NIFA Nassau County Interim Finance Authority

# MEMORANDUM

**TO:** NIFA Directors

**FROM:** Richard Luke

**RE:** Review of Adopted Financial Plan

**DATE:** October 31, 2002

Introduction

On October 7, 2002 the Directors accepted the proposed Multi – Year Financial Plan for Fiscal Years 2003 - 2006 (the "Plan") submitted to NIFA by the County Executive and authorized the distribution of a staff report concerning the Plan. At that time the Directors also required that upon approval of the Plan and Fiscal Year 2003 Budget by the Legislature, the County Executive resubmit them to NIFA together with the other information required by the NIFA Act ("Act"). The Directors also required that the County Executive submit an updated Plan to the Board no later than May 1, 2003.

We have now received the Financial Plan, Budget and such additional information as is required by the Act. Based upon the factors discussed below, we recommend that you take the final actions and make the necessary findings required by the Act to approve the plan. The comments contained in this Memorandum need to be read in conjunction with our October 7, 2002 report.

Legislative Changes

On October 28, 2002 the County Legislature took action to modify the proposed FY 2003 budget, and the first year of the FY 2003 – FY 2006 financial plan. The changes satisfy the major risks identified in our October 7th report.

While the real property tax levy remains unchanged, the sales tax estimate has been increased by $8.9 million to reflect recent receipts. In addition, based upon historical information unused encumbrances are projected to generate an additional $2.7 million of revenue.

The Legislature has not made any changes to the out years of the financial plan. Any changes to the financial plan resulting from the adjustment of the FY 2003 budget will be reflected in the updated financial plan that will be submitted on May 1, 2003.

The following tables present the major expenditure and revenue changes made by the Legislature to the FY 2003 budget, with an * identifying those items that satisfy a risk set forth by NIFA. The net effect is to increase the budget by approximately $9 million.

170 Old Country Road, Suite 205, Mineola, NY 11501
Tel: (516) 248-2630 Fax: (516) 248-4050

## Major Changes from Proposed Budget to Adopted Budget

| | Expenditure Changes | Amount | |
|---|---|---|---|
| | Correct debt service error | $7,344,169 * | |
| | Increase debt service expense – variable rate interest | 3,000,000 * | |
| | Termination pay – Hospital | 3,000,000 * | |
| | District Attorney funding | 1,000,000 | |
| | Other expenditure increases (net) | 563,112 | |
| | Reduce contingency | (4,886,063) | |
| | Reduce Police District salaries | (1,070,000) | |
| | | | |
| | Total Expenditure changes | $8,948,218 | |

| | Revenue Changes | | |
|---|---|---|---|
| | Increase sales tax estimate | $8,888,197 | |
| | Increase funds from unused encumbrances | 2,714,021 | |
| | Grant revenues | 149,000 | |
| | Technical correction - Fire Commission revenues | (2,800,000) | |
| | | | |
| | Sub-total | $8,948,218 | |

Key Updates

To assist us in evaluating the Legislative changes made to the FY 2003 budget, the first year of the financial plan, we looked at the following key areas that were discussed in our October 7th report. We wanted to provide an update on their status and assess their potential impact on FY 2002 results and the FY 2003 budget:

- Sales tax revenues
  - Based upon recent receipts the County has increased its projection of sales tax revenue for FY 2002 from $851.9 million to $860.6 million. Using the projected FY 2002 receipts as the new base, and continuing the assumed growth rate of 2.5%, the County has increased the budget estimate of sales tax revenue in FY 2003 by $8.9 million to $882.5 million. However, the County might have been better off leaving the FY 2003 budget as originally projected (to account for economic uncertainty) and made additional expenditure cuts to balance the 2003 budget.

- Pension costs

    - Our October 7th report indicated that the County could be exposed to \$26.4 million in unfunded pension costs despite the significant additional resources appropriated for pension payments in FY 2003. The recent recovery of the financial markets (the Russell 3000 has increased by 8% since we wrote our October 7th report) reduces this risk to approximately \$15 million, illustrating how vulnerable the County's pension obligation is to stock market volatility. The Legislature did not modify the budget to address this risk. The administration has previously indicated that once the final year-end staffing levels are known, the \$30 million of excess salary appropriations will be used to modify the FY 2003 budget, and provide resources against the possible pension risk. The County must monitor these costs closely and, as soon as practical, modify the budget to more accurately reflect known spending needs.

- Police severance pay

    - The proposed financial plan assumes that 250 officers will leave before the 2002 fiscal year ends. As of October 28th, 217 sworn officers have separated from service and an additional 14 have filed for retirement. If fewer officers than assumed retire in FY 2002, the County will not spend as much on termination pay in FY 2002 as originally projected. While the County maintains that the number of retirements in FY 2002 are driven by extraordinary overtime earnings related to the events of September 11, 2001, we remain concerned that police attrition rates and average termination payouts may not fall to the 125 officer and \$225,000 level assumed in the FY 2003 Adopted Budget, respectively.

- Workforce reductions

    - Including prospective attrition during the remaining three months of the fiscal year, the County projects that its five-fund headcount could be 942 full-time employees smaller on December 31, 2002, than it was on January 1, 2002. This includes a reduction of 111 contract employees. Excluding the contract employees, the workforce reduction program will bring County-funded full-time headcount levels to 8,309, a level which is 322 employees below FY 2000 year-ending levels of 8,631. To date, the County's workforce has fallen by a net of 779 full-time employees, including 245 civilians and sworn officers in the Police Department. The County has separated 523 employees through its early retirement incentive program and a net of 256 through normal attrition and retirement. The County needs a net reduction of 52 additional employees to achieve its targeted reduction of 942 full time positions in FY 2002.

- Debt service
  - The County modified the 2003 Budget to substantially respond to the debt service risks identified by NIFA. It corrected the erroneous $7.1 million underbudgeting of debt service and added $3.0 million (of the recommended $3.7 million) to provide a cushion against interest rate increases in NIFA's variable rate debt. The County was unable to add in the full $3.7 million due to technical budget hearing notice constraints. The $3.0 million provided does not bring the full budgeted rate to the 4% level NIFA believes prudent, but does cover 80% of the identified risk.
- FY 2002 year end results
  - As the result of additional information since the release of our October 7th report, several things have arisen that make it much more likely that FY 2002 will end with revenues exceeding expenses. These items, totaling approximately $15 million, include: sales tax revenues, which the County believes are likely to exceed the FY 2002 budget by $10 million; and the County Comptroller has identified $5 million of grant funds that belong in the general fund. In addition, as part of a State-wide effort Governor Pataki has proposed additional state aid to all counties for Medicaid relief, including $15.3 million for Nassau County. Since this item requires approval of the State Legislature, the County has not included this in its FY 2002 projections. The aid would provide additional unbudgeted resources in the year in which the State Legislature approves this measure. It should be pointed out that without NIFA assistance, the County would end FY 2002 with a significant deficit.
- Other issues
  - The County has met with staff of the State Senate, State Assembly, and the Division of the Budget to continue discussions about the Sewer and Storm Water Authority. County officials are optimistic that the State Legislature will act favorably on their proposal.

Staff Recommendation

Based upon the Legislative changes that have been made and our analysis of the key areas described above, we recommend that the Directors approve the adopted Financial Plan. We continue to have concerns about the external risks identified in our October 7, 2002 report. The May 1, 2003 update of the financial plan will provide important information about some of the risks, since it will incorporate more current information about:

- The value of the pension funds assets as of March 31, 2003.
- The appropriate base for projecting FY 2003 sales tax receipts.
- Actual workforce reductions achieved at the end of FY 2002.

- Police salary increases and labor concessions if an award is made under binding arbitration.
- The status of State legislative action on the creation of the Sewer and Storm Water Authority.

A "balanced" 2003 budget does, of course, reflect a structural deficit of $72 million, including $15 million of State aid, and $57 million of budget relief from NIFA restructuring of County debt. If the County generates surpluses in FY 2002 or FY 2003 NIFA will look at ways that these funds might be used to reduce this structural deficit. Since the NIFA Act precludes the County from using fund balances as operating revenue, we would look for the County to use these funds in a way that provides long term relief for the out-years of the financial plan or to fund non-recurring expenditures. Among the possible use of these surpluses would be: reducing the amount of NIFA restructuring relief to be provided in FY 2003; paying the cost of the early retirement incentive rather than bonding it; using the funds for pay-as-you-go capital needs rather than bonding; and eliminating some of the less fiscally prudent measures proposed in the financial plan.

NIFA continues to believe that the County needs to accelerate some of its out-year initiatives to ensure the implementation of projected savings. The County has clearly made significant progress in addressing its fiscal ills, but much more work needs to be done in order to strengthen the County's structural position and eliminate the need for NIFA assistance. NIFA will continue to closely monitor all aspects of the County's finances until this is accomplished.