Nassau County Interim Finance Authority

NIFA

MID-YEAR REVIEW AND ANALYSIS
OF THE MAY 1, 2008 NASSAU COUNTY
MULTI-YEAR FINANCIAL PLAN UPDATE
FISCAL 2008 – 2011

June 18, 2008

NASSAU COUNTY
INTERIM FINANCE AUTHORITY

Table of Contents

I. INTRODUCTION

At its meeting on November 8, 2007, NIFA's Directors concluded that the County's Multi–Year Financial Plan for Fiscal Years 2008–2011 (hereinafter, the "Plan") was in compliance with the NIFA Act. However, they also found that the Plan continued to rely on: (1) non-recurring revenues and the depletion/drawdown of reserves; (2) optimistic projections of cost saving measures; (3) temporary shifting of resources; and (4) revenue initiatives that remained to be adopted by the State and County Legislatures.

Consequently, the Directors of NIFA recommended that the Plan be closely monitored and required the County Executive to submit a contingency plan in January of 2008 (the "Contingency Plan") and an updated Plan to NIFA no later than May 1, 2008 (hereinafter, the "Update").

What follows is an analysis and review of the County's Contingency Plan, Update, and fiscal health as of this writing. If the reader desires to more fully understand NIFA's opinions regarding the County's financial position, they should also read NIFA's October 10, 2007 report on the Plan, which can be found on the NIFA website at www.nifa.state.ny.us.

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II. SUMMARY OF FINDINGS

The County Executive submitted an update to the Budget and Multi-Year Plan on May 1, 2008. The Budget, which is the first year of the Plan, remains tightly crafted and leaves little room for miscalculations by the County. While the Update quantifies the significant fiscal challenges that must be addressed in the Out-Years, it continues the County's reliance upon skill in managing through crises and obtaining bipartisan support for uncertain State and County Legislative initiatives, most of which are needed to ensure balance in FY 2009.

A lack of long-term planning and fiscal discipline led to the County's initial fiscal crisis. Consequently, NIFA has continually urged the County to institutionalize sustainable long-term budgeting practices, which do not rely on short-term solutions to systemic problems. These practices have, in the past, exacerbated the structural imbalance between current revenues and expenses.

The County's budgeting and planning process have greatly improved during the eight years since the creation of NIFA, and this progress was achieved by hard work and courageous introspection into past problems and mistakes. These same qualities continue to be needed now, as much as ever.

<u>MAJOR FINDINGS</u>

We find that the County has fulfilled the requirement by NIFA that it submit an Update, but in doing so, it has:

1) Relied on current management's success in managing through crises and, as a consequence, has developed only a rudimentary Contingency Plan.

2) Continued to rely on non-recurring resources, potentially overly optimistic assumptions, and unsuccessful initiatives of prior years.

3) Balanced its Budget through use of reserves, fund balances, and one-time revenues such that, structurally, its recurring expenditures still exceed its recurring revenues.

4) Continued to show significant Out-Year budget gaps that are continuing to grow from $134.3 million in FY 2009 to $194.6 million in FY 2011.

ADDITIONAL FINDINGS

The County has:

1. Not accounted appropriately for a slowing economy that could threaten its sales tax estimates.

2. Utilized aggressive assumptions regarding certain new revenue streams and savings in such areas as health insurance and workers' compensation.

3. Scaled back by $10 million, funding its $50 million annual operating budget commitment to certiorari liability.

4. Proposed using an additional $18 million of bond proceeds to fund certiorari claims, which are a recurring operating expense.

5. Increased the amount of its cash flow borrowings from earlier projections.

6. Failed to adequately track its expenditures of bond proceeds.

7. Unsuccessfully proposed new expenditures including the acquisition of certain new sewage treatment facilities.

8. Reduced the number and potential impact of Smart Government Initiatives ("SGIs") in the gap-closing program.

9. Increased estimated 2008 property taxes in its major operating funds by approximately $35 million ($15 million in FY 2008 in addition to the increase of $20 million in FY 2007). The County also plans to increase property taxes by an additional $33.5 million in FY 2009, $68.1 million in FY 2010, and $103.9 million in FY 2011.

10. Funded a significant number of positions that it has no immediate plans to fill, thereby providing a potential source of expenditure relief.

11. Acknowledged unanticipated negative variances in the State budget, investment income, and employee compensation.

III. FY 2007 OPERATING RESULTS

The County reported that it ended FY 2007 with an operating surplus of $23.8 million. However, in its report on the 2007 year-end results, the County Comptroller concurred with NIFA's assessment that the FY 2007 year-end results included the use of a significant amount of non-recurring revenues and bond proceeds as operating income, thereby contributing to a large and growing structural deficit.

The Comptroller also concluded that the structural deficit - the difference between recurring revenues and expenditures - had grown in each of the last three years from $36.8 million in FY 2005 to $59.0 million in FY 2006 to $114.8 million in FY 2007. His conclusion means that the structural deficit in FY 2007 is larger than at any time since FY 2001, the last year of the prior Administration, as discussed beginning on page 19.

When we examined the County surplus, we found that it was based on the following major actions:

• draw down of designated reserves	$71.1 million
o pensions - $26.4 million	
o tobacco proceeds - $23.6 million	
o debt service - $14.8 million	
o termination payments - $6.3 million	
• use of fund balance	$38.1 million
• use of bond proceeds from over-funded capital projects	$27.7 million
• use of bond proceeds to pay for operating expenses (tax certiorari refunds)	$12.0 million

These actions are troubling because:

- Use of bond proceeds and off-budget reserves to pay operating expenses masks an imbalance that many would characterize as a deficit, and also exacerbates the budgetary gaps that must be resolved in future years.

- The County has returned to its former practice of bonding tax certiorari refunds, a fiscally imprudent practice, which led to the creation of NIFA.

In our view, a true structural surplus will only arise when the necessary steps are taken so that current County services can be sustained by revenues generated in the same year. This is prudent fiscal practice and is also more equitable to future generations that are otherwise forced to pay debt service on bonds used to provide "budgetary balance" in the current fiscal year.

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IV. STATUS OF FY 2008 OPERATING RESULTS

The County projects that it will end FY 2008 with a modest operating surplus in its major operating funds despite projecting negative variances in certain expenditures and revenues. These negative variances include:

- An increase of $6 million in salaries and wages primarily due to overtime overages;
- A reduction in investment income of $3 million attributed to current economic conditions and reduced earned interest rates;
- Additional cost projections within Health and Human Services of $1.1 million for pre-school/special education and $1 million due to increased day care market rates;
- Removal of the FIT tuition reimbursement initiative valued at $4.1 million that was excluded from State funding; and
- Across-the-board State budget cuts of 2% amounting to approximately $2 million.

