# Nassau County Interim Finance Authority

NIFA

## REVIEW OF THE APRIL 1, 2006 NASSAU COUNTY MULTI-YEAR FINANCIAL PLAN UPDATE FISCAL 2006 – 2009

May 4, 2006

# NASSAU COUNTY
# INTERIM FINANCE AUTHORITY

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When NIFA approved the County's Multi – Year Financial Plan for Fiscal Years 2006 – 2009 (hereinafter, the "Plan"), the Directors were concerned about a number of issues that could affect the County's financial plan and as a result mandated that the County Executive submit an update of the Plan to NIFA no later than April 1, 2006 (hereinafter, the "Update"). The Update was delivered to NIFA on April 3, 2006.

What follows is a review and analysis of those parts of the Update where substantive changes have occurred, or where NIFA felt that the Update would be predictive of the County's future financial position. This report only comments upon the major changes to the Plan; therefore it needs to be read in conjunction with NIFA's October 14, 2005 report on the Plan, since not all of the concerns raised in that report are repeated here. NIFA is also not commenting on the level or quality of services provided by the County.

This report is divided into five sections: (1) summary of findings, (2) status of the FY 2006 operating results, (3) the baseline, (4) the gap-closing program, and (5) issues that require further scrutiny.

## SUMMARY OF FINDINGS

1) The County has fulfilled NIFA's request that it submit an update to the Plan. The Update demonstrates continued and steady progress toward resolving the County's financial difficulties in FY 2006 and FY 2007. However, we are concerned that the Update continues the recent pattern of using increasingly larger amounts of non-recurring resources to balance the Plan, and that a number of reserves have been removed from the budget, making it less conservative and more risky.

2) According to the Update, the baseline gap, which is the difference between recurring revenues and expenditures, has increased by approximately $10 million a year, primarily because of reduced sales tax projections. The out-year gaps are now projected to be $186.1 million in FY 2007, $240.0 million in FY 2008, and $284.4 million in FY 2009.

3) The County plans to use an additional $19 million of non-recurring resources to pay pension costs, an additional $4.9 million of non-recurring resources to fund pay-go certiorari payments in FY 2007, and reduced the amount of judgments that will be paid from operating funds by $12.1 million in FY 2007, FY 2008 and FY 2009.

4) The County has wisely reduced its projected FY 2006 sales tax revenues because FY 2005 receipts were less than budgeted. To offset this decrease the County no longer plans to fill a number of funded positions and implemented a limited freeze on hiring and non-essential purchases.

5) The County has significantly reduced it backlog of tax certiorari claims from $310 million at the end of FY 2004 to $131 million at the end of FY 2005. The County

believes that this backlog level will allow them to limit their annual payments to $50 million or less.

6) NIFA and the County will need to continue to work together to resolve several outstanding challenges, including: the Nassau County Health Care Corporation ("NHCC") and, in particular how the County will prudently use the $120 million of tobacco proceeds, especially if the NHCC does not provide a credible recovery plan.

## STATUS OF FY 2006 OPERATING RESULTS

The County believes that it will end FY 2006 with an operating surplus of $4.9 million for the current fiscal year. The County plans to use this surplus to pre-fund 2007 debt service costs. In making this projection the County has reduced its projected sales tax revenues by $17.8 million, and increased its workforce management savings. In addition, while there were a number of positive and negative variances, they generally offset each other. In order to compensate for the reduced sales tax revenues the County Executive imposed a hiring and OTPS freeze.

Because FY 2005 sales tax growth was only 1.48% the County has reduced its FY 2006 sales tax revenue estimate by $17.6 million to $978.2 million, which represents an increase of 2.8% from last years receipts. Since year-to-date receipts are 12.4% more than last year, the County needs 0.3% growth in this year's remaining payments to meet its revised target. Subsequent information indicates that a portion of the FY 2006 receipts relate to prior year adjustments and late filing due to the December 2005 transit strike. As a result FY 2006 growth may not be as robust as it currently appears, therefore, the County's actions in revising downward sales tax growth is prudent.

In order to achieve its $4.9 million surplus, the County must achieve workforce savings of $24.9 million, including $10.8 million from not filling a number of funded vacancies, and implementing a hiring freeze that is projected to save $14.1 million.

Other adjustments to FY 2006 operating costs include higher health insurance growth rates for active employees, increased utility costs, upward revision of Special Education costs, and increased Medicaid costs.

NIFA is concerned about the County's ability to achieve a positive operating surplus in FY 2006 because:

- The removal of the funded vacancies has made the budget less conservative and therefore more risky.

- The projected workforce management savings will only be achieved through an ