City of Atlantic City, NJ

Supplement to the Five-Year Recovery Plan

Submitted to the State of New Jersey Department of Community Affairs

November 3, 2016

On October 25, 2016 the City of Atlantic City (the "**City**") submitted its Five-Year Recovery Plan (the "**Plan**") to the Commissioner (the "**Commissioner**") of the Department of Community Affairs (the "**DCA**"). On November 1, 2016, the Commissioner issued a "Review of the City of Atlantic City's Recovery Plan Pursuant to the Municipal Stabilization and Recovery Act" (the "**Review**"). The Review concluded that the Plan "is not likely to achieve financial stability." The City believes strongly that this is the wrong conclusion, and is concerned that the basis for this finding rests on an inaccurate and incomplete review.

The City is requesting that the Commissioner reconsider that determination in view of the information provided herein that addresses the issues raised in the Review. To assist the Commissioner in better analyzing the Plan, the City determined to supplement the Plan with this document. The information herein was presented in the Plan in summary fashion, has been available throughout the initial review period, and is now provided within the City's 150-day period for Plan submittal. We believe this submittal will ensure that the Commissioner has the information desired to complete a thorough and accurate review. Our goal is to assist the Commissioner in more fully understanding how the Plan is, in fact, likely to achieve financial stability.

Before beginning this process, however, we believe there is value in summarizing the implications of the Review because, as will be described below, the implicit result of rejecting the Plan will be to thrust Atlantic City deeper into fiscal crisis; missing the opportunity, now available with the Plan, to begin an upward trajectory.

First, the Review concluded that because it disagrees with several key assumptions in the Plan, the City is facing an approximately $22 million average annual structural deficit after all of the expense cuts and revenue enhancement initiatives set forth in the Plan are met. As will be illustrated below, these conclusions are based largely on choices fully within the discretion and control of the State and DCA. It further concludes that neither the Atlantic City Municipal Utilities Authority (the **"ACMUA**") nor City proposed bond financings "seem achievable" even though City outreach to the market strongly indicates otherwise, if State partnership and support for the Plan is part of the approach going forward.

These State conclusions are driven largely by which path the State itself chooses at this juncture. If Plan rejection remains the course adopted by the State, the direct result is no solution to $215 million of identified, unfunded liabilities, which will only continue to grow. In turn, the resulting pressures on the operating budget will ensure continued crisis, require more costly measures to maintain cash solvency, and impede the City's economic recovery indefinitely.

As the Plan clearly demonstrates, without a balanced budget and liability resolution, MGM and Borgata will likely continue to take credits against their obligations thereby depriving the City of approximately $39 million in annual revenues. Further, the City will have to account for amounts owed to the State for 2015 Deferred Liabilities ($46 million) and other tax appeals ($30 million). Together, these two items will have an additional impact on the budget of approximately $9.06 million[1] – a shortfall that could not, under any circumstances, be solved without substantial additional State Aid and draconian local impacts.

The Review's solution to this problem is to dissolve the ACMUA. Unfortunately, without rate increases, the incremental annual benefit to the City budget from such a transaction is approximately $3 million, even if a thorough and successful process can be achieved during 2017 at all. Accordingly, the only remaining solution for the State in 2017 would be to raise taxes over 125% or layoff approximately 700 employees[2] assuming the State is not interested in providing the City with an additional $65+ million[3] in Transitional Aid ("**TA**") (above and beyond the $13 million included in the Review).

Recognizing that the Commissioner is limited to an evaluation of whether the Plan is likely to achieve financial stability, it is no less important to consider the financial instability that would be created by rejection of State partnership to advance the Plan. The result as described above is untenable. Further complicating such a decision by the State is that there will be no multi-year financial plan providing comfort to the rating agencies and capital markets which, in turn, will perpetuate market access issues, deter community investment and foment political unrest.

For these reasons, we respectfully ask that the Commissioner reconsider his decision based upon the additional information provided herein and allow the City to implement the Plan, with conditions, if he so determines, that are beneficial toward enhancing the likelihood of financial stability. This will provide a strong platform for the City and all of its stakeholders to move forward while the State retains the right to step in and take control if, at any time, the City falters with implementation of the Plan.

---

[1] The 2015 deferred pension obligations are accruing at a 10.14% rate which, if amortized as level debt service over 10 years would be approximately $3.56 million/year. The 2015 deferred health benefit obligations are accruing at an adjustable rate, however using the most recent rate of 3.42%; the annual level debt service obligation over 10 years would be $2.5 million/year. Thus, total budget impact per year of these two items (if not paid for with proceeds from sale of Bader Field) is estimated to be $6.06 million/year. If the S30 million portion of the proceeds from Bader Field described above for tax appeals are otherwise funded equally over 10 years, without interest, this will add $3 million to the shortfall. All, in unless such costs are funded through an asset sale it adds an additional $9.06 million to the budget short fall.

[2] Not including the related costs of such a layoff such as cashouts and unemployment benefits.

[3] This number is the product of the State estimated shortfall of $17.7 million plus $39 million in MGM & Borgata credit of the $9.06 million stated in footnote 1.