To offset these increased costs and funding reductions, the County optimistically assumes that it will utilize past accrual balances, receive new revenues from initiatives that require State legislative approval and realize additional increases to current revenue streams from, for example, housing Suffolk County inmates in the correctional center. Additionally, cost containment efficiency measures are projected to save the County approximately $1 million.

Finally, the County continues to rely on a "workforce management strategy" that leaves unfilled many budgeted positions. By not filling these positions, the County saves money; however, we question the wisdom of annually appropriating resources in the budget for positions that the Administration never intends to fill.

Contingency Plan

As noted in NIFA's November 2007 staff report, submission of a detailed Contingency Plan to NIFA by January 15, 2008 was a major factor in NIFA's decision to conditionally approve the County's FY 2008 - FY 2011 Plan. However, the Contingency Plan that NIFA received consisted of only three broad strategies and totaled approximately $23 million. The Contingency Plan was subsequently reduced to less than $15 million, as shown below.

FY 2008 CONTINGENCY PLAN STRATEGY

($ in millions)	Estimated Value (as of Jan 15)	Estimated Value (as of May 15)
Utilize Reserves	$15.8	$5.8
Targeted Workforce Management	6.0	8.0
Targeted OTPS Savings	1.0	1.0
Total Plan	**$22.8**	**$14.8**

The Contingency Plan that was submitted fell short of NIFA's expectations because of its lack of specificity and new initiatives to help insulate the County from negative budgetary variances. Its continued reliance on the current Administration's ability to manage through crises does not address the structural imbalances in the County's operating model. We are not convinced that promises of aggressive management of the FY 2008 Budget, absent concrete plans, will be sufficient to make recurring expenditures keep pace with recurring revenues.

We can only repeat our advice that the County needs a comprehensive contingency plan that lays out specific "alternative" gap-closing initiatives that can be implemented to close mid-year budget variances. The contingency plan should identify the critical tasks that must be accomplished and the important milestone dates by which they must be completed

V. MULTI-YEAR FINANCIAL PLAN UPDATE

THE BASELINE

The projected gaps have not changed significantly from the adopted Plan. By the County's own estimates the baseline gaps will increase by $9.6 million in FY 2009, remain unchanged in FY 2010, and decrease by $2.9 million in FY 2011, as shown below. The changes resulted primarily from salary and wage expenditures related to contract settlements.

BASELINE GAPS
FY 2008-2011

($ in millions)	FY 2008	FY 2009	FY 2010	FY 2011
Adopted MYP	$0.0	($124.7)	($174.6)	($197.5)
MYP Update	0.0	(134.3)	(174.6)	(194.6)
Change	**$0.0**	**($9.6)**	**$0.0**	**$2.9**

There were also a number of other positive and negative baseline changes that have generally offset each other. In addition, as discussed below, the County did not make any changes to its sales tax revenue forecast.

While the baseline gaps have not increased significantly since November, the existing gaps remain significant. This situation is unsettling because the major options provided by the County to close the projected deficits, which have also not changed, are speculative. In general they require State legislative approval, which to date, has not been forthcoming.

Our concerns have heightened with the passage of time. What were initially characterized as "aggressive" place-holding assumptions in the Out-Years of the adopted Plan have now become essential to the submission of a balanced FY 2009 budget, which will be submitted to NIFA and the County Legislature in less than 3 months.

Labor Contracts

As discussed in our October 2007 staff report, the Police Benevolent Association ("PBA") interest arbitration award (the "Award") serves as the County's model for collective bargaining with its other unions. After submission of the Plan, the County entered into contracts with the Detectives' Association ("DAI") and the Sheriff Officers Association ("ShOA"). OMB has included the costs of these contracts in its baseline projections and estimates of Out-Year gaps.

As the County had anticipated, both the DAI and the ShOA settlements, although not identical, were patterned after the PBA agreement. The County had budgeted savings of $7.0 million for ShOA and $7.3 million for DAI. Although projected savings were not achieved, excess prior period accruals offset the cost of the awards in FY 2008.

The County has not yet reached settlements with the Superior Officers' Association ("SOA") and the Civil Service Employees' Association ("CSEA"), each of which has recently been turned over to an arbitration panel for mediation. Based on the wage patterns and terms of the contracts with unions that have already settled, it is expected that the County will be able to achieve some level of contractual savings from the CSEA and SOA, although they are likely to fall short of the County's original savings estimates.

While there is reason to be cautiously optimistic, these risks are still significant. The County must be prepared to move quickly to mitigate negative variances that may develop in its baseline and gap-closing plan assumptions from either a failure or delay in securing requisite concessions. NIFA will review the County's analysis of the financial impact of the arbitrators' decisions on the Financial Plan.

