance construction of manufacturing plants. Its bonds were issued for large-scale housing and community development projects.<sup>58</sup> The UDC, therefore, did not operate outside the spirit of the "gift and loan" provision.

In my opinion, the question of whether or not it is sound policy to eliminate the "gift and loan" provision in order to permit unfettered use of tax moneys for industrial and economic development is a difficult one, contrary to the Committee's assertions. Policymakers should, however, be counseled that, in general, the current constitutional provision has prevented the use of general obligation bonds for such purposes and that there has been no wide-scale circumvention of the provision. General tax moneys are not being used to aid or guarantee debt of private corporations, other than in the constitutionally permitted housing and urban development areas. Thus, the Committee is proposing an entirely new power for the city, under the guise of corrective action.

### **III. City Bar Association Proposal: Retention of the Requirement that the Municipality Pledge its Faith and Credit in Every Debt Instrument.**

No indebtedness shall be contracted by any local government unless such local government shall have pledged its faith and credit for the payment of the principal thereof and the interest thereon.<sup>59</sup>

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57. The city sought to expand the limits of its taxing power and avoid debt limitations to raise moneys for current expenses. See Comment, *Constitutional Debt Limit in New York City*, *infra*, at

58. N.Y. UNCONSOL. LAWS §§ 6251-6285 (McKinney 1979).

59. For the full text of the Bar's proposals see Appendix A. The present statute, in pertinent part, provides:

No indebtedness shall be contracted by any county, city, town, village or school district unless such county, city, town, village or school district shall have pledged its faith and credit for the payment of the principal thereof and the interest thereon. N.Y. CONST. art. VIII, § 2.



The pledge of faith and credit is particularly important. It has been given added force by the Court of Appeals in its recent decision in *Flushing National Bank v. Municipal Assistance Corp.*<sup>60</sup> In 1975, as part of the financial recovery plan for New York City, holders of the city's short-term notes were offered an opportunity to exchange their notes for an equal principal amount of long term bonds issued by the Municipal Assistance Corporation ("MAC"). Those who declined this offer were obliged to accept payment of the notes at maturity, owing to a three-year moratorium imposed on actions to enforce the city's short-term obligations.<sup>61</sup> The court placed central reliance on the faith and credit requirement in declaring the moratorium unconstitutional.

A pledge of the city's faith and credit is both a commitment to pay and a commitment of the city's revenue generating powers to produce the funds to pay. Hence, an obligation containing a pledge of the city's "faith and credit" is secured by a promise both to pay and to use in good faith the city's general revenue powers to produce sufficient funds to pay the principal and interest of the obligation as it becomes due. . . . The constitutional requirement of a pledge of the city's faith and credit is not satisfied merely by engraving a statement of the pledge in the text of the obligation. The last is a strange argument made by respondents. It is difficult to understand the financial value of such a commitment as contrasted with a "moral" obligation, wisely prohibited by the Constitution for municipalities (N.Y. Const., Art. VIII, §2). Instead, by any test, whether based on realism or sensibility, the city is constitutionally obliged to pay and to use in good faith its revenue powers to produce funds to pay the principal of the notes when due.<sup>62</sup>

The Committee's proposal would maintain the faith and credit pledge requirement as that requirement was interpreted in *Flushing Bank*.<sup>63</sup> The proposal would require that municipal debt be supported by such a pledge without regard to the purpose for which the debt was issued.<sup>64</sup>

*Flushing Bank*, should be read in light of *Quirk v. Municipal Assistance Corp.*<sup>65</sup> In *Quirk*, the Court of Appeals addressed a challenge to a state statute which "diverted" the city's sales tax and

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60. 40 N.Y.2d 731, 358 N.E.2d 848, 390 N.Y.S.2d 22 (1976).

61. 1975 N.Y. Laws ch. 875.

62. 40 N.Y.2d at 735-36, 358 N.E.2d at 851-52, 390 N.Y.S.2d at 25-26.

63. *Proposals*, *supra* note 1, at 87.