ADDRESSING THE REVIEW COMMENTS

Revenue Projections:

Section VI. of the Review ("**Analysis of the City's Plan**") includes a discussion of various City and alternative revenue forecasts. Before addressing each of these items individually, the City notes that it is common for revenue forecasters to reach somewhat varying projections for the same jurisdiction, and it is a recognized best practice for multiple stakeholders (e.g. executive and legislative fiscal analysts, in a more typical example) to develop a consensus revenue forecast. Given DCA's position that it could not advise the City on Plan development because of the Commissioner's role as evaluator of the Plan, the City was unable to engage in this type of consensus process with DCA during Plan development. At this stage of the process, however, the City would be happy to pursue development of a consensus forecast as part of advancing a successful partnership and Plan.

In addition, the City would note at a general level, as also recognized in the Review, that the variances in the forecasts between the Plan and Review were found in both directions – i.e., the City had higher revenue forecasts than DCA's estimates in some categories, and lower in others. Further, the City used conservative practices in other areas of its overall revenue forecasts not referenced in the Review. As a result – particularly when further viewed in combination with the budgeted reserves and conservative expenditure forecasts also included in the overall Recovery Plan – the City believes that any remaining net variances identified in the Review are fully manageable within an overall framework likely to achieve financial stability, so long as there is State partnership and support for revenue sources fully under State control.

Review Comment:	The Plan did not provide detail on Revenues; particularly on "Local Revenues" and "Other Revenues."
City Response:	**SEE EXHIBIT A.**
Review Comment:	The Plan did not allocate accelerated tax sale and land sales properly among 2016 and 2017.
City Response:	As the Review notes, this adjustment would add $4.5 million to the revenue estimates in the Plan, thereby enhancing the likelihood of achieving financial stability during the Plan period. Further, it may be noted that the Plan assumes no revenues from property sales reaching agreement after 2016 at all, even though active programs are underway to dispose of foreclosed properties and unused municipal assets. The City

estimates that this would generate an additional $6 million over the five-year Plan period, which – for conservatism - is assumed in the Plan only as a supplemental resource for funding productivity investments, and is not applied to fiscal gap closure (pages 72-73 and 83 of the Plan).

Other conservative revenue assumptions not acknowledged in the Review include: potential parking revenue gains beyond the initial contracted program (page 78 of Plan); a 2019 start date for the $1.4 million Stockton PILOT, despite a 2018 scheduled project completion (page 79 of Plan); the potential for additional PILOTS from nonprofit institutions (page 79 of Plan); and new non-tax revenues from beach fees and municipal advertising (pages 81-82 of Plan). For conservatism, this "next wave" of non-tax revenue enhancements being pursued to build on the recent parking meter and cost recovery (fee) initiatives was not credited toward fiscal gap closure in the Plan. In each case, however, these initiatives support the likelihood of the City achieving financial stability and generating the capacity to offset shortfalls elsewhere.

Review Comment: The Plan underestimates County share of payment in lieu of taxes ("**PILOT**") from the casinos, and provides no support for its assumption that a 10.3% County share of the PILOT would be reasonable or appropriate.

City Response: The Act provides that the Pilot shall be allocated "in the same manner as property taxes are paid to counties and school districts." Accordingly, the Plan allocates the PILOT on an annual basis aligned with the same percentages calculated each year for each entity for total non-casino property taxes. This approach is intrinsically fair, reasonable, and appropriate, because it allocates the PILOT in exactly the same proportions as the revenue stream which it replaces.

We believe this is the most reasonable method for allocation, but sought the advice of DCA on this issue because the law also provides discretion to the Local Finance Board to allocate a specific portion to the County. Given DCA's position that it could not advise the City on Plan development, no direction was received.

While the City is aware that County representatives have previously sought a higher (13.5%) share, such a larger allocation to the County is not included or referenced in the Casino Property Tax Stabilization Act (the "**Stabilization Act**"). Further, as noted on page 113 of the Plan, the City's consultants met with Atlantic County officials to discuss this and other issues during plan development. During those discussions, County officials acknowledged that this PILOT allocation was not a resolved matter, and explained their position that a 13.5% figure represented an approximate long-term average for the County's share of total tax receipts that might be more reflective of future trends than a single-year figure.

In developing the Plan, the City listened to this County concern, and included an approach that would adjust the County and School District shares on an annual basis based on the actual tax rates in each year, rather than locking into any one particular rate. For forecasting purposes only, the estimated 2016 share was used for each entity. In using this figure in its projections, the City acknowledges that this share may vary from year-to-year, but believes that this approach is highly conservative overall given the expectations for the much larger School District allocation, as further outlined below.

Review Comment: The Plan overstates School portion of the PILOT.

City Response: As described above, the Plan views the most reasonable and appropriate allocation of PILOT payments to other public entities to be to do so based on each year's share of the total tax rate within the City for non-casino property taxes. For the School District, changes in statewide school funding practices create a strong likelihood that the school tax levy in Atlantic City will decrease, such that the School District share of the PILOT would also decrease under this approach. In turn, should this occur, the effect will be to increase the City's share of the PILOT over time.

While the Review does not fully detail its analysis of the School District PILOT allocation, this may be why the Review projects that the City's payment obligation to the School District will be $10 million lower than the Plan assumed. Further, if the Commercial Valuation Stabilization Aid included in the Governor's 2017 Budget is adopted, or another funding reform enacted with similar impact, the resulting School District levy reductions could further increase the City's share of the PILOT beyond these DCA-projected levels.