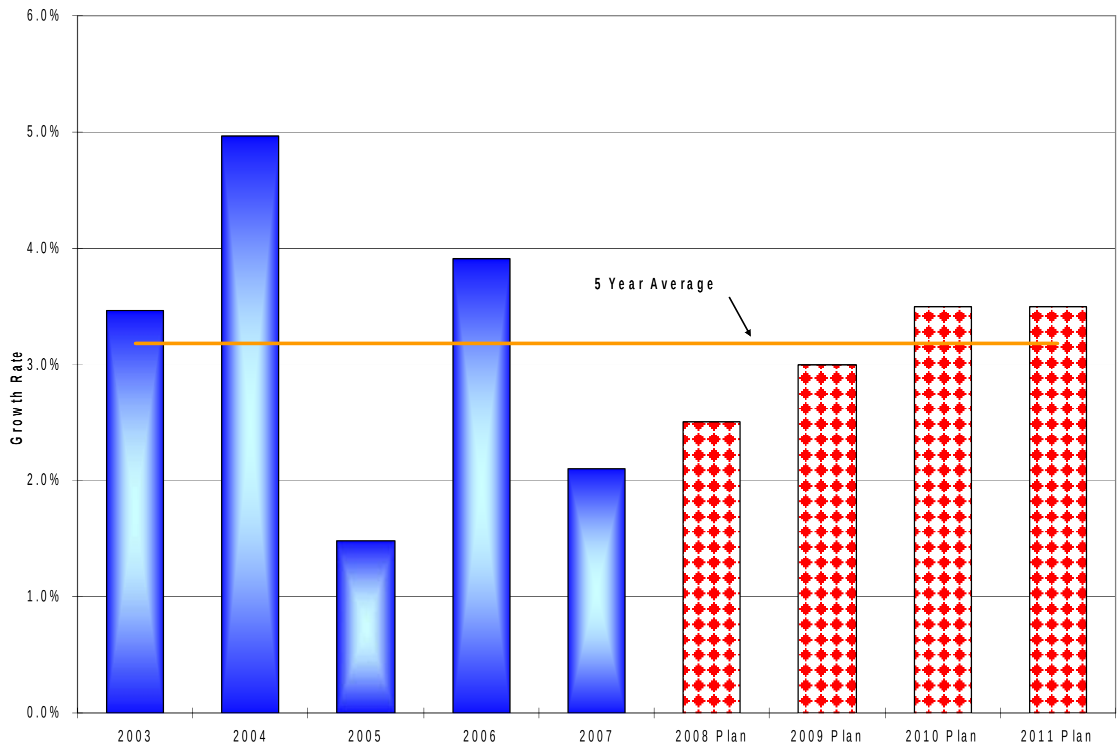
Sales Tax

Sales tax revenue comprises more than 40% of the County's total revenue stream, which makes this an area that both the County and NIFA need to continue to monitor carefully. The County has maintained its FY 2008 sales tax forecast of $1.04 billion, which necessitates growth of more than 2.5% over collections in FY 2007. We remain concerned whether the current economic environment will be robust enough to generate the necessary growth.

Sales tax revenue grew by only 2.1% in FY 2007. Furthermore, based upon actual sales tax receipts through June 5th, the County needs the remaining payments to grow by 3.1% in order to achieve its FY 2008 budgeted target. The County believes that it may achieve this goal with the help of the Federal Economic Stimulus Package. Although the Stimulus Package may help increase consumer spending and thereby tax receipts, there is also a strong possibility that the extra monies will be spent on items that do not generate significant additional sales tax.

The County assumes that the economic weakness will abate and translate into sales tax growth of 3.0% in FY 2009 and 3.5% in each of FY 2010 and FY 2011. These projections are not unreasonable based on historical performance since, as shown in Chart 1, sales tax revenues have grown by an annual average of 3.2% over the last 5 years. However, much of that recent growth resulted from a number of positive economic factors which are currently not present, such as strong jobs growth and rising housing prices. Moreover, many economists fear that the economy will continue to slow because of the continuing housing and credit debacle as well as surging energy prices. In fact, sales tax growth in FY 2008 has already lagged prior years.

(Chart 1)
ANNUAL SALES TAX GROWTH HAS
AVERAGED 3.2 PERCENT DURING THE LAST FIVE YEARS



GAP-CLOSING PROGRAM

Despite many questionable assumptions that NIFA highlighted in its October 2007 Report, the County's gap-closing program, as shown below, remains substantially unchanged from the adopted Plan. Many of the initiatives have been included for a number of years with only moderate success and some have experienced repeated delays in various stages of implementation.

GAP-CLOSING PLAN
FY 2008-2011

($ in millions)	FY 2008	FY 2009	FY 2010	FY 2011
County Projected Baseline Gap	**$0.0**	**($134.3)**	**($174.6)**	**($194.6)**
Baseline Measures:				
Smart Government Initiatives	$0.0	$5.5	$11.3	$13.4
Workforce Management	0.0	10.0	15.0	15.0
Annual Property Tax Increase	0.0	29.6	60.3	92.2
Value of New Construction - Increase in Property Tax Levy	0.0	3.9	7.8	11.7
Use of Remaining Tobacco Proceeds	0.0	23.0	5.0	0.0
Pension Reserve	0.0	0.5	0.0	0.0
Health Insurance Cost Reductions	0.0	15.0	20.0	20.0
PAYGO Judgments and Settlements	0.0	(5.0)	(10.0)	(15.0)
Subtotal – Gap-Closing Initiatives	**$0.0**	**$82.5**	**$109.3**	**$137.2**
Remaining Gap	**$0.0**	**($51.8)**	**($65.3)**	**($57.4)**
Options to Close Remaining Gap:				
Video Lottery Terminals	$0.0	$20.0	$20.0	$20.0
Proposed Legislative Cigarette Tax	0.0	28.4	28.4	28.4
Red Light Cameras	0.0	7.0	7.0	7.0
Residential Energy Tax	0.0	21.0	21.6	22.3
Discretionary Programming Reductions	0.0	7.5	7.5	7.5
Debt Restructuring	0.0	0.0	5.0	5.0
Subtotal – Options	**$0.0**	**$83.9**	**$89.5**	**$90.2**
Surplus - Assuming All Options	**$0.0**	**$32.1**	**$24.3**	**$32.8**

Smart Government Initiatives

The County's gap-closing plan includes Smart Government Initiatives ("SGIs") in the amount of $5.5 million in FY 2009, $11.3 million in FY 2010 and $13.4 million in FY 2011. The Update reduced or removed initiatives for all three Out-Years totaling $4.3 million in FY 2009, and approximately $0.5 million for FY 2010 and FY 2011.

SMART GOVERNMENT INITIATIVES
FY 2009-2011

Vertical	Initiative	2009	2010	2011
Law Enforcement & Public Safety	Electronic Court Appearance	0	500,000	520,000
	Police Academy Adjunct Profs	445,329	463,587	482,595
	Radio Tower usage Fee	768,000	791,808	816,354
Health & Human Services	Day Camp Inspection Fee	78,000	78,000	78,000
	Pre-Demolition Site Inspection Fee	67,000	67,000	67,000
	Realty Subdivision Fee	25,000	25,000	25,000
	Tanning Salon Fees	4,000	4,000	4,000
	Lost Handicapped Permit Fee	25,000	25,000	25,000
	Persons in Need of Supervision (PINS)	0	0	0
Economic Development	NY State Empire Zones Program	2,000,000	4,000,000	6,000,000
Management, Budget & Finance	Risk Management	75,000	175,000	175,000
	Revenue Options	942,557	1,195,469	1,240,630
	Energy Efficiency	1,064,130	546,128	546,128
	Commercial Tax Grievance Filing Fee	0	3,400,000	3,400,000
	TOTAL	5,494,016	11,270,992	13,379,707

The reductions between the adopted Plan and the Update occurred within only two initiatives: Electronic Court Appearance, an SGI within the Correctional Center and Persons in Need of Assistance (“PINS”), an HHS Social Services SGI.