64. *Id.*

65. 41 N.Y.2d 644, 363 N.E.2d 549, 394 N.Y.S.2d 842.

stock transfer tax from the general revenues of the city and pledged these taxes to the payment of MAC bonds.<sup>66</sup> City general obligation bondholders argued that their bonds were impaired to the extent the city revenues were diminished by the diversion in contravention of the federal constitutional prohibition against the impairment of contracts.<sup>67</sup> The court of appeals, in a *per curiam* decision, held that these revenues could be so diverted. The "first revenues" provision of article VIII, section 2<sup>68</sup> did not give bondholders the right to any particular revenues; the provision "only assures that out of the revenues which are collected, money must be provided to satisfy obligations to the bondholders."<sup>69</sup> The court cautioned, however, that this did not mean that the city could be stripped of all revenues so as to leave the bondholders with an empty promise: "With respect to the traditional real estate tax levies, the bondholders are constitutionally protected against an attempt by the State to deprive the city of those revenues to meet its obligations."<sup>70</sup>

The faith and credit requirement, coupled with an unlimited power to tax real estate to pay debt service,<sup>71</sup> reinforces the reliance on the real estate tax as the ultimate source of payment of debt. Thus, the Committee's proposal makes no changes in the mechanics of securing the payment of debt, except that it does not distinguish the purpose of the debt (*i.e.*, whether the debt is issued to supply an essential governmental function or to support private enterprise). Because the ability to tax real property for the payment of

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66. *Id.* To provide the newly created Municipal Assistance Corporation with a financial base, the state legislature suspended the city sales tax and replaced it with an identical sales tax imposed by the state. These revenues were committed to MAC. N.Y. TAX LAW § 1210 (McKinney Supp. 1978); N.Y. STATE FIN. LAW § 92(d) (McKinney Supp. 1978). The suspension of the City tax is to continue until all MAC obligations are repaid. N.Y. TAX LAW § 1210 (McKinney 1978). In addition, revenues collected from the stock transfer tax are to be appropriated to MAC to the extent necessary to pay off its obligations. N.Y. STATE FIN. LAW § 92(b)(McKinney Supp. 1978).

67. 41 N.Y.2d at 646, 363 N.E.2d at 550, 394 N.Y.S.2d at 843.

68. "[U]npaid bondholders for whom moneys have not been appropriated are entitled to have sufficient sums for repayment 'set apart from the revenues thereafter received and . . . applied to such purposes.' (N.Y. CONST. art. VIII, § 2)." 41 N.Y.2d at 647, 363 N.E.2d at 550, 394 N.Y.S.2d at 843.

69. *Id.* at 647, 363 N.E.2d at 550-51, 394 N.Y.S.2d at 844.

70. *Id.*

71. N.Y. CONST. art. VIII, § 12, provides, in pertinent part: "[t]he legislature shall not . . . restrict the power to levy taxes on real estate for the payment of interest on or principal of indebtedness theretofore contracted."

debt is unlimited, and because any other city revenues could be diverted under the holding of *Quirk*, the Committee's proposal would allow an already overworked tax base to be used for support of more debt.

Contrary to the Committee's assertions, there is no need for a city to pledge its faith and credit to finance a project that generates sufficient revenues to secure the obligation. The Committee proposal, by requiring the faith and credit pledge on every city obligation, would only compel the creation of authorities for revenue financing. The Committee's proposal to require a municipality to pledge its faith and credit may be criticized even when coupled with its proposal to permit the issuance of general obligation bonds for economic development and to eliminate the "gift and loan" provision. If the proposals are designed to give municipalities a large degree of flexibility to further economic development, those same municipalities should not be deprived of available financing tools necessary to achieve this goal. It may not be necessary, or even appropriate, in every instance of economic development for the municipality to promise to the bondholder its faith and credit; something far less may be sufficient to attract the necessary capital. It is essential that the municipality retain and preserve, to the fullest extent possible, the ability to pledge its taxing power for the financing of capital improvements necessary to provide essential municipal services. Given the kinds of political influence that might be brought to bear upon a municipality in the absence of a gift or loan prohibition, particularly since *Flushing National Bank* has reinforced the vitality of the pledge of faith and credit, it is important that the municipality use this pledge only when necessary. The level of disclosure now required in the market place<sup>72</sup> supports this conclusion, for the best method to prevent instances of fiscal abuse, such as revenue anticipation financing, is the requirement that potential purchasers of municipal securities look to and rely upon the existence and receipt of the project revenues for payment of obligations. There is no better mechanism than the market to test the feasibility of projects or cash flow estimates.

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72. See Currier, *Mandating Disclosure in Municipal Securities: Proposed New York Legislation, infra*, at 67.

#### IV. Committee Proposal: Retention of the "First Revenues" Lien Provision.

Provision shall be made in each fiscal year by every local government for the payment of interest on all indebtedness and for the amounts required for repayment of all principal thereof maturing or otherwise coming due during such fiscal year. If at any time the respective authorities shall fail to make such provision for payment or shall fail to make payment, a sufficient sum shall be set apart from the first revenues thereafter received and shall be applied to such purposes. The fiscal officer of any such local government may be required to set apart and apply such revenues as aforesaid at the suit of any holder of obligations issued for any such indebtedness.<sup>73</sup>

The present "first revenues" lien provision requires a municipality to make an annual appropriation sufficient to pay its bonds.<sup>74</sup> In the event the appropriation is not made the constitution provides that a "sufficient sum shall be set apart from the first revenues thereafter received" to pay debt service.<sup>75</sup> The provision then states that the chief fiscal officer of a municipality "may be required to set apart" such revenues and apply the same to the payment of debt service.<sup>76</sup>

The "first revenue" provision was designed to assure investors that their obligations would be paid in cash. The provision became part of the constitution in 1938 in response to the failure of city officials to appropriate the moneys required for debt service.<sup>77</sup> Recently, the problem has not been a failure to appropriate debt service. Rather, the problem is the city's inability to pay all obligations for which appropriations have been made.<sup>78</sup> The bondholder has very little hope of having the money set aside in his favor when it comes to choosing between payment of debt service or the payment of salaries and other essential services.<sup>79</sup> I believe that bondholders'

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73. PROPOSED LOCAL FINANCE ARTICLE § 2, *Proposals, supra* note 1, at 110 (reprinted in Appendix A).

74. N.Y. CONST. art. VIII, § 2.

75. *Id.*

76. *Id.*

77. N.Y.S. CONSTITUTIONAL CONVENTION 1938, JOURNALS AND DOCUMENTS, DOC. NO. 16, at 92 (1938).

78. *Flushing Nat'l Bank v. Municipal Assistance Corp.*, 40 N.Y.2d 731, 358 N.E.2d 848, 390 N.Y.S.2d 22 (1976).

79. One exception to this practice occurred in Ohio where school districts closed before the end of the semester so that borrowings would be repaid. However, even in this state, such practice is being reexamined in light of a perceived reality to provide essential services prior

rights may be better secured by providing constitutional sanction for a special tax levy for debt service to be set aside upon receipt; *i.e.*, segregated from the general fund, and used only for the payment of debt service. Analogous solutions were adopted by the city of Buffalo as a legislative matter.<sup>80</sup> In addition, I believe that the technique of granting municipalities the power to pledge and secure a source of revenue, such as a sales tax, should be explored. There would then be no need to devise an intricate arrangement such as the Municipal Assistance Corporation if the constitution sanctioned the capitalization of future receipts of the sales tax.

In sum, I question whether or not the "first revenues" provision, which, for all practical purposes, has proved to be of no value, and which, in addition, has been one of the most misleading and least understood provisions in the constitution, ought to be retained in any revision of the Local Finance Article. I do not suggest that the requirement to appropriate the moneys should be repealed, but it must be recognized that a constitutional first lien of revenues provision in favor of bondholders is not realistic.

### V. Committee Proposal: Retention of Debt and Tax Limitations.

No local government shall contract indebtedness . . . [nor shall a] local government . . . levy taxes except as authorized by law, provided however, that the legislature shall not restrict the power of any local government to levy taxes on real estate without limit for the payment of interest on or principal of indebtedness.<sup>81</sup>

A thorough analysis of the rationale for the present debt limit and tax limit provisions in the constitution may be found in the records of the 1938 Constitutional Convention Committee,<sup>82</sup> and need not

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to the service of debt. N.Y. Times, Jan. 13, 1977, at 22, col. 3.

The limited usefulness of this provision is illustrated in *Van Derzee v. City of Long Beach*, 177 Misc. 894, 31 N.Y.S.2d 359 (Sup. Ct. 1941) wherein the court refused plaintiff's request to order the defendant's chief fiscal officer to appropriate the city's first revenues to pay bond indebtedness. The court held that the words "may be required" in the constitutional provision permitted a city's chief fiscal officer to exercise his discretion in enforcing the provision. *Id.* at 896, 31 N.Y.S.2d at 361. *Accord*, *Flushing Nat'l Bank v. Municipal Assistance Corp.*, 40 N.Y.2d 731, 358 N.E.2d 848, 390 N.Y.S.2d 22 (1976).

80. 1977 N.Y. Laws ch. 12.

81. PROPOSED LOCAL FINANCE ARTICLE §§ 3,4, *Proposals, supra* note 1, at 110-11 (reprinted in Appendix A).

82. NEW YORK STATE CONSTITUTIONAL CONVENTION COMMITTEE, STATE AND LOCAL GOVERNMENT IN NEW YORK 542-43 (1938).

be repeated here. Succinctly stated, the general rationale for these limits is that they prevent excessive spending and, consequently, excessive taxation.<sup>83</sup> In view of the repeated attempts over half a century to circumvent such debt limits,<sup>84</sup> I believe that such limits are wholly unrealistic and ought to be revised or abolished entirely.

However interesting the theories for and against debt limitations may be, in my experience no theory has worked either to explain or describe solutions. Apparently New York City looks upon debt limits as an authorization to spend to the limit and then some.<sup>85</sup> It has been pointed out that the city is probably discriminated against because it is a single entity, and does not have the aggregate debt limit advantages that areas overlapping villages, towns, counties, fire districts or school districts may have.<sup>86</sup> The abandonment of debt limits would, in my opinion, restore the only true test, and the only discipline, that can be brought to bear on a municipality. This is the test and discipline of the marketplace. If New York City, for example, continues to be effectively exempt from that test by virtue of federally guaranteed obligations or through MAC, there is no straightforward way of determining the amount of debt that the city could sustain as an independent, self-sufficient borrower of public funds.

Additionally, the Committee's proposal to move debt limits from the constitution to the domain of the legislature merely subjects the inflexible to the politically expedient, although it appears to be tempered somewhat by a requirement that debt limits pass two sessions of the legislature.<sup>87</sup> If, as a matter of policy, it is decided that there should be some limit on the issuance of debt, it would be much more effective to structure it in terms of *per capita* debt, and to recognize that real estate valuations are not the sole source of security for municipal debt. The Committee proposals fail to ad-

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83. *Levy v. McClellan*, 196 N.Y. 178, 89 N.E. 569 (1909); *People ex rel Guaranty Trust Co. v. Cook*, 18 N.Y.S.2d 965 (Sup. Ct.), *aff'd*, 261 A.D. 993, 27 N.Y.S.2d 999 (2d Dep't 1940).

84. *Wein v. City of New York*, 36 N.Y.2d 610, 331 N.E.2d 514, 370 N.Y.S.2d 550 (1975); *Comerski v. City of Elmira*, 283 A.D. 556, 128 N.Y.S.2d 913 (3d Dep't 1954), *aff'd*, 308 N.Y. 248, 125 N.E.2d 241 (1955). See Comment, *The Constitutional Debt Limit and New York City*, *infra*, at 185.

85. *Macchiorola*, *supra* note 14, at 273.

86. *Id.* at 274.

87. PROPOSED LOCAL FINANCE ARTICLE § 3(a), *Proposals*, *supra* note 1, at 54 (reprinted in Appendix A).

dress the former point, although in tying debt limits to revenues they address the latter point.

Regarding tax limits, the Committee's proposal to retain the present provision avoids addressing the serious problems confronting several of our larger municipalities, in particular, the problem of financing operating expenses. Cities that have attempted, for example, to finance operating expenses in a capital budget have not been successful when challenged in the courts,<sup>88</sup> and, consequently the state legislature has been forced to face this problem each year with imaginative methods of circumventing court decisions.<sup>89</sup> A full review of tax limitations in relation to operating budgets should be undertaken, especially for New York City, because the result of the Municipal Assistance Corporation's financings have, in part, rendered tax and debt limits academic.<sup>90</sup>

