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Local Finance Notice

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Impact of Superstorm Sandy on Local Government Finances

This Local Finance Notice is being shared in response to numerous questions the Division received concerning Superstorm Sandy's impact on New Jersey local government finances. The Notice is intended to help those local government officials undertaking a note sale or bond issuance articulate to the financial community why New Jersey local government debt, even among those communities most adversely impacted by Sandy, remains a sound investment option. The Division strongly encourages all local government professionals involved in issuing notes or bonds to share this Notice in the course of its debt sales to obtain the best possible interest rates.

INTRODUCTION

The Division of Local Government Services (the Division) is the State of New Jersey's regulatory authority with respect to the finances of counties, municipalities, local authorities and fire districts. A State entity called the Local Finance Board is staffed by, and shares certain regulatory jurisdiction with, the Division. Together, the Division and Board have extraordinarily broad powers to ensure local government financial solvency, integrity and stability. New Jersey is set apart from many other States where local governments have comparatively little State oversight.

The Division and Board place a premium on maintaining a strong relationship with the financial community; understanding that our local governments' ability to recover from Sandy will be hampered without the trust of investors. The flip side is equally true – with a strong relationship and the trust of investors, local governments will be ensured the ability to access capital at reasonable rates for purposes of rebuilding.

**THE FUNDAMENTAL STRENGTH OF STATE'S FINANCIAL REGULATORY SYSTEM ENDURES;
CONTINUING THE TRADITION OF NEW JERSEY LOCAL GOVERNMENT DEBT BEING AMONG
THE MOST STABLE INVESTMENTS IN THE COUNTRY**

The reason all New Jersey municipalities have made their full debt payments for over 80 years – even in the most trying times (as when credit froze during the 2008 financial sector turbulence) – is strong state oversight.

In New Jersey, municipalities must receive Division approval before adopting their budgets. The Division will only approve a budget for adoption if it contains sufficient appropriations to pay debt obligations. Certain municipalities are permitted “self-examination” and are only subject to State examination every third year. The Director of the Division has determined that any municipality estimated by the Division to have a potential ratable loss exceeding 5% due to Sandy impacts will be subject to State-examination and will not be eligible for self-examination. If any municipality fails to set forth a budget with sufficient appropriations, the Division has the authority to unilaterally set the local government’s tax levy and adopt their budget in lieu of local action. As an additional safeguard, no local government may file for Chapter 9 Bankruptcy without first receiving the approval of the Board – and no such approval has been given for 80 years. The Division routinely reminds local governments that it could well be another 80 years before such approval is granted.

Our fundamental system is enhanced by further State involvement. To ensure quality actors, the Division licenses Chief Financial Officers, Tax Collectors, Clerks and other professionals involved in local government finance. The Division regularly provides guidance, technical assistance and continuing education for local government officials. State law imposes conservative investment discipline among municipalities and other local government entities. When municipalities face distress, or are in danger of becoming distressed, the Division possesses some of the strongest statutory and regulatory authority in the country to effect aggressive State intervention.

Bottom line: the Division uses its authority to assure that all obligations, including principal and interest of bonds and notes, are paid timely and in accordance with their terms. None of this is changing any time soon. New Jersey will continue providing a local government oversight model for the rest of the country to follow.

**THE DIVISION HAS COMPLETED A THOROUGH PRELIMINARY REVIEW OF SANDY'S
FINANCIAL IMPACTS ON LOCAL GOVERNMENT FINANCES**

Our review has consisted of the following:

- Affirmatively reaching out to every coastal community to discuss estimated tax base losses and damage assessments.
- Contacting every bond counsel in the State and discussing various disclosure documents that discuss financial concerns.
- Analyzing aerial photography of damaged areas.
- Conducting teleconferences with various municipal officials.
- Reviewing claim filing data collected by New Jersey’s Department of Banking and Insurance.
- Analyzing miscellaneous State and local documents prepared by various officials explaining the impacts of Sandy on communities.