Electronic Court Appearance is designed to utilize technology within the Corrections Center to improve efficiency through video conferencing. Savings from this SGI has been completely removed for FY 2009 and reduced by approximately $20,000 in FY 2010 and 2011. The reason projected savings have been pushed back is that by benchmarking against other municipalities that have undertaken this initiative, experience has shown that set-up and implementation of this new system is a time-consuming process.

The Health and Human Services SGI, PINS, was designed to decrease the cost of vendor payments by placing youths in less formal residential placement. Savings from this SGI was provided in the adopted Plan, but is completely eliminated in all years of the Update because savings are reflected within the PINS emergency services baseline rather than highlighted as an initiative.

The Commercial Tax Grievance Filing Fee continues to be included in the Update at the levels assumed in the adopted Plan and requires State legislative approval, which has still not materialized. Therefore, we remain concerned if this initiative will ever achieve its potential for a positive financial impact.

The Energy Efficiency Improvement Program initiative remains unchanged and we have been provided with a list of facilities that will potentially be included in this project. While we feel that the high cost of utilities warrants the pursuit of an energy management program, we are not optimistic since the County has unsuccessfully pursued these types of savings in prior years.

Workforce Management

The County continues to achieve significant savings in personal service expenditures because each year it holds many of its budgeted positions vacant. As of this Update, the variance between budgeted positions and "on-boards" is 361 positions. Continuing this "workforce management program" is expected to produce savings of $10.0 million in FY 2009 and $15 million in each of FY 2010 and FY 2011.

Historically, the majority of the workforce management savings have resulted from not filling vacant positions in the Correctional Center, and the Probation and Police Headquarters. We doubt that this initiative can continue indefinitely without adversely affecting the delivery of services or resulting in significantly more costly overtime.

Property Tax Levy Increases

The Update maintains the County Executive's proposal to implement annual property tax levy increases totaling 4.3% beginning in FY 2009, including capturing the value of new construction. After increasing the property tax levy by $20 million in FY 2007 and $15 million in FY 2008, these additional increases will raise property tax revenues by $33.5 million in FY 2009, by $68.1 million in FY 2010, and by $103.9 million in FY 2011.

If these tax increases are approved, they will result in an increase in the annual tax levy in the major operating funds by $363.9 million (70.9%) since FY 2000, and $256.6 million (41.3%) since FY 2002. While completely within the County's control, it is unclear if there is sufficient legislative or other political support for these proposed increases.

Use of Remaining Tobacco Proceeds and Pension Reserves

The County plans to use an additional $28 million from the 1999 tobacco securitization to fund operating expenses. Of this, $23 million will be used in FY 2009, and $5 million in FY 2010. This will exhaust the proceeds from this borrowing. The County also plans to exhaust the remaining $0.5 million currently held in its pension reserve fund.

Health Insurance Cost Reductions

The County has demonstrated modest success with securing labor savings in recent years, but has had little success with extracting long-term savings from modifications to its employee fringe benefits package. Nevertheless, the County is seeking annual savings which grow from $15 million in FY 2009 to $20 million in FY 2010 from reductions in the County's cost of health insurance.

The easiest way to accomplish these financial goals in the healthcare area would have been to require employees to contribute to their insurance premiums. Instead, the County hopes to explore alternative health insurance options, a path that proved disastrous for the prior Administration.

We also note that the CSEA Memorandum of Agreement, FY 2003-2007, already provided for the establishment of a committee to study alternative health insurance concepts. Although the County had agreed that one-quarter of any cost savings resulting from implementation of the committee's recommendations would be shared with the CSEA, no savings have been identified to-date.

PAYGO Judgments and Settlements

The County has discussed a transition to paying for non-certiorari judgments and settlements in its operating budget. These have been funded in the capital budget; a practice which the Administration understands is not optimal.

Every municipality encounters judgments and settlements in the normal course of business. Within a limited range, these costs are predictable. Consequently, they should be budgeted as part of the normal operating budget. Only in the case of extraordinary judgments or settlements should they be funded through borrowing or from an appropriate reserve.

Options to Close Remaining Gap

Even if all of the previous gap-closing actions were successful, projected gaps would remain of $51.8 million in FY 2009, $65.3 million in FY 2010, and $57.4 million in FY 2011. The Update continues to assume that these gaps can be closed through a number of options including increasing certain taxes and other revenue generating options. For FY 2009, the more significant of these options include $20 million from video lottery terminals to be installed at Belmont Park, $28.4 million from a proposed increase in the cigarette tax, and/or $21 million in a new residential energy tax. The County assumes that these revenues would remain flat through the Plan period, except for the residential energy tax which would grow by 2.9% in FY 2010, and 3.2% in FY 2011.

The County has not yet secured State legislative approval for these actions. In fact, the recent increase in the State's tax on cigarettes further decreases the likelihood of garnering requisite support for the County's initiative.

The need to balance the FY 2009 Budget and Out-Years of the Plan with recurring actions that provide continuing budgetary relief is essential. The County should be more aggressive in pursuing its existing smart government initiatives or in creating new initiatives, restructuring government operations, and managing its workforce to achieve structural budgetary balance.

To a lesser degree, the "Remaining Gaps" are also to be closed by discretionary program reductions and debt restructuring. Neither of these have any specificity; consequently, we are unable to evaluate whether they would or would not be achieved.

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VI. ISSUES THAT REQUIRE FURTHER SCRUTINY

Notwithstanding the many accomplishments of the County, a number of major challenges and concerns identified in our previous report remain including the Sewer and Storm Water Resources District and Finance Authority, the significant and steep reduction of reserve balances, the Nassau Health Care Corporation, tax certiorari, and debt issuance.

SEWER AND STORM WATER SERVICES

In 2003, at the request of Nassau County, the New York State Legislature created the Nassau County Sewer and Storm Water Finance Authority ("SSWFA") and a consolidated County-wide Sewer and Storm Water Resource District ("District"). The original justification for the Legislation was potential savings that would be achieved by doing certain financings under the auspices of the New York State Environmental Facilities Corporation ("EFC").

To the best of our knowledge, no financings have ever taken place with the assistance of the EFC. Instead, the SSWFA has taken every legal opportunity to enlarge its mandate by: using fund balance from each of the combined sewer districts to subsidize other County funds; by charging back the salaries of County employees to the District; and by attempting to fund the acquisition of additional sewage treatment facilities in three localities.