## VI. Summary

Article VIII, section 1, has worked as a restraint on cities pledging and using their taxing power for the purpose of aiding or guaranteeing debts of private corporations and has not been seriously circumvented. Repealing the "gift and loan" provision would directly permit a municipality to invest in the stock of private corporations or to guarantee the financing of private capital expenditures. Accordingly, the wisdom of the repeal of article VIII, section 1, remains a political and social question, not one related to the failure of a constitutional and legal restraint. Certainly, most states have not yet authorized their municipalities to issue general obligation bonds for the purpose of financing industrial development and economic expansion as the Committee suggests.<sup>91</sup>

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88. *Hurd v. City of Buffalo*, 41 A.D.2d 402, 343 N.Y.S.2d 950 (4th Dep't 1973), *aff'd*, 34 N.Y.2d 628, 311 N.E.2d 504, 335 N.Y.S.2d 369 (1974); *Waldert v. City of Rochester*, 90 Misc.2d 472, 395 N.Y.S.2d 939 (Sup. Ct. 1977), *modified sub. nom. Bethlehem Steel Corp. v. Bd. of Education*, 61 A.D.2d 147, 402 N.Y.S.2d 665 (4th Dep't), *aff'd*, 44 N.Y.2d 831, 378 N.E.2d 115, 406 N.Y.S.2d 752 (1978).

89. See Comment, *The Constitutional Debt Limit and New York City*, *infra*, at 183.

90. The need for this is underscored by other issues raised by the tax and debt limitations. For example, the assessment of real property, as required by N.Y. REAL PROPERTY LAW § 306 (McKinney & Supp. 1978), which has been the subject of substantial litigation (*See Merrick v. Board of Assessors*, 45 N.Y.2d 538, 382 N.E.2d 1341, 410 N.Y.S.2d 565 (1978); *Hellerstein v. Assessor of Town of Islip*, 37 N.Y.2d 1, 332 N.E.2d 279, 371 N.Y.S.2d 388 (1975) and the overlapping jurisdiction situation (*see, e.g., N.Y. CONST. art. VIII, §§ 2, 3*).

91. *Proposals*, *supra* note 1, at 85.

To the extent that innovative financing can help the rehabilitation of the city, the constitutional restraints should be reviewed, assuming tax abatement has not entirely eroded the tax base. To this end, it does not seem appropriate to continue to require the pledge of faith and credit. This only encourages the establishment of separate authorities or trusts to achieve special project financing. There may be independent reasons for establishing authorities, but the ability to issue revenue bonds need not be one of them. To advocate such a repeal, however, we must have confidence in our elected officials. The time to consider the repeal of the loan of credit prohibition is not now, but only after the city has proven its ability to issue its general obligation bonds for its traditional purposes. Thereafter, it would be appropriate to consider whether economic development can be accommodated within the purposes for which the city must issue its bonds.

Second, the "first revenue" appropriation provision to debt service should be recognized as useless and abandoned. However, consideration should be given to constitutionally mandated debt service levies segregated from the general fund. This would improve the credit of New York's communities.

Third, debt and taxing limits have been seriously circumscribed by the establishment of authorities and serious consideration should be given to the adoption of a market-oriented test for limiting tax rates and establishing debt limitations.

Finally, the classic example of circumvention of a constitutional restraint has been the issuance of bonds by public authorities or municipalities and the use of lease financing for purposes that originally should have been the subject matter of a state general obligation bond. However, the difficulties that attend the passage of a state bond referendum are well known.<sup>92</sup> Governor Rockefeller tried twice to have housing financed by general obligation bonds. Only after the issue was twice defeated did he move for the creation of the New York State Housing Finance Agency with its moral obligation provision. The debt attributed to the State of New York in the last twenty years through the authorities and the moral obligation has had a serious impact on the credit of the city and the state and

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92. See, e.g., *New York Public Interest Research Group, Inc. v. Carey*, 59 A.D.2d 172, 398 N.Y.S.2d 968 (3d Dep't), *rev'd*, 42 N.Y.2d 527, 369 N.E.2d 1155, 399 N.Y.S.2d 621 (1977).



has not in any significant way restricted the amount of debt, albeit, most of it has not been a general obligation debt.<sup>93</sup> Accordingly, because of the continued successful circumvention of the State referendum requirement, it may be appropriate to begin serious debate on the usefulness and the effectiveness of the voted debt requirement. Certainly, general obligation financing by the State would save some of the tax dollars that are used to support indirect financings.

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93. Comment, *The Constitutional Debt Limit and New York City*, (pt. III) *infra*, at 185.