Review Comment: The Plan overestimates the Investment Alternative Tax (the "**IAT**").

City Response: For IAT forecasts, the Plan relied on forecasts provided by the Casino Reinvestment Development Authority (the "**CRDA**"), which has historically received these revenues, to estimate future net IAT receipts. The Review raises the possibility that these CRDA forecasts may not account for new credits for which some casinos could become eligible under the provisions of the Tax Stabilization Act. In the Review, insufficient information was provided for the City to evaluate the assumptions underlying Nassau Capital Advisers' projected impact of these credits, nor to assess the impact of evolving events such as the potential reopening of TEN (the former Revel property) or other casinos on these estimates. As part of a consensus revenue process, the City would welcome the opportunity to further evaluate the Nassau analysis.

Review Comment: The Plan overestimates TA.

City Response: The City recognizes that TA is a discretionary State funding source, but also believes that the unprecedented and extraordinary economic transition experienced by Atlantic City is exactly the type of circumstance for which this program has been established.

While the City also acknowledges the general guidelines promulgated by the DCA for TA applications and awards, the City believes that DCA has the full flexibility to adopt the approach proposed in the Plan to address these extraordinary conditions. In multiple other New Jersey cities experiencing far less abrupt economic challenges, DCA has previously provided TA awards that did not decline by 15% annually and/or has "converted" TA dollars into increased the Consolidated Municipal Property Tax Relief Aid ("**CMPTRA**") funding. Similarly, again consistent with the key goals of the State Emergency Manager, DCA has previously recognized the doubling of Atlantic City's property tax rates from 2010 to 2015 by not requiring additional tax rate increases when TA was awarded in 2015.

The Review also clearly shows that assuming some TA was expected by the State. We sought advice on the appropriate number from the State and were advised that no guidance would be forthcoming. Given DCA's legal flexibility and past actions, the City continues to believe that its proposed 15% annual phase-down of TA beginning in 2018 (one year after Atlantic City Alliance funds decline by $15 million) is consistent with the program goals, reasonable and warranted, and fully within DCA's discretion.

Review Comment: The Plan does not raise taxes.

City Response: The Plan goes into great detail about how much taxes have already been raised in the City, the resulting high tax burdens, and why further tax increases will not be in the interest of the City, neighboring communities and Atlantic County. It may also be noted that one of the State Emergency Manager's two "key goals" for 2015 was "stabilizing the property tax with little or no increase in property tax rates" (City of Atlantic City, Update Report of the Emergency Manager, January 15, 2016, page 8, emphasis added. On page 43 of this most recent Emergency Manager's report, it may also be noted that tax rates were held constant in these January 2016 State projections throughout the FY2016-2020 projection period). The City believes strongly in stable tax rates as a policy matter. Nevertheless, the State clearly has the authority to impose taxes if it disagrees with this policy. Because the Plan does not require such increases we continue to strongly recommend against any increases. Atlantic County and the City have the highest foreclosure rates in the county and higher taxes will only exacerbate that.

Review Comment: The Plan overestimates real estate taxes. The Review estimates such taxes to decline annually beginning in 2018 while the Plan estimated such revenues remain flat over 5 years.

City Response: The Review and the analysis of its advisers (Nassau Capital Advisors, LLC) forecasts property tax base trends of no change in 2017, with declines of 5% for 2018, 4% for 2019, 3% for 2020, and 2% for 2021. As noted above, however, forecasters can reach different conclusions. Earlier this same calendar year, for example, the State Emergency Manager similarly forecasted no change to the property tax base in 2017, but projected growth of 5% in the City's ratables for each of 2018 and 2019, citing the positive activity of ACDevCo and other ongoing efforts to redevelop vacant and previously tax exempt land (City of Atlantic City, Update Report of the Emergency Manager, January 15, 2016, page 43).

Since the State Emergency Manager's report was published earlier in 2016, ACDevCo has indeed broken ground on the major Stockton University-South Jersey Gas-Gateway project, the City has sold and shifted multiple properties onto the tax rolls, a major program to address and sell vacant properties has advanced in the City's neighborhoods, a broader base of proven urban developers has begun investing in Atlantic City, and multiple other redevelopment initiatives are underway – all as outlined in the Plan's "Economic and Community Development" section on pages 95-103.

Also of note, gaming revenues have stabilized and turned upward in 2016, and the remaining casinos are reinvesting in their facilities (which, even where covered under the PILOT, will contribute positively to overall City economic activity and property values). Further, the recent sale of a significant interest in the Borgata at a market price well above the implicit assessed value strengthens the City's position in pending tax appeals, and substantial reserves are included in the Plan to fund settlements and any adverse rulings.

In light of all of the above factors, the Atlantic City Assessor's view is that property values in Atlantic City have now stabilized, with the potential for an upturn within the five-year plan period. As a matter of conservatism, however, the Plan does not assume the 5% ratable growth for 2018 and 2019 used in the State Emergency Manager's 2016 Update Report nor develops a new growth factor reflective of the City Assessor's perspective on potential opportunity. Instead, the Plan assumes a flat tax levy in each year of the next five years.

For 2017, this Recovery Plan assumption is consistent with the 2016 assumptions of both the State Emergency Manager's Report and the analysis by Nassau Capital Advisers released subsequent to Recovery Plan development within the Review. In 2018-2021, the Recovery Plan assumes a rate between those in these two State reports, which the City believes to be reasonable and conservative based on recent redevelopment activity. Further, in the event that out-year experience does vary negatively from these Recovery Plan assumptions, the magnitude of such an outcome would remain manageable through a range of potential mid-course corrective actions and the significant reserves for tax appeals and other actions included in the Plan.

In the aggregate, the revenue concerns cited in the Review fall into two categories – technical and policy.

- For the policy issues under DCA's control – Transitional Aid and determination of the allocations of the PILOT – the City believes that its Recovery Plan approach is reasonable, and fully justified by and consistent with historical practice. All that is required is the State's continued partnership and support and these "deficits" are resolved.

- For the various technical issues raised in the Review, the City is confident that a consensus revenue approach would support balance within the Plan's parameters, and that financial stability will be achieved. For some line items, the Review concluded that its consultant's estimates were lower than those developed by the City (ratable base, IAT). In other cases, however, the DCA consultant estimated revenue levels higher than the City's estimates (PILOT net of the School District allocation, property sales, accelerated tax sale).

In the aggregate, these DCA technical variances result in a 2017 revenue forecast approximately $2.7 million higher than the City's forecasts for 2017, excluding the TA and County allocation percentage within DCA control. While these Review technical revenue projection variances do subsequently result in a net shortfall across the out-years, the City believes that rejection of the Plan based on inherently uncertain economic projections for periods several years into the future would be unwarranted and premature – particularly given that the State's own projections reflect inconsistent views on these forecasts, and that the Nassau property tax projections are the outlier forecasts. In fact, simply substituting the State Emergency Manager's ratable base growth assumptions from January 2016 instead of those used by Nassau Capital would effectively eliminate the entire projected net revenue shortfall across all categories based on technical concerns (i.e., other than TA and the County share of the PILOT questioned by DCA on policy grounds).

No less important, even if Nassau Capital Advisers' pessimistic view were to come to pass, the net adverse impact would still be manageable based on the availability of an estimated $6 million in unbudgeted asset sales, the multiple other conservative revenue assumptions referenced above, additional conservative expenditure assumptions further highlighted in the section to follow, and the significant Budget Stabilization and Tax Appeal Reserves included in the Plan. Again, fair and reasonable State partnership is all that is required to achieve revenue stability and sufficiency.

Expense Projections:

Review Comment:	The City did not address lucrative salary and benefit packages.
City Response:	Contrary to the statements on page 8 of the Review, the City has evaluated salary and benefits packages for its employees, inclusive of work rules, and has negotiated significant changes to cash compensation, health and welfare benefits, paid leave, overtime, and multiple other areas of these agreements as highlighted on pages 62-65 of the Plan and fully documented in the ratified agreements provided to DCA within the initial five-day review period.
Review Comment:	The City did not reduce fire personnel to 150 persons.
City Response:	Contrary to the statements on page 8 of the Review, the City has reduced its locally funded firefighter staffing from 235 to 150. The difference between the figures cited in the Review and the Plan reflects 85 positions funded by a federal SAFER grant. It is important to note that the State originally directed the City to apply for the SAFER grant.
Review Comment:	The City did not implement 50 person layoff plan.
City Response:	Two layoff plants were pursued by the City. One that impacted 22 people was withdrawn, although many of such persons are no longer employed by the City. The second was implemented. The City will continue to pursue structured layoffs as required and appropriate to achieve savings set forth in the Plan.
Review Comment:	The City did not transfer tax assessor services.
City Response:	On May 29, 2015, Kevin Lavin and Michael P. Stinson met with the Atlantic County Tax Administrator and her Deputy to discuss possible alternatives. They were told that the County could not consolidate the City's Tax Assessor's Office absent any State legislation. The State has two county wide PILOT programs, but Atlantic County is not involved.
Review Comment:	The City did not account for an additional $30 million in tax appeals.

City response: The City has in its projected plan budget $15 million over five years to pay for tax appeals in addition to more than $30 million raised in the Bader Field sale, and thus is fully able to cover expected settlements during the five-year period. No additional $30 million has been identified by the City, and this figure in the Review is inaccurate. Although the full claims in hand do exceed the Recovery Plan reserves, such claims are never paid at 100%, and the City Solicitor believes it has a strong position in any litigation, particularly in light of the recent sale of a portion of the Borgata property at a price well above the most recent valuation. The remaining, unresolved appeals are primarily recent claims and need to be litigated over the next several years to determine value. In the unlikely event that resolutions are less favorable than now anticipated, the City would consider issuing tax appeal notes in years 4 or 5 of the Plan, but at this time believes it has included sufficient resources within the Plan to meet realistic settlement expectations.

Review Comment: The Plan did not include a list of the exact 100 cuts in personnel.

City Response: The Plan targets a goal of eliminating 100 or more positions during 2017, but conservatively counts only the 86 positions specifically identified to date toward fiscal gap closure. The City anticipates that the remaining 14 (or more) will be eliminated as additional competitive contracting initiatives advance and/or through ongoing hiring controls and attrition. Given the multiple contract opportunities under evaluation and historical employee turnover, these additional positions could potentially be reasonably quantified. For conservatism, however, the Plan chose to treat these additional goals as "upside" and contingencies, which the City believes significantly enhances the overall likelihood of the Recovery Plan to achieve financial stability.

While information regarding these 86 positions identified to date is outlined on pages 51-55 of the Plan, supplemental information is now provided as **EXHIBIT B** of this submittal to address the concerns raised on page 40 of the Review. Among these 86 positions, 52 are conservatively estimated to be netted from the PERS Early Retirement Incentive ("**ERI**"), drawn from a list of applicants for whom detailed information was provided to DCA during the initial five-day review period.

Review Comment: The Plan did not include an explanation why these are so little savings from headcount cuts in 2017.

City Response: In this same section of the Review (page 40 of Review), it is stated that the projected 2017 savings should be higher than the $2.6 million in savings shown in the Plan, and that "no explanation is provided for this discrepancy." To the contrary, however, pages 65 and 66 of the Plan explain that the savings estimates shown are net of one-time transition costs such as terminal leave payouts, and also take into account potential timing delays for ERI implementation (given the timeline for State approval), as well as the possibility that a subset of ERI participants may be kept on until the end of calendar 2017 to manage operational transitions. As a result of such real world factors, net savings are estimated at lower levels than in future years, which see increased savings after the transitional costs have been cleared and savings are fully annualized. These assumptions are further detailed in **EXHIBIT C** of this submittal, and, again, are considered to be conservative such that greater savings would be possible with, for example, State partnership to accelerate the ERI effective date. Also of note, the savings estimates for all years shown are net of any contract costs with private vendors or the County for alternative service delivery.

Review Comment: The Plan should implement 12 hour shifts for police to have further cuts.

City Response: On pages 41-42, of the Review, potential additional police/fire personnel savings are identified. The City agrees that some such upside may be available, and intends to develop a revised PFRS ERI, as noted in the Recovery Plan (page 55) as one additional approach. The City believes that these and other non-quantified opportunities, conservatively excluded from the calculations toward fiscal gap closure because still under development, again enhance the overall likelihood of achieving financial stability. This is because such opportunities provide additional upside and contingencies in the event that unforeseen difficulties require additional budget actions in the future.

Review Comment:	The Plan does not state when it will complete analysis of privatization or how it will evaluate same.
City Response:	The analysis of privatization opportunities is ongoing (i.e. sanitation bids recently received) and the evaluation of same is a financial analysis. If privatization saves money, the City will move forward with such effort.

Review Comment:	The Plan does not explain why licensing and construction were rejected for privatization.
City Response:	Privatization was not cost effective.

Review Comment:	There are no wage freezes in the Plan.
City Response:	On pages 42 and 43, the Review discusses recent collective bargaining agreements, stating that the Recovery Plan does not include a true "wage freeze" because step increments continue where applicable, and suggests that the Plan's reference to a wage freeze is inaccurate – even though the most recent settlements include three years with no general wage increase. In the experience of the City and its consultants, "wage freeze" is a widely used term to reference a period with no across-the-board increases, and is simply used consistent with such common practice in the Recovery Plan. Because the City provided the full settlement terms to DCA within the five-day review period, the City was completely transparent regarding these agreements. Further, the City notes that its estimated savings from these recent labor settlements did not include the impact of certain provisions that are more difficult to quantify precisely (e.g., reduced promotional differentials for civilians from 8% (two-step promo) and 6% (one-step promo) to 7% and 5%, respectively; reduction in civilian overtime rates for hours worked on Sundays, 7th Days, and holidays from 2.0-3.0x pay to 1.5x pay; freeze on current civilian sick leave banks at levels upon ratification of new contracts for the purposes of calculating future terminal leave payments; new tier of civilian vacation accrual, with a slower accrual schedule and lower maximum accrual for hires after January 1, 2015; police extended sick leave is reforms; freeze on civilian education pay). As with many other areas of the Plan, this conservatism enhances the likelihood of achieving financial stability.

Review Comment: It is unclear why City says State will assume ERI costs in Plan.

City Response: On page 43 of the Review, DCA states that the Plan "suggests" that the State will assume the incremental pension costs associated with the ERI, even though the letter of the Municipal Stabilization and Recovery Act requires that the City fund these actuarial costs.

To clarify the structure of the Plan, as described on page 66 of the original submittal, the City does <u>not</u> rely on the State covering these costs in meeting its goals of financial stability, and the Plan includes funds to cover the estimated costs. This *potential* for the State to cover these costs is referenced in the Plan as an approach for enhanced long-term capital investment beyond the base levels already funded, and not as an underpinning for budget balance.

As also noted in the Plan, this opportunity was highlighted because legislative leadership indicated during stakeholder interviews that an agreement had been reached with the Executive branch to provide this supplemental funding – and that these dollars should be included in the Plan to honor that agreement.