Each of these initiatives have met with resistance from certain groups within the County, which is one of the reasons that we have continually urged the County to make the relationship between the SSWFA, the District, and the County more transparent. We have also urged the County to have a single person or entity to oversee the SSWFA and District. This would help minimize the general lack of accountability and unforeseen disconnects among certain departments including, but not limited to, legal, debt issuance, treasury, public works, planning, and personnel.

RESERVE BALANCES

As discussed in our October 2007 staff report, Section 3667 (4) (c) of the NIFA Act requires that the financial plan include "adequate reserves …to maintain essential programs in the event that revenues have been overstated or expenditures underestimated for any period." The legislative intent was that monies be available for unplanned or extraordinary events which might arise and were not planned for in the County's budgets or multi-year plans.

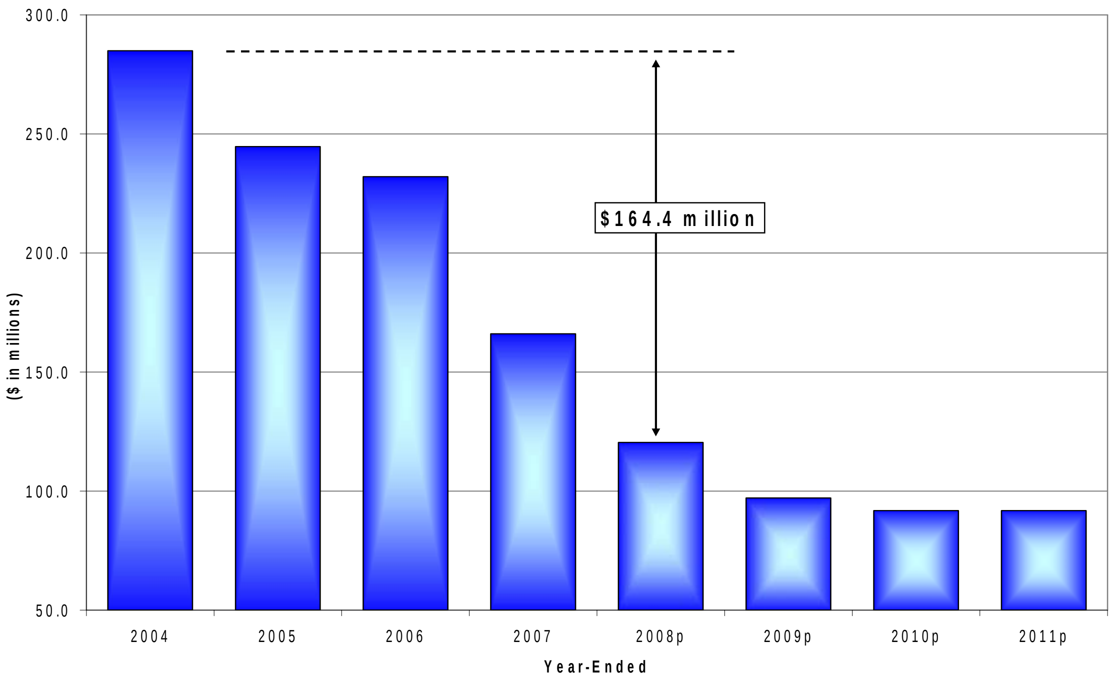
The County understands the wisdom of maintaining reserves, which for purposes of this discussion we have divided into "General Reserves" and "Restricted Reserves." (See the Appendices for a detailed breakdown of the amount in each of the reserve funds which we have combined into General and Restricted Reserves). In fact, the County has documented its commitment to sound fiscal practices by reporting a number of steps it has taken including "a refusal to utilize non-recurring revenues and prior-year undesignated fund balances to cover current year baseline operating expenses," "the implementation of appropriate borrowing practices," and "the establishment of reserves to address contingencies should they arise."

Notwithstanding general and widely held consensus opinions to the contrary, the County has strayed from its commitment to these prudent fiscal practices. For example, it has continued to utilize non-recurring resources to fund recurring expenditures. This has been accomplished, in part, by depleting contingency reserves, which should be tapped only in response to unplanned or extraordinary events rather than during the County's routine financial planning process.

This contravenes the County's Fund Balance and Reserve Policy which stipulates that to the extent that the County utilizes its unreserved fund balance, its policy shall be to use these funds either for: (i) non-recurring expenditures that promote important policy objectives; or (ii) extraordinary operating and capital purposes that could not be anticipated and which otherwise cannot be financed with current revenues in the annual operating budget.

As shown in Chart 2, the County's General Reserves are projected to fall to $120.4 million by the end of FY 2008, illustrating the County's notable use of $164.4 million in non-recurring reserves to pay for recurring expenditures over the four year period since FY 2004.

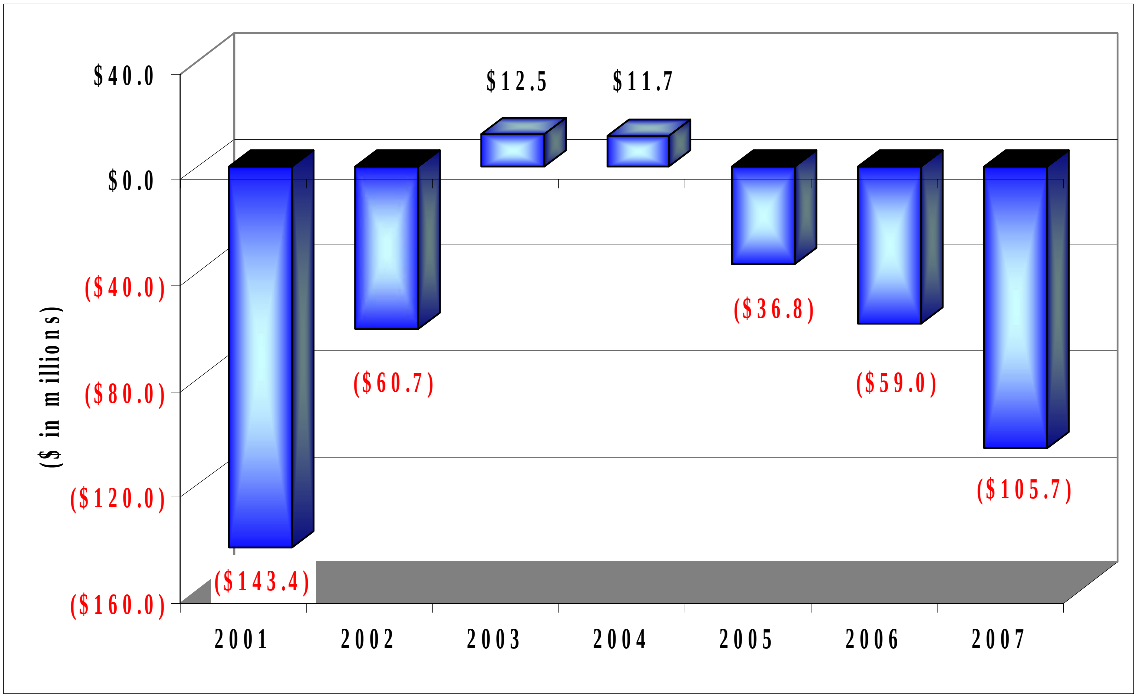
(Chart 2)
COUNTY GENERAL RESERVES HAVE DECLINED SHARPLY SINCE FY 2004



We encourage the County to evaluate whether the size of its projected reserves is sufficient to buffer the impact of an unexpected economic downturn – an event which the County has largely escaped in recent years – and if necessary begin to replenish these reserves. In fact, the County's proposed Fund Balance and Reserve Policy calls for the replenishment of its unreserved fund balance by direct appropriation in the event that for two successive years, the County's level of unreserved fund balance falls below 4% of normal expenditures made from its General Fund and the County-wide Special Revenue Funds.

Chart 3 illustrates how the County's use of its reserves, combined with its continued dependence on other non-recurring resources to ensure short-term balance, has undermined the County's progress in attaining long-term structural balance. In fact, NIFA is disappointed to note that the County's fiscal actions began a dramatic reversal in its long-term fiscal outlook even during a period (FY 2005–FY 2007) of relative economic strength. The structural deficit - the difference between recurring revenues and expenditures - has grown in each of the last three years from $36.8 million in FY 2005 to $59.0 million in FY 2006 to $114.8 million in FY 2007. This means that the structural deficit in FY 2007 is larger than at any time since FY 2001, the last year of the prior Administration.

(Chart 3)
PROGRESS TOWARD STRUCTURAL BALANCE HAS REVERSED



NASSAU HEALTH CARE CORPORATION

The financial health of the Nassau Health Care Corporation ("NHCC") and its potential impact on Nassau County has been a major concern for NIFA since its inception. Perennial operating losses and the concomitant erosion of cash balances have been difficult to counteract, but at least there now appears to be an improvement in accountability and a modest turnaround in operating results.

NHCC's budget projects that it will end FY 2008 with a break even operating result after implementation of its gap-closing program. However, we are skeptical because NHCC's finances have already performed below expectation in the first four months of FY 2008. Through April, NHCC has reported an operating loss of $4.1 million, which is $2.4 million unfavorable to budget.

To achieve break-even status, NHCC is hoping it will receive disproportionate share hospital ("DSH") payments and group price appeals totaling $7.0 million. NHCC is pursuing the Federal DSH payments, but the group price appeal is subject to State approval. If NHCC is unsuccessful in securing these resources, it must identify other revenue producing initiatives and cost cutting measures.

There has been some improvement in NHCC's monthly net patient service revenue, most notably at the A. Holly Patterson Nursing Home, although receipts continue to fall short of budgeted targets, with the first four months reflecting a negative variance of $0.3 million. In addition, operating expenses continue to exceed budget, most notably for employee salaries and fringe benefits as well as for interest expenses driven higher by its auction rate debt.

NHCC plans to convert its outstanding ARS bonds to variable rate demand bonds this month after redeeming $34 million of its ARS debt using HEAL proceeds. Receipt of these funds and expectations of additional future funding has put the institution on less precarious footing from a cash flow and working capital stand-point, and will also reduce future interest costs due to the reduction of outstanding principal.

Money given to NHCC by the County must be carefully monitored and released only upon the attainment of specific goals and not based only upon projections. The County needs to remember that the money it gives to NHCC, especially those monies raised from the tobacco financing, were raised at very high interest rates and subject to a pledge of future cash flows far into the future.

CERTIORARI

Resolution of the certiorari problem has been seen as essential to Nassau County's return to fiscal stability. The State Legislature recognized the severity of the problem and under the legislation that created NIFA in June of 2000, Nassau County was given the authority to borrow up to $800 million for certiorari settlements and judgments. The County was also given $5 million of State aid to assist it in streamlining the tax certiorari claims process.

ANNUAL PAYMENTS FOR CERTIORARI CLAIMS

Activity ($ in millions)	FY 2006 Actual	FY 2007 Actual	FY 2008 Projected
Current-Year Operating Funds	$0.0	$25.0	$40.0
Prior-Year Surplus	$50.0	$25.0	$10.0
Debt	$1.0	$12.0	$18.0
Total	**$51.0**	**$62.0**	**$68.0**

The County made funding certiorari refunds out of its operating budget a cornerstone of its recovery. Unfortunately, the County's continues to postpone or scale back its transition to pay-as-you-go funding for certiorari in the following ways:

1. As shown in the table above, instead of fulfilling its promise to use at least $50 million per year in current year resources to pay certiorari refunds, the County has used prior year surpluses to make these payments. This is the third year that the full implementation of this $50 million initiative has been postponed.

2. In January of 2008, the County borrowed an additional $50 million for payment of certiorari claims. At least $12 million of that money was used to pay for certiorari claims in 2007 and it appears that at least $18 million will be spent in 2008.

   It is noteworthy that the County had already borrowed $800 million for this same purpose and is carrying approximately $150 million annually in debt service costs related to past certiorari borrowing

We also note that in response to the certiorari crisis, the County very rapidly hired new employees and built in house expertise. Now that the crisis is lessening, we cannot find any budgeted reductions in costs for personnel in ARC, the County Attorney, the Department of Assessment or Treasury. This is an area where we hope that the County can begin to show the benefit of increased experience and investment in technology as they try to put together a new budget and financial plan.

DEBT ISSUANCE

Several important matters have occurred since the Plan was adopted that impact the County's issuance of debt and payment of debt service.

1. **Refunding –** NIFA has refunded all of it outstanding auction rate securities ("ARS") bonds ($718 million) and substituted variable rate demand bonds at a lower interest cost to the County. This refunding was endorsed by the County because of the lack of liquidity in the ARS market that had caused ARS rates to rise. Additional bonds were also refunded to smooth out NIFA's debt service and thereby relieve the County from any current year budget dislocations it might have suffered due to the temporary increase in rates caused by the ARS problem.

2. **NIFA Upgrade –** The County has become the beneficiary of a NIFA upgrade to "AAA" by Standard & Poor's. This is the highest rating given by Standard & Poor's and saves NIFA, and thereby the County, several basis points in interest on its variable rate debt. This savings should be part of any new projection of the County's debt service costs.

