Nassau County Interim Finance Authority

NIFA

STAFF REVIEW OF THE MULTI-YEAR FINANCIAL PLAN UPDATE FISCAL 2011 – 2014

July 14, 2011

I. OVERVIEW

On June 24, 2011 the County submitted its Multi-Year Financial Plan Update (the "Update"). The following discussion reflects the observations of staff regarding their submission.

The explanatory text in the Update is less than five pages. The Update reflects the County's proposed actions to ensure balance on a purported "budgetary basis of accounting," even though the County Executive is required by the NIFA Act to submit a plan that is balanced in accordance with Generally Accepted Accounting Principles ("GAAP"). No "budgetary basis of accounting" is recognized by any professional or regulatory agency or association. The County's budgetary level of risk for FY 2011 on a GAAP basis continues to exceed, by multiple times, the one percent threshold mandating the imposition of a Control Period.

Regrettably, the Update is not reassuring; in fact, it indicates that the County is moving in the wrong direction. Many proposed gap-closing actions have either been postponed, scaled back, or are expected to produce outsized savings in the second half of the year. The time left for the County to reverse course and aggressively mitigate these growing risks is rapidly expiring.

These obvious deficiencies are further exacerbated by the County's failure to include enough detail to allay our concerns regarding the County's likelihood of success in FY 2011. Moreover, we are extremely skeptical that the foundation laid in the current budget will be sufficient to ensure balance in the Out-Years in accordance with GAAP. In fact, the risks for FY 2012 and other Out-Years are even more significant, suggesting the need for the Control Period to continue indefinitely.

II. DISCUSSION

The following is a focused discussion of the County's FY 2011 projections and major Out-Year risks, as well as a summary of our findings and related concerns.

The Update includes the County's revised projections for FY 2011. Based on first quarter results, the County projects a modest year-end surplus. Unfortunately, the Update continues to rely on State approvals for the expansion of the Red Light Camera program, labor savings that have not been secured, and revenues from the sale of surplus land and the securitization of Mitchel Field leases. Not only are these revenue sources tenuous, but most of the proceeds from the securitization of the Mitchel Field lease are probably not recognizable under GAAP in the period in which the transaction ultimately occurs.

Most disturbing, the Out-Year projections contained in the Update are also extremely problematic. For example, FY 2012 projections include significant savings from labor and unspecified departmental efficiencies. In addition, the County's projections include significant non-recurring revenues beginning in FY 2012 from a "public-private partnership" involving the lease of its wastewater system, totaling $375 million over three years, for which the County is not known to have either a counterparty or active efforts to achieve such a transaction.

The absence of a detailed discussion of Out-Year initiatives heightens our skepticism regarding the County's ability to timely effectuate its proposed gap-closing program. Inexplicably, the discussion in the Update is virtually identical to the one included in the adopted Plan despite the passage of more than six months. Consequently, since very little meaningful new information is available to us, we reluctantly must conclude that the Plan remains significantly out of balance.

FY 2011 Projections

On January 26, 2011, NIFA determined that the County's FY 2011 Budget reflected a substantial likelihood that it would produce an operating funds deficit in excess of one percent of the aggregate result of operations. Consequently, NIFA adopted a resolution declaring a Control Period, as defined in the NIFA Act, to be in effect. At that time, NIFA estimated that the statutory deficit was approximately $176 million.

Since that time, our assessment of the budgetary risks has shifted slightly, but remains significantly above the one percent threshold for imposing a Control Period. Overall, our analysis indicates that the projections included in the Update for FY 2011 contains risks of approximately $81 million on a cash basis and almost $120 million on a GAAP basis. In contrast, the County projects that it will end FY 2011 with a small surplus of $457,256 on a purported (and otherwise undefined) "budgetary basis."

Listed below is NIFA's evaluation of the major risks underlying the County's revised projections contained in the Update for FY 2011. For comparative purposes, we have included in the Appendices to this report NIFA's previous analysis of the major risks underlying the adopted Budget.

FY 2011 Risks: Current Analysis of Projections in the Update ($ in millions)		
	Cash Basis	**GAAP Basis**
Revenues		
Red Light Camera Program Expansion	$8.7	$8.7
Ambulance Fees	2.0	2.0
Parks Revenue	1.0	1.0
Housing Suffolk Inmates	0.8	0.8
Investment Income	1.0	1.0
Sale of County Land	23.0	23.0
Sale of Mitchel Field Leases	0.0	37.5
Total Revenue Risk	**36.5**	**74.0**
Expenses		
Salary Adjustments/Union Concessions	37.6	37.6
Outsourcing Medical Care for Inmates	1.0	1.0
Overtime	4.0	4.0
Coliseum Referendum	2.2	2.2
Total Expense Risk	**44.8**	**44.8**
Total Statutory Deficit	**$81.3**	**$118.8**

The County's positive result is driven by the inclusion of $33 million from the anticipated sale of County land and $37.5 million from the proposed sale of Mitchel Field leases, which combined are approximately $15 million higher than originally contemplated in the FY 2011 Budget. As previously noted, the County's ability to recognize the proceeds from these transactions as revenue may be limited by the Act's requirement that the budget be balanced in accordance with GAAP as well as significant execution risk. Regardless of the accounting treatment required by the NIFA Act, to-date no transactions have closed.

Furthermore, while the County Legislature recently approved the sale of the former Grumman property for $15 million, the County will receive only $10 million in FY 2011 and $5 million in FY 2012. This amount is $8 million short of the $18 million projection for FY 2011 assumed for this transaction in the Update.

The County stated that it expects to close the land sales and lease securitization deals by the end of the third quarter. In addition to the accounting treatment risk, we believe the timetable is too optimistic and that there is execution risk related to these transactions. Overall, we currently hold at risk $23 million of the projected $33 million anticipated from land sales.

We also have significant concerns regarding budgeted labor savings and ongoing management of headcount. The County will realize significant recurring savings to the extent that it limits the number of positions that are backfilled; however, the current level of headcount may be difficult to sustain. Implementation of the proposed headcount plan will require strong managerial oversight and an acknowledgement by all stakeholders that service levels will likely decline to match the level that the County has calculated as affordable.

In FY 2011, the Update also includes projected savings from several major personnel related actions totaling $66 million, most of which did not commence before July 1, including approximately $13 million from layoffs, $15 million from furloughs, $13 million from overtime savings in the Police Department and Correctional Center, and $25 million from budgeted vacancies. All of these actions still involve significant execution risk except for vacancy savings, which can likely be realized to the extent that the County limits backfilling.

The County's decision to lay off 128 employees effective July 1 is projected to generate savings of only $3.4 million in FY 2011, which is well below the County's revised projections contained in the Update. It is unclear if the County will pursue additional layoffs since the 128 terminations and the related dollar savings were well below the number originally contemplated. It is also unclear how these savings will ultimately be impacted by the outcome of threatened litigation by the CSEA.

We consider the proposed savings of $15 million from employee furloughs to be at risk because the County has apparently backed away from implementing this initiative. Since the County has not identified any new actions that it will implement to realize the requisite budget relief, we continue to include this initiative in our analysis, but hold the projected savings at risk.

On top of baseline overtime concerns, we also continue to hold at risk the projected overtime savings the County anticipates realizing from its redeployment initiative in the Police Department. In addition to the missed opportunity to capture overtime savings caused by implementation delays, it is unclear if the County remains committed to the original scope of the redeployment initiative. Most importantly, to-date the County has not demonstrated that the Department's actions have favorably impacted actual overtime spending.

The County is projecting a current year property tax certiorari refund liability of $70 million. The County has included the entire cost of this projected liability in its revised projections, but does not contemplate the use of any bond proceeds already on hand for this purpose. It is difficult to determine the accuracy of the County's projection and we are concerned that any additional unfunded liability could end up simply being added to the tax cert backlog.

The County eliminated its projection of revenue from its LIE ticket surcharge initiative and reduced its revenue forecast in other areas, including investment income, OTB, and Red Light Cameras; however, the County is still counting on State approval of

Phase II of the Red Light Camera Program in time to implement the expanded program for the final four months of 2011. We feel there is significant execution risk with the Red Light Camera program even if the County secures approval by the State Legislature.

Finally, the County makes no provision for the projected $2.2 million cost of the special referendum on August 1st.

Major Out-Year Risks

The County is required to submit its FY 2012-2015 Multi-Year Plan to NIFA on September 15, 2011, which is only two months from now. By then, the County will have to craft a credible plan that is balanced in accordance with GAAP. The Update fails to accomplish this task.

The County's current plan for FY 2012, as outlined in the Update, lacks sufficient detail for us to make a favorable determination on the likelihood of avoiding a one percent deficit. In fact, considering the impact of the inclusion of the "public private partnerships," it appears likely that a deficit which is a multiple of the requisite threshold would occur in each of the three years. The County currently projects a baseline gap for FY 2012 – which is a projection of the budgetary shortfalls that would exist if no remedial actions were taken – of $213.6 million.

What follows is a discussion of our concerns related to the County's proposed gap-closing plan, which is detailed below. For comparative purposes, we have included in the Appendices the County's gap-closing plan from the adopted Multi-Year Plan.

FY 2011-14 Gap-Closing Plan	2012 Plan	2013 Plan	2014 Plan
County Projected Baseline Gap ($ in millions)	**($213.6)**	**($244.5)**	**($271.8)**
Financing Options/Asset Sales			
Public-Private Partnerships	150.0	125.0	100.0
Surplus Land Sales	5.0	10.0	10.0
Expense Reductions			
Department Efficiencies	20.0	25.0	30.0
Union Concessions/Layoffs/NIFA Wage Freeze	43.1	75.5	110.0
Revenue Initiatives			
Value of New Construction	3.0	6.0	9.0
Increased Departmental Revenues	3.0	3.0	3.0
Shared Services – Improved Accounts Receivable	3.0	3.0	3.0
Cedar Creek Driving ranges	3.0	3.0	3.0
Hub Revenues		5.0	5.0
GIS Map Usage		10.0	10.0
Surplus/(Gap)	**$16.5**	**$21.0**	**$11.2**

Public-Private Partnership

The largest Out-Year initiative is the privatization of the County's wastewater system through a public-private partnership or P3. The County is proposing to enter into a public-private partnership with a private entity to lease, on a long-term basis, its wastewater system. The transaction would be governed by a concession agreement (GASB standards refer to it as a "Service Concession Arrangement"). The County would retain ownership of the asset(s) with a right to reclaim the asset(s) if the standards established in the agreement are not met (or presumably at the end of the term of the agreement). Certain risks and responsibilities would transfer to the private entity.
The County believes that this asset could generate budgetary relief of $375 million over a three year period. However, based on our understanding of the County's proposal, the entire amount received in cash would not, under GAAP, be considered "revenue," but must be amortized over the life of the financing. We also believe that any proceeds from a privatization should be used for capital purposes or to reduce planned borrowings and not for operating expenses, which would perpetuate the structural deficit in the same amount.

Furthermore, notwithstanding the accounting treatment of a public-private partnership for wastewater treatment, the County has a long way to go to demonstrate that this initiative is even feasible. P3 deals are complicated and expensive to orchestrate. Among other costs would be the assistance of professional advisors to ensure the protection of the County's interests. A P3 deal from inception to signing can take more than a year to complete and we see little movement on the part of the County to take the steps necessary to find counterparties and effect such a transaction. Indeed, the County states "A typical Public-Private Partnership would take approximately 12-18 months to complete…." NIFA believes even this 12-18 month estimate is overly optimistic.

Surplus Land Sales

The Update reflects the County's plan to sell surplus land in each of FY 2012, FY 2013, and FY 2014 for $5 million, $10 million, and $10 million, respectively. While it may be prudent to dispose of assets the County no longer needs, we remain concerned that these sales are not based on long-term strategic planning and are being used solely for one shot cash infusions.

Expense Reductions through Department Efficiencies

The Update includes significant savings the County expects to realize from expense reductions and unspecified departmental efficiencies. While we recognize that the County will realize recurring savings from its recent round of layoffs, expenditure reductions resulting from departmental efficiencies will necessitate a further contraction of the workforce. We consider these projected savings to be at risk since the County has not identified the departments involved or explained how these savings can be realized.

Union Concessions/Wage Freeze

The County projects that it will realize significant recurring savings in its Out-Year labor costs. While the County continues to pursue concessions from its labor unions, we remain skeptical that large negotiated concessions will be forthcoming since it has been unsuccessful in negotiating any substantive savings to-date. More likely, the County will look to achieve substantial salary savings in the Out-Years by continuing to implement the wage freeze that was imposed by NIFA in 2011 at the County's request. This, of course, requires that NIFA each year determine that the County is continuing to experience a fiscal crisis necessitating the imposition of a wage freeze.

Revenue Initiatives

The Update reflects the County's intention to increase the size of the property tax levy by $3 million each year to capture the projected value of new construction. If implemented, this action will generate $9 million in recurring gap-closing relief by 2014. This revenue target is achievable to the extent that the Legislature approves the proposed annual increases in the property tax levy.

The County maintains that it will realize $3 million in additional departmental revenues beginning in FY 2012. The Update does not describe the actions the County will take in order to enhance its departmental reimbursements or expand its revenue streams. Consequently, we assume that this action will involve increases in County-assessed user fees, which will require Legislative approval.

The County assumes that it will realize $3 million annually in additional revenue from improved accounts receivable processing and $3 million annually from the opening of a driving range at Cedar Creek Park. It is unclear if the County can achieve these targets since it did not provide any backup for these projections.