No New Jersey municipality's 2012 budget experienced a loss of revenue from Sandy that triggered Division concern about inability to make a debt service payment. Final property tax collections for the year were statutorily due November 1. The grace period for payment without penalty was extended beyond 10 days in certain municipalities, but no extensions crossed the fiscal year or disrupted tax sales. Property tax collection rates were comparable to those in the prior year. It should be noted that unlike municipalities in other States, local revenues in New Jersey are not contingent on a local sales tax or other sources of revenue vulnerable to short term business disruption, which would account for the strong finish for revenue realization in 2012 even in the hardest hit communities. Finally, the State's financial condition was strong enough to have made its final aid payments to the more than 550 calendar year municipalities on time, on schedule and consistent with the anticipated amount of aid.

The Division of Local Government Services has identified those municipalities potentially facing challenging calendar year 2013 revenue losses – primarily from reductions in taxable property assessments. As of the date of this writing, the Division believes there are fewer than 15 municipalities that could potentially lose 10% or more of their tax ratable base; and an additional approximately 10 municipalities that could potentially lose more than 5% but less than 10% of their ratable base. These internal advisory, consultative, and deliberative planning estimates are updated daily by the Division as better data becomes available and has been used. It should be noted these losses are mostly temporary as most damaged properties will be repaired and/or rebuilt. More firm data will become available in late January or February as assessors complete revised assessments for damaged properties.

The Division has been meeting individually with all municipalities where the Division believes ratable base losses could potentially reach 10 percent or more to establish an ongoing discussion of their 2013 budget challenges. In these meetings, the Division seeks to ensure that appropriate budget planning is taking place and that municipalities are aware of, and aggressively pursuing, any and all financial assistance available whether through insurance, State programs or Federal programs. The Division also offers affirmative technical assistance. Mayors and their senior administrative and budget staff are encouraged to attend. The Director of Local Government Services, along with Division professionals with expertise in FEMA matters, accounting, tax collection, shared services, public procurement and other relevant disciplines, attend these meetings. More than half of the initial meetings have transpired. Additional meetings are scheduled for early 2013.

SHORT TERM NOTES CONTINUE TO BE RELIABLE INVESTMENTS

For the following reasons, short term notes continue to be sound investments:

- 1) As noted, 2012 budgets ended well, even for hard-hit communities. Tax payments were mostly made for 2012 and tax sales, where scheduled in approximately 100 communities, proceeded as scheduled.
- 2) Payments of all debt, including short term notes of single or multi-year maturity, are exempt from New Jersey's property tax levy cap whether or not such debt relates to the costs of an emergency.
- 3) Most of the money borrowed to pay storm-related costs will be eventually reimbursed by FEMA. Power restoration and certain exigency costs for a period of time after the storm are

being reimbursed at 100% rate with the balance of reimbursable costs being reimbursed at a rate of 75%, though there are efforts to secure a 90% reimbursement rate for the balance of reimbursable costs. IMPORTANT CHANGE FROM PAST STATE POLICY: Upon issuance of estimated project costs by FEMA, the State has been issuing cash assistance to local governments equal to 50% of the federal share of FEMA's estimated project costs. This is a departure from a past practice where the State issued reimbursements far more slowly. Such expedited assistance will reduce municipalities' need to issue short term notes at all and help ensure that municipalities have the cash flow necessary to promptly pay down notes issued.

4) The Division is in regular contact with agencies responsible for issuing FEMA assistance. Those agencies have committed to being receptive to Division guidance on which municipalities may warrant expedited review and approval of reimbursements to prevent cash flow problems.

5) The State has the authority to make short term loans to those fiscally distressed municipalities having exhausted all efforts to obtain or renew short term loans in the private sector. These loans are generally only available for those municipalities that have attempted to sell notes through a competitive sale and/or have had extraordinary difficulties with negotiated transactions. Loans can be made with Treasurer and Division approval and there is no regulatory delay associated with Legislative or Board actions. The State budget language authorizing such loans, which is very broad, states the following:

The State Treasurer, in consultation with the Commissioner of Community Affairs, is empowered to direct the Director of the Division of Budget and Accounting to transfer appropriations from any State department to any other State department as may be necessary to provide a loan for a term not to exceed 30 days to a municipality faced with a fiscal crisis, including but not limited to a potential default on tax anticipation notes.

Our assessment of the short term market has been bolstered by recent successful note sales in hard hit communities including Bay Head, Mantoloking, Lavallette, Union Beach and other shore municipalities. The Division appreciates the investors who have bid on those note sales and who successfully lent money at competitive rates.

