New Jersey Law Journal

VOL. CXCII - NO.16 - INDEX 162 APRIL 21, 2008 ESTABLISHED 1878

Local Government
& Public Finance Law

Asset Monetization: Is It a Thing of the Past?

Local governments are reminded of their duty to be fiscally responsible

By Thomas P. Scrivo and Alexandra V. Gallo

In a time when the use of debt to ameliorate budget problems has reached a critical stage, the Appellate Division recently dealt the County of Passaic a severe blow, and in the process reminded local governments of their duty to be fiscally responsible with taxpayers' dollars. Following in the footprint of *Lance v. McGreevey*, 180 N.J. 590 (2004), *Rumana v. County of Passaic,* 397 N.J. Super. 157 (App. Div. 2007), the court found as a matter of law that the Local Budget Law and the Local Bond Law preclude a county from guaranteeing bonds issued by a county improvement authority in connection with the purchase of county property where the county is recognizing the sale proceeds as miscellaneous revenue in its operating budget.

Plaintiffs in the case were Mayor Scott Rumana and councilpersons of the Township of Wayne, who sued in their capacities as elected officials and taxpayers of Passaic County. They filed an action to enjoin the county from selling the Passaic County Golf Course (the "Golf Course") to the Passaic County Improvement Authority (PCIA) as part of the county's scheme to fix its 2007 budget deficit.

The structure of the transaction was rather simple and not unusual for a government's sale of an asset. Indeed, to drum up the money needed to fill a large budget hole, the county intended to shift title of the golf course to the PCIA for $18.5 million. The PCIA, an entity with a staff of one and no expertise in running a golf course, would then issue bonds to cover the purchase price and capital improvements to the golf course. Thereafter, the PCIA would pay the bond proceeds to the county to balance its 2007 budget. To complete this deal, the county agreed to unconditionally guarantee the repayment of the bonds.

Plaintiffs argued that the county's proposed budget maneuvering was legally defective on several bases. First, the proposed transfer sought to accomplish that which the county is statutorily prohibited from doing — borrowing money to pay current expenses to fill a budget hole. N.J.S.A. 40A:2-3. To sidestep that facial prohibition, the county lined up the PCIA to borrow the money and pay the bond proceeds over to the county.

Second, plaintiffs argued that the transaction was illegal because it constituted unlawful deficit financing. In *Lance v. McGreevey*, the New Jersey Supreme Court ruled prospectively that bond proceeds intended to fund general expenses, no matter how deftly cloaked, cannot be classified as revenue for the purposes of satisfying annual balanced budget requirements. Notwithstanding that, the Supreme Court found support for its holding in the Appropriations Clause to the New Jersey Constitution. Plaintiffs argued the county's proposed transaction was similarly prohibited. Third, plaintiffs argued that the county violated the Local Budget Law by improperly recognizing revenue and indebtedness for the same monies. N.J.S.A. 40A:4-3.

Plaintiffs further challenged the sale price of the golf course as well as the PCIA's ability to repay the large debt. Through an expert real estate appraisal, plaintiffs showed that the proposed purchase price exceeded the golf course's true value by more than $13 million. Indeed, the sale price bore no rational relation to the actual value of the property. Instead, plaintiffs argued, the county and the PCIA "backed into" a number to plug the budget hole. A proffered cash-flow analysis further revealed that the county's bond guaranty would have been triggered and the county taxpayers would have been saddled with repayment of the debt.

In addition to the county and the PCIA, plaintiffs sued the Division of Local Government Services (DLGS), for

---

Scrivo is a member of, and Gallo is an associate with, the law firm of McElroy, Deutsch, Mulvaney & Carpenter in Morristown and Newark. Scrivo is also the author of the New Jersey Local Government Deskbook.

approving the county's proposed deficit financing, and the Local Finance Board (LFB), for approving the PCIA's proposed bond issuance despite: a) its inability to repay same and b) the inflated purchase price that the PCIA was willing to pay for the golf course, which by the county and PCIA's own admissions, was in a condition of serious disrepair.

Defendants argued that each of the component parts of the proposed transaction, standing alone, was permitted by the Local Bond Law and the Local Budget Law. The Appellate Division rejected such a myopic approach, stating, "[i]t is the cash basis requirement of the Local Budget Law, N.J.S.A. 40A:4-3, and the Local Bond Law prohibition from engaging in deficit financing, N.J.S.A. 40A:2-3, that infuse our review of the entire transaction before us, rather than its component parts."

The court refused to honor form over substance, finding that the county was not permitted by N.J.S.A. 40A:2-3 and 40A:4-3 to recognize the proceeds from the sale of the golf course as miscellaneous revenue while at the same time increasing its overall indebtedness by unconditionally guaranteeing the PCIA's repayment of the bonds at issue. The court noted that the "overriding purpose of the Local Budget Law is to promote sound business practices and prevent deficit financing."

Ultimately, the court found that the proposed transaction was "no more than a thinly disguised attempt to circumvent the Local Budget Law and the Local Bond Law, as well as the Local Government Cap Law limitations on tax levies because the repayment of debt service is an express exception to the cap against which the County was struggling. N.J.S.A. 40A:4-45.3(d)." In so finding, the court concluded that the county could not guarantee the repayment of the PCIA bonds while at the same time recognizing those proceeds as miscellaneous revenue. As a result, the court retroactively vacated the LFB's approval of the county guaranty and reversed the director's approval of the county's 2007 budget.

The Appellate Division's message of fiscal responsibility is sure to resonate throughout the state. For many years, the sale of assets has been employed by municipalities and counties to fill budget holes. Although such maneuvering has been condemned by some as a "quick fix" and as fiscally irresponsible, the practice has not only continued in recent years, but has increased. Given the Court's holding in *Rumana,* local governments will be hard-pressed to rely on the sale of assets to plug budget holes in the future.

Like municipalities, the state, too, is reminded of the Supreme Court's admonishment regarding the monetization of assets to plug budget holes. In fact, notwithstanding the Supreme Court's decision in *Lance v. McGreevey*, it had appeared that the state was headed down that road once again. Indeed, up until December 2007, all indications were that Gov. Corzine was poised to propose the sale of the state's toll roads. One could hardly read a daily newspaper in the state without a discussion of asset monetization being bandied about by legislators and public interest groups.

While the public was awaiting the governor's announcement to sell the toll roads, however, that plan was scrapped in favor of the governor's proposal to increase the tolls on the roadways and monetize those anticipated revenues. One is left to wonder whether the governor's decision to reverse course was based, in part, on a closer reading of *Lance v. McGreevey,* as reinforced by *Rumana,* wherein the courts specifically struck asset monetization plans. ■