Other Concerns

Although the Update uses a more conservative growth rate than the adopted Multi-Year Plan to project employee and retiree health insurance expenditures in FY 2012, we believe that the County may be understating these costs, beginning in FY 2013, after reducing the Out-Year growth rate assumptions to 3.9% for active employees and 6.2% for retirees.

The Update assumes that pension contribution rates will stabilize after FY 2012. These costs are a function of the investment returns posted by the State Common Retirement Fund.

The County eliminated its $10 million contingency reserve previously budgeted in each of the Out-Years. While this gap-closing action provides certain budgetary relief, it reduces the available options the County can utilize to cushion unfavorable variances during the year.

The County has also eliminated the "County Guarantee" of property tax refunds after 2012 by shifting most of these costs to other levels of government. However, even if this highly controversial initiative survives all legal hurdles, the Update assumes that these operating costs will be $50 million in FY 2012, $40 million in FY 2013, and $30 million in FY 2014. We believe that the amounts budgeted may be too low based on the level of refund payments in recent years. Even after the County Guarantee ends, the County is liable for the tax certiorari backlog, which currently is estimated by the Comptroller to be $152 million. In any case, this initiative continues to have significant litigation risk.

III. CONCLUSION

We find that the gap-closing plan included in the Update is unlikely to result in budgetary balance in FY 2011 and the Out-Years in accordance with GAAP.

The County's submission of its FY 2012 Proposed Budget and FY 2012-2015 Multi-Year Plan is approximately two months away. We advise the County to use this time to review and expand the list of available actions – within its control – that can be taken to bring its recurring expenditures in line with its recurring revenues. The County must identify sufficient new actions that will reduce recurring expenditures, raise recurring revenues, or effect a combination of the two. Most importantly, the County should remove from the financial plan consideration of non-recurring initiatives that are either speculative or not consistent with the NIFA Act.

In sum, we recommend to the NIFA Directors that the revised FY 2011-2014 Multi-Year Plan be disapproved and returned to the County for modification with special attention to FY 2012 and the removal of the revenues we have outlined as not attainable due to significant risk and unacceptable treatment as revenue under GAAP.

IV. APPENDICES

APPENDIX A

FY 2011 Risks: NIFA's January 25, 2011 Analysis of the Adopted Budget ($ in millions)		
	Cash Basis	**GAAP Basis**
Revenues		
Red Light Camera Program Expansion	$17.0	$17.0
LIE Ticket Surcharge	5.0	5.0
Ambulance Fees	4.0	4.0
County Clerk Fees	4.0	4.0
Parks Revenue	1.0	1.0
Housing Suffolk Inmates	1.5	1.5
FIT Reimbursement	6.0	6.0
Investment Income	4.0	1.0
OTB Profits	1.5	1.5
Total Revenue Risk	**44.0**	**44.0**
Expenses		
Salary Adjustments/Union Concessions	61.0	61.0
Outsourcing Medical Care for Inmates	4.5	4.5
NIFA Restructure Savings	8.0	8.0
Overtime	2.0	2.0
Total Expense Risk	**75.5**	**75.5**
Assessed Risk before Bonding Items	**119.5**	**119.5**
"High Probability" Offsets	(70.5)	(43.5)
Bonding of Property Tax Refunds		100.0
Total Statutory Deficit	**$49.0**	**$176.0**

APPENDIX B

FY 2011-14 Gap-Closing Plan (Adopted MYP)	2012 Plan	2013 Plan	2014 Plan
County Projected Baseline Gap ($ in millions)	**($162.2)**	**($220.1)**	**($271.0)**
Financing Options/Asset Sales			
Public-Private Partnerships	125.0	125.0	125.0
Privatization of LI Bus	9.6	9.6	9.6
Debt Restructuring	5.0	5.0	10.0
Surplus Land Sales		10.0	15.0
Expense Reductions			
Department Efficiencies	20.0	25.0	30.0
Headcount Reductions	5.0	10.0	20.0
Workers' Compensation	3.0	3.0	4.0
Revenue Initiatives			
Value of New Construction	3.0	6.0	9.0
Increased Departmental Revenues	3.0	3.0	3.0
Shared Services – Improved Accounts Receivable	3.0	3.0	3.0
Cedar Creek Driving ranges	3.0	3.0	3.0
Hub Revenues		20.0	30.0
GIS Map Usage		10.0	10.0
Assessment Reform			
Debt Service on Assessment Reform	2.0	8.0	14.0
Surplus/(Gap)	**$19.4**	**$20.5**	**$14.6**