NEW JERSEY LOCAL GOVERNMENT LONG TERM DEBT WILL CONTINUE TO BE A RELIABLE INVESTMENT

The State is assessing the impacts to property tax ratable bases throughout the affected areas, and is working to facilitate rebuilding those ratable bases to ensure long term financial sustainability and stability. Ongoing efforts by the State include:

1) Aggressively promoting Federal and State grant and loan programs that can help residents rebuild and help businesses open their doors.

2) Strongly lobbying to maximize federal grant and loan programs through a bipartisan coalition of State and federal officials throughout the region.

3) Allowing, through the State Department of Environmental Protection, a "build first and apply for permits later" policy for rebuilding.

- 4) Focusing the State Environmental Infrastructure Trust Program on providing towns with low interest loans for infrastructure improvements crucial to sustain rebuilding efforts.
- 5) Encouraging the waiver of local reconstruction approvals and fees where appropriate.
- 6) Expanding the availability of code professionals at the State and local level to get buildings quickly certified for occupancy.
- 7) Advancing beach reconstruction, replenishment and other protective measures to prevent recurrences of damage.

For those Sandy-impacted communities requiring short term help until redevelopment is substantially completed, relief may be available from the Federal government through the Community Disaster Loan Program. That program allows loans in areas where revenue sources have been significantly impacted – greater than a 5% loss of revenue. Loans are offered at very low rates (currently less than 1%) and can be extended or forgiven in certain circumstances. The Program has been activated by the Federal Government, and our Division has met with senior officials to better understand the program. We are in the process of issuing more formal guidance about how to appropriately apply for assistance. Local government entities will have to work through the Division when seeking assistance. In the event federal assistance is insufficient, there is also a State Transitional Aid Program that can provide assistance in the form of grants and loans for municipalities in distress. Overall funding for that program will be determined in the State's Fiscal Year 2013-2014 budget, which begins in July 2013.

Additionally, New Jersey's local governments are permitted to purchase the notes of other local governments as investments. In the past, this option has only been utilized by two local governments (Monmouth County and the Township of East Brunswick). However, other municipalities that the Division recognizes as having exceptionally strong financial conditions are being encouraged to participate as necessary to: (1) provide additional liquidity assurance for challenged municipalities; and (2) allow the local governments with sufficient cash reserves to receive better rates of interest from these prudent vehicles than they may otherwise receive from their other short term investments. Only municipalities determined by the State to be in strong financial positions with adequate reserves will be permitted to make such purchases.

As noted previously, the State itself can make loans directly to prevent a default. Our 80 year track record of payments being made has shown that the State steps up to the plate when it must in the form of aid or loans.

Municipalities can also enter a State Aid intercept program called the Qualified Bond Act Program, making their long term debt even more attractive for investors. Once the Local Finance Board grants a municipality's application to enter the Program, the State withholds the municipality's aid and places it in escrow for payment of municipal debt; giving investors an added layer of assurance that funds will always be available to pay long term debt. The Qualified Bond Act Program will greatly benefit larger communities where annual State Aid exceeds debt service payments.

**SANDY DISRUPTIONS AT TOWN HALLS DID NOT CREATE AN OVERWHELMING ISSUE –
WHAT STATE IS DOING TO PREVENT LATE MUNICIPAL PAYMENTS**

Disruption in municipal buildings is behind us; those communities that were evacuated are running again with municipal operations having been relocated as necessary. Only two disrupted municipal governments paid debt service late, and in these cases payments were made one day and two business days late respectively. The municipal disruptions consisted of a complete evacuation of one municipality and severe flooding and loss of communications in the other. In neither instance did cash flow or financial issues lead to the late payments. These two local governments have taken steps to ensure automating debt payments in the future to prevent reoccurrences – even in similarly 100 year storm conditions. Both had their ratings affirmed.

At its December 12, 2012 meeting, the Local Finance Board began the process of imposing new rules on local governments requiring to the establishment of automated debt service payment with strict reporting requirements. New Jersey places top priority on ensuring its local governments pay debt service on time, every time – even when there is a thousand year storm.

CONCLUSION

In conclusion, the Division thanks local officials and those in the investment community for taking the time to read this Local Finance Notice. The Division and our local governments appreciate the investment community's well-placed trust in the financial stability of our local communities.

Approved: Thomas H. Neff, Director, Division of Local Government Services