Debt Strategies; Bader Field:

The Review questions the viability of the sale of Bader Field; the cornerstone of the Plan. It is the cornerstone because the $110 million of real obligations (the "**Obligations**") that are paid off with the proceeds of such sale (MGM settlement, deferred State obligations and other tax appeals) will otherwise cripple the City. The issues raised by the Review are identified below and answers are provided. However, before addressing the specific issues, it is important that the State understand why this is the core component of the Plan. The reason is simple - it is the **only** reasonable way for the City to achieve financial stability without replacing the proceeds from such sale with one of the following:

1. *Issues Bonds to pay the Obligations*. Our analysis shows that the Tax Appeal Bonds and Capital Notes described below represent the outer limit of debt the City can reasonably expect to issue at this time. The review questions whether such bonds could even be issued much less an additional $110 million for this purpose.
2. *Raise Taxes*. For the reasons described in the Plan, the City believes, as a policy matter, that raising taxes will be counter to recovery efforts. While

the State may disagree on whether there should be no tax increase, the City believes that even the State would agree that the extraordinary tax increase required to address these Obligations would be unacceptable.

3. *Cut Expenses*. The Plan includes expense cuts and as described in the Plan and above, further cuts would begin to effect essential services. As with taxes, the City believes that even the State would be unwilling to accept the implications of the draconian cuts required to absorb the Obligations.
4. *Sell the water system to a private water company*. As with raising taxes this goes to a core policy issue for the State and its residents – the desire to maintain public control over the water system. Putting that aside, such an option cannot be undertaken for a year per applicable law, this option is dependent on participation from third parties (i.e. private water companies) and would likely resemble a "fire sale" as it would be undertaken by a desperate City and would ultimately have the same effect on ratepayers as the City's proposal – higher rates. In fact, it could be reasonably argued that such a sale would result in a greater impact will be greater on ratepayers than the City's proposal due to the returns such company's shareholders will demand.

As for the specific issues raised by the Review:

Review Comment: The Plan did not detail debt information (rates, maturities, yields, sources and uses).

City Response: See attached **EXHIBIT D** for debt service schedule. As interest rates have risen marginally since the time of Plan submission, the attached **EXHIBIT D** reflects rates as of 10/24/16.

Review Comment: The ACMUA debt issue does not seem achievable.

City Response: The ability of the ACMUA to purchase Bader Field rests upon its ability to raise rates sufficiently to afford the debt service on the new bond issue and to reform its bond resolution to provide covenants regarding debt service coverage and additional bond test in the range of 1.20 times net revenues. The proforma provided with this submittal shows that a one-time rate increase of 25% (approximately $4 per month on average) would be sufficient to achieve these goals; thereafter a rate increase of 1% over CPI was projected assuming a 2% CPI for these purposes. **SEE EXHIBIT E.** Of note, final rate design may vary, and could potentially focus more on commercial customers and/or reflect other factors, such as ongoing cost reduction measures. Current ACMUA rate are well below those elsewhere in the State and region, and would be projected to remain comparatively low and competitive even after an adjustment to cover these financing costs.

Review Comment: The Plan did not include a proforma for the ACMUA.

City Response: Because the ACMUA is an independent authority the City did not deem it appropriate to provide our independent analysis of their financial proforma in the Plan. Nevertheless, the City certainly undertook such analysis to determine if the proposed ACMUA bond issue was realistic, achievable and could be absorbed by the rate payers. We have attached such analysis but it remains, of course, within the ACMUA's discretion on how it manages its finances. **SEE EXHIBIT E.**

Review Comment: Service contract issues; City might have to pay debt; failed to address.

City Response: The City's service contract provides the MUA no value while the City's bond rating remains below investment grade and it is proposed that the service agreement could even be terminated as an aid in obtaining an investment grade rating for the ACMUA based upon the projected water revenue bond project finance approach. This approach will be explored by the City and the ACMUA. In any event, with the proper rate structure as is required by law and covenants with bondholders, there should be no concern that the ACMUA would have to look to the City for payments thereunder.

Review Comment: The sale of Bader Field may not be permitted by MUA Law.

City Response: The City is confident that its ability to sell the water system to the ACMUA is legal. The ACMUA is represented by experienced and competent lawyers and the City has no doubt that they have properly vetted this issue for their client as well.

Review Comment: The City has not begun this process; it did not apply to LFB.

City Response: The City did begin this process by introducing an ordinance. As with many of the actions described in the Plan, those required to implement the sale of Bader Field will come once the Plan is approved. To expect that the City would use resources pursuing the implementation of the Plan before it is approved is not reasonable. And to use the failure to begin implementing the Plan before it is approved also seems unreasonable. The Plan anticipates the completion of this process on or about March 1, 2017. We believe this is a reasonable timetable. Further, the State retains all of it rights to take over the City if this effort is unsuccessful.

Review Comment: The money used from Bader Field is being used as a single cash injection. This is troubling.

City Response: The proceeds from Bader Field will be used to pay off unfunded Obligations described above. To characterize this transaction as a single cash infusion, similar to ones approved by the Local Finance Board in the past to pay operating expenses, is unfair. These Obligations exist and cannot be paid in a single budget year under any circumstances. This transaction is more akin to a refunding of existing debt than a single cash infusion. The use of anticipated non-recurring revenues is used to resolve non-recurring liabilities, not for one-time budgetary balance. This approach is consistent with recognized best practices in financial management, and further achieves the goal of stemming growth in a set of liabilities with high interest rates (the deferred State benefits repayments) and/or ongoing exposure (tax liabilities).

Review Comment: This transaction masks the issue by having ratepayers pay instead of taxpayers.