3. **Recent County Ratings –** The County recently asked for ratings for its proposed issuances of General Obligation Bonds and Revenue Anticipation Notes. Standard & Poor's upgraded the County's long term rating, but noted the County's use of non-recurring revenues and continued budgetary exposure to other significant items including NHCC, sales tax fluctuations, and tax certiorari payments. The other two rating agencies maintained their ratings and sounded notes of caution about the County's financial condition.

4. **Cash Flow Borrowings –** The County has substantially increased its use of short-term borrowing for cash flow purposes, evidencing deteriorating balances and liquidity. The County re-commenced cash flow borrowings in FY 2005 and has increased the levels steadily such that they are budgeted for approximately $210 million in FY 2008, $215 million in FY 2009 and FY 2010, and $225 million in FY 2011. Moreover, the County recently concluded that it needed to increase its planned mid-year borrowing to $110 million in FY 2008, or 10% above previously adopted assumptions.

5. **Capital Borrowing and Spending Patterns –** Over the years the County has had a poor record of predicting its capital needs and timely spending money that was raised for those purposes. The most recent and significant example of this problem occurred at the end of the 2007 fiscal year when the County discovered that it had borrowed $39 million more for capital purposes than it needed.

   The County redirected the unspent bond proceeds to its operating budget where it was used to pay debt service. This action freed up $39 million in resources that had already been budgeted for this purpose, thereby resulting in an out-of-period budgetary windfall in FY 2007. While the County has assured NIFA that its bond counsel has affirmed the legality of this action, it results in future taxpayers bearing the burden of paying for bonds whose proceeds were used to benefit only current year taxpayers. A full list of the projects, as provided to NIFA by the County, is in the Appendices.

6. **Rebate Liability –** The County continues to have potentially significant rebate liability. Some of this liability arose because of the practices of prior Administrations, but it may also have arisen because of the excessive time it has taken the current Administration to size this problem and draw down the money that NIFA borrowed on its behalf. Six years into the current Administration, the County should be able to figure out its liability and that of the former Administration. Not paying money that may be owed to the Federal Government puts the County debt issuance program at a significant and unnecessary risk.

7. **Tobacco Securitization –** The County Legislature recently approved a successor agreement whereby the Nassau University Medical Center (“NUMC”) was assured receipt of approximately $115.9 million that was raised by the County’s March 2006 tobacco securitization. Although we do not question the County Legislature’s decision to grant these monies, we have continually objected to their use as a substitute for County operating expenses. For example, although the County claimed they would not be used for this purpose, the aforementioned successor agreement eliminated a recurring $4 million inmate healthcare subsidy from the County to NUMC. In return, the County gave a one-time grant

of the tobacco securitization monies to NUMC. This transaction resulted in a concomitant reduction in the County's operating budget expense related to NUMC subsidies.

8. **Auction Rate Exposure –** The Sewer and Storm Water Financing Authority ("SSWFA") continues to carry approximately $45 million in auction rate debt, which they plan to refund in the near future.

VII. APPENDICES

GLOSSARY

May Update – Multi-Year Financial Plan Update submitted May 1, 2008

Fund Balance – The excess of the assets of the fund over its liabilities, reserves and carryover.

General Reserves – any monies that are held in reserve by the County and could be used to fill unanticipated budget gaps.

Major Fund – is the term the County uses to refer to the departments that comprise its General Fund, Fire Commission Fund, Police District Fund, Police Head Quarters Fund.

Multi-Year Financial Plan (the Plan) – The County's four-year projection of baseline operating revenues and expenses and its plan for closing any projected gaps.

Out-Years – FY 2009-2011

Pay-as-you-go – A term used describe a financial policy where capital outlays are financed from current revenues to avoid incurring costly debt financing or issuing new debt.

proposed Budget – Fiscal Year 2008 proposed Budget submitted September 15, 2007

proposed Plan – Multi-Year Financial Plan submitted September 15, 2007

Plan – Adopted Multi-Year Financial Plan submitted November 1, 2007

Restricted Reserves – monies held in separate accounts and usually restricted by law as to their use.

Tax Certiorari (certs) – Grievances filed by Nassau County property owners contesting the assessment of their properties.

ACRONYMS

AFA - Adjunct Faculty Association

AHP - A. Holly Patterson

ARC - Assessment Review Commission

ARS - Auction Rate Securities

Authority - Nassau County Interim Finance Authority

CON - Certificate of Need

CSEA - Civil Service Employees Association

COLA - Cost-of-Living Adjustment

CPI - Consumer Price Index

DAI - Detectives' Association Inc.

District - Sewer and Storm Water Resource District

DOH - Department of Health

FY - Fiscal Year

FTE - Full-time Equivalent

HEAL - Healthcare Efficiency and Affordability Law

ICR - Institutional Cost Report

LIRR - Long Island Railroad

MTA - Metropolitan Transit Authority

NHCC - Nassau Health Care Corporation

NUMC - Nassau University Medical Center

NCC - Nassau Community College

NCCFT - Nassau Community College Federation of Teachers

NIFA - Nassau County Interim Finance Authority

OMB - Office of Management & Budget

OTPS - Other than Personal Services

PAYGO - Pay-as-you-go

PBA - Police Benevolent Association

PINS - Persons in Need of Supervision

RANS - Revenue Anticipation Notes

SGIs - Smart Government Initiatives

ShOA - Sheriff Officers Association

SOA - Superior Officers Association

SNA - Safety Net Assistance

SSWFA - Sewer and Storm Water Finance Authority

TANF - Temporary Assistance for Needy Families

TANS - Tax Anticipation Notes

VRDB - Variable Rate Demand Bond

EXCESS CAPITAL FUNDS USED TO PROVIDE OPERATING RELIEF IN FY 2007

	Project Title		Balance
Grant Recoveries			
840	PROJECT 410 RES FOR RTRMNT OF BNDS	$	2,594,046.88
840	PROJECT 410 RES FOR RTRMNT OF BNDS	$	579,750.50
840	PROJECT 91017 MSBA GRANT NY03-0307	$	21,787.00
840	PROJECT 62410 OLD COUNTRY ROAD	$	270,078.98
840	PROJ 61-587 RESURFACING VAR COUNTY ROADS	$	6,201,957.96
840	PROJECT 60-040	$	1,452,026.67
840	PROJECT 61041 MARCUS AVE PROJECT	$	1,307,192.34
840	PROJECT 61-585 CAP FUND	$	1,301,710.31
840	PROJECT 81021 FIREMAN'S TRAINING CENTER	$	1,197,822.28
840	PROJECT 61067 BAYVIEW ROAD	$	785,937.79
840	PROJECT 63-024	$	774,348.00
840	PROJECT 62150 PAVEMENT MARKINGS	$	292,877.40
840	PROJECT 62410 OLD COUNTRY ROAD	$	250,000.00
840	PROJECT 61-584	$	161,638.57
840	PROJECT 91019 MSBA GRANT 90X334	$	122,970.00
840	PROJECT 91260 RES FOR RET OF BONDS	$	102,985.00
840	PROJECT 91017 MSBA GRANT NY03-0307	$	68,174.00
840	PROJECT 62126 TRAFFIC CONTROL	$	63,077.83
840	PROJECT 91091 HUB MIS STDY SEC 5309	$	54,377.00
840	PROJECT 91014 MSBA GRANT NY90-X300	$	53,891.00
840	PROJECT 91013 MSBA GRANT NY03-0301	$	41,927.00
840	PROJECT 70-054 COLLEGE MASTER PLAN	$	29,609.67
840	PROJECT 9C-480 CAP FUND	$	10,000.00
840	PROJECT 91005 RES FOR RETIRMENT OF BONDS	$	2,920.00
840	PROJ 90-023 VAR CTY BLDG BCKFLOW PH III	$	1,573.44
840	PROJECT 41823 VARIOUS COUNTY PONDS	$	100.00
840	PROJECT 60019 MEADOWMERE ROAD BETTERMENT	$	50.00
Grant Recoveries		$	17,742,829.62

Project Closeouts			
21006	AHP 200 BED HEALTH RELAT	$	42,640.32
41515	Fine Arts Museum Site Improvements	$	3,833.85
50616	Police Department/District Attorney Vehicle Replacement	$	9,879.99
52023	Fire Communications Center Equipment	$	48,429.00
60035	Middle Neck Road (Sands Point)	$	67,817.76
60571	Kentuck Brook Drainage Improvements Phase II	$	396,779.52
61041	Marcus Avenue at Hillside Avenue	$	1,681.88
62151	Traffic Pavement Marking Material	$	6,242.20
66301	Requirements Contract Roads/Drainage/Bridge/Joints '02-6	$	6,702.64
81021	FTC Environmental Site Cleanup	$	2,900,000.00
90421	MINEOLA COMPLX PKNG LOTS	$	92,367.69
90602	Various County Buildings Replace Air Handling	$	15,094.99
91017	MTALIB 1995 FTA Sec 5309 Grant NY03-0307	$	104,625.64
91028	MTALIB 1999 FTA Grant Sect 5307 NY90-X404	$	14,622.00
91300	LIRR Various Projects	$	1,929,107.00
91302	LIRR Reconstruction Various Bridges & Bldgs	$	3,271,267.00
91306	LIRR Resurface Various Parking Areas	$	9,027,809.00
91321	Employee Facility Rehabilitation	$	3,217,821.00
97110	Performance Measurement Statistical Software	$	2,205.00
9E486	Grumman Buildings and Property	$	58,230.88
Capital Project Closeouts		$	21,217,157.36

Total Debt Service Revenue $ 38,959,986.

SUMMARY OF COUNTY RESERVES

	General Reserves						Restricted Reserves			
Year	Retirement Contribution	Bonded Indebtedness	Employee Accrued	Unreserved Fund Balance	Tobacco Settlement	Sub-Total	Tobacco Borrowing	SSWRD	SSWFA	Total
YE 2004	$79.8	$25.0	$28.9	$90.5	$60.6	$284.8		$32.4	$60.9	$378.1
2005 Uses	($35.0)	$0.0	($7.5)	$0.0	($23.0)	($65.5)		$0.0	($11.5)	($77.0)
2005 Contributions	$24.8	$0.7	$0.0	$0.0	$0.0	$25.5		$30.5	$0.0	$56.0
YE 2005	$69.6	$25.7	$21.4	$90.5	$37.6	$244.8	$0.0	$62.9	$49.4	$357.1
2006 Uses	($34.2)	($10.9)	($1.3)	($13.4)	($23.0)	($82.8)	($10.3)	$0.0	($53.3)	($146.4)
2006 Contributions	$16.0	$0.0	$1.3	$27.0	$25.8	$70.1	$119.8	$58.8	$23.7	$272.4
YE 2006	$51.4	$14.8	$21.4	$104.1	$40.4	$232.1	$109.5	$121.7	$19.8	$483.1
2007 Uses	($26.4)	($14.8)	($6.3)	($38.1)	($23.0)	($108.6)	($10.5)	($4.0)	($19.8)	($142.9)
2007 Contributions	$0.0	$0.0	$0.0	$23.8	$21.2	$45.0	$0.0	$0.0	$0.0	$45.0
YE 2007	$25.0	($0.0)	$15.1	$89.8	$38.6	$168.5	$99.0	$117.7	$0.0	$385.2
2008 Uses	($24.5)	$0.0	$0.0	($10.0)	($23.0)	($57.5)	($33.4)	($32.5)	$0.0	($123.4)
2008 Contributions	$0.0	$0.0	$0.0	$0.0	$12.0	$12.0	$0.0	$0.0	$0.0	$12.0
YE 2008	$0.5	($0.0)	$15.1	$79.8	$27.6	$123.0	$65.6	$85.2	$0.0	$273.8
2009 Uses	($0.5)	$0.0	$0.0	$0.0	($23.0)	($23.5)	($35.0)	($35.1)	$0.0	($93.6)
2009 Contributions	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
YE 2009	($0.0)	($0.0)	$15.1	$79.8	$4.6	$99.5	$30.6	$50.1	$0.0	$180.2
2010 Uses	$0.0	$0.0	$0.0	$0.0	($4.6)	($4.6)	($22.0)	($27.1)	$0.0	($53.7)
2010 Contributions	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	0	$0.0	$0.0	$0.0
YE 2010	($0.0)	($0.0)	$15.1	$79.8	$0.0	$94.9	$8.6	$23.0	$0.0	$126.5
2011 Uses	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	($8.6)	($23.0)	$0.0	($31.6)
2011 Contributions	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	0	$0.0	$0.0	$0.0
YE 2011	($0.0)	($0.0)	$15.1	$79.8	$0.0	$94.9	($0.0)	($0.0)	$0.0	$94.9