City Response: If the State believes this to be true, then it would also object to the sale of the water system to a private water company (or to the County as some have suggested). In both of those instances, the monetization of the water system increase rates to ratepayers. In the City's view, impacting ratepayers is a necessary component of the City's recovery. It seems inconsistent that DCA would insist on tax increases while opposing water rate increases if in fact it sees those two things as similar. The City's liabilities must be resolved, and that will require some eventual payments by some City stakeholders. The City approach included in the Plan minimizes these costs by enabling repayment to happen quickly (thereby stemming liability growth), efficiently (maximizing the tax-exempt structure with minimal interest costs), on a balanced basis (with less impact on homeowners and small businesses), and with minimal impact on economic competitiveness (given that current water rates are, and will remain, comparatively low, while City tax rates are comparatively high). By retaining a long-term interest in Bader Field in the event of eventual redevelopment, the approach also avoids permanently giving away significant public assets at "fire sale" prices.

Review Comment: The Green Acres restrictions are not addressed.

City Response: This is an issue to be addressed as a component of the sale of the Bader Field to the ACMUA with multiple solutions including the one identified in the Review. If selling the portion of Bader Field that is restricted becomes too cumbersome, the City can subdivide and retain such land. This is not an obstacle to the transaction, only an issue to be dealt with during the process.

Review Comment: Is this a benefit to general economic recovery?

City Response: A fundamental basis upon which the City determined to sell Bader Field is that its value is depressed today. If it could be sold for a fair price in relatively short order, the City would undertake such a sale. It simply cannot and should not be achieved at this time. Such a transaction is certainly much less likely to succeed than the transaction proposed by the City. If the City had included such a sale to a private developer, there is no doubt the Review would have rejected it – rightfully so. On the other hand, a financial recovery that will result from an approved Plan will benefit the general economic recovery.

Review Comment: There is no discussion of future MUA money from Bader.

City Response: Such a discussion would be too theoretical to merit a discussion and is not necessary because, as described above, rate increases will be sufficient to pay the ACMUA debt. However, it is and was entirely appropriate to identify this as a future source of revenues for the ACMUA.

Review Comment: The City did not provide the purchase and sale agreement.

City Response: **SEE EXHIBIT F.**

Debt Strategies; Tax Appeal Bonds and Capital Notes:

Review Comment: The issuance of tax appeal bonds does not seem achievable.

City Response: The tax appeal bonds will be secured by the Municipal Qualified Bond Act ("**MQBA**") and achieve the same rating as the State of New Jersey – "A3". Last week, the State sold over $2 billion of TTFA bonds with this rating at spreads slightly higher than our estimate of 175 basis points over AAA MMD, but these bonds are now trading at 135 basis points over MMD and yielding 3.85%.

Additionally, we have closely followed the market for lower rated bonds for the last three months and observed that even below investment grade bonds are trading at rates near our estimate. As an example, NJEFA issued bonds for the non-investment grade "BB" College of St Elizabeth maturing in 2041 at a yield of $4.27%. As compared to the proposed tax appeal bonds, the College's bonds are not backed by taxes or a State credit enhancement and are 4 rating grades lower than the rating that will be achieved for the Atlantic City tax appeal bonds. Another example is the MQBA bonds issued by the City of Newark (Baa1) at competitive sale on 8/31/16, which achieved rates that were no greater than 94 basis points over MMD put to 2035. These bonds were insured and that provided an advantage of about 20 basis points so without insurance bonds would yield about 114 basis points over MMD.

As recently as this week, we checked with various market participants about both market accesses when the City has an approved plan and also pricing. The spread over MMD offered was consistently between 150 and 200 basis points versus our calculations at 150 basis points. An additional 25 basis points would add approximately $250,000 per year in debt service that would not be material to the ability to meet debt service payments.

The State analysis erroneously assumes a 5.40% interest rate for the bonds based upon the 2015 Atlantic City MQBA bonds which were issued in a market at least 50 basis points higher in interest rate than the current market and at a time when the City's future was highly uncertain. Since that time the two State laws were passed to provide ten years of monetary assistance worth hundreds of millions of dollars and added the City to the

State's CMTRA program with an annual allocation of $20 million which when added to the excising $6.2 million of energy receipts from the State gives the City $26.2 million to pledge as MQBA support. Given this aid, State laws and an approved Plan, embraced by the State to assure the market of stability the market reception would be highly improved.

We have discussed the transaction directly with Moody's and are quite comfortable that the "A3" rating will be achieved. We have also talked with bond insurers and believe a portion of the bonds may be able to obtain this additional credit enhancement, although it may not be cost effective. **SEE EXHIBIT G** for details on such tax appeal bonds.

Review Comment: Need 3X MQBA Coverage to issue bonds secured by MQBA.

City Response: This excessive coverage would not be needed due to the combination of actions that have already taken place combined with an approved and agreed to 5 year plan embraced by the State. This has been confirmed with the Rating Agency.

Review Comment: The City did not apply to the Local Finance Board to issue bonds.

City Response: As described above, this is a step to implement the Plan and it is neither required nor reasonable to expect the City to begin to implement the Plan before it is approved.

Review Comment: There is no evidence the City sought bond insurance or credit enhancement.

City Response: Active discussions with Assured Guarantee were undertaken and they indicated an interest in perhaps $20 million of additional exposure to the City but would look at taking more exposure if the State amended the MQBA to provide greater protection to bondholders in an event of bankruptcy. The City believes the benefit of credit enhancement is limited and not necessary beyond the MQBA.

Review Comment: There is no agreement with Borgata.

City Response: Borgata was unwilling to enter into a written settlement with the City unless and until there was a Financial Plan of the City approved by the State. The City is under a confidentiality agreement with Borgata on any settlement discussions. Nevertheless, Mr. McManimon had several conversations with Borgata and is satisfied that the amount provided for in the City bond ordinance that is part of the Plan is consistent with a confirmed verbal agreement with Borgata if it is paid in full in cash within 90 days of the State approved plan.

Review Comment: It is not preferred to exceed debt limitations and this requires same.

City Response: The bond ordinance obligations are deductible from the City's gross debt under *N.J.S.A.* 40A:2-52 and are not counted against the City's net debt. As a result, the bond ordinance will not cause the City to exceed its borrowing capacity.

Review Comment: The maturity schedule is non-conforming.

City Response: Since the City bonds would be issued as refunding bonds under *N.J.S.A.* 40A:2-51, the maturity schedule requirements of *N.J.S.A.* 40A:2-26 do not apply. As a result, there is no "non-conforming maturity schedule". This maturity schedule, as with all refunding bonds, including tax appeal refunding bonds like the one proposed by the City, is determined by the Local Finance Board (the "**LFB**"). The City plans to apply to the Local Finance Board under the Municipal Qualified Bond Act and to seek approval of the proposed maturity schedule. The extraordinary obligations created in relationship to the size of the City's budget require the need to extend the debt over an affordable period that the City can reasonably absorb. This is an unprecedented tax appeal in an amount that does not fall within any particular historical perspective of the LFB. The City considered the usual LFB standard that establishes the length of time to mature such tax appeal refunding bonds based on whether the tax impact on an average home exceeds $50 per year. Based on an average home value in Atlantic City of $150,000, the average impact on the first five year period using an annual $4 million debt service obligation would be $90 per year. When that converts to $7 million, that number will be approximately $160 per year. That of course remains in the discretion of the Local Finance Board, but a shorter maturity would only increase the debt service and the annual impact on the average homeowner.

Review Comment: The City will need a 5 year CMPTRA history for such security mechanism to work.

City Response: Once again, there is no evidence of this in the market as hundreds of millions of dollars of MQBA bonds have been issued for many municipalities throughout the State. Furthermore, discussions with underwriters reflect that is not a concern since they believe that the MQBA program is a solid one and any change (if the suggestion is a change for Atlantic City) is unlikely as it would impact the overall credit of the MQBA Program.

Review Comment: Will notes be subject to the MQBA?

City Response: While notes are not covered by the MQBA, notes would be issued as bond anticipation notes and represented in the offering document as being taken out with MQBA Bonds. This is common practice in New Jersey and for MQBA towns, the takeout with future MQBA Bonds for ordinances approved by the LFB provides significant comfort to the purchaser of the notes which are highly marketable based on that. In today's market, these notes would receive a yield of between 2 and 2.25%. In our projections, we used a rate of 3%; the State used a rate of 5%.

Review Comment: Are down payments included for capital notes?

City Response: No, but it could be easily absorbed within the 5 year projection if the State felt it was necessary.

Miscellaneous Comments:

Review Comment: Problem not overnight and the City has done nothing meaningful.

City Response: Elsewhere, the Review accurately notes that the City has significantly reduced its workforce, reached an agreement with the County for shared services, pursued privatization and asset monetization, reduced multiple areas of operational cost, and maximized non-tax revenues. Throughout the Plan, most notably on page 13, a broader (but still not exhaustive) range of examples is provided regarding the extensive City actions taken to date.

Review Comment: The City has not pursued Emergency Manager Report recommendations to pursue development of the Gardner's Basin property.

City Response: Contrary to the statements on page 9 of the Review, and further referenced on page 44, the City has pursued development of the Gardner's Basin property. As noted on page 96 of the Recovery Plan, bids have been issued to operate this property and are actively under review.

Review Comment: Did not complete 2017 budget forms.

City Response: We did not read the law to require same but it is attached as **EXHIBIT H.**

Review Comment: City defaulted under Loan Agreement per Loan Agreement.

City Response: While true, an approved Plan would free up the funds requested to pay all amounts due to the State.

Review Comment: City did not enter into 10-year financial agreements with each casino gaming property.

City Response: The City does review this as a post plan approved action.

Review Comment: The Plan and 2016 budget don't match.

City Response: The Review notes on page 24 that the 2016 Budget expenditure figures presented in the Plan are at variance from the City Budget provided to the Division on October 17, 2016. As stated on page 8 of the Plan, these variances are due to certain grant-related revenues and expenditures being removed from the presentation to provide a clearer picture of underlying City trends when compared to future years. There is no "unexplained" difference, and the basis of comparison shown provides a relevant reference point for the subsequent years of the plan period.

Review Comment: The City did not dissolve the ACMUA.

City Response: For the reasons explained above, the City does not believe that the dissolution of the ACMUA would serve the City well. It would be counter to the goal of financial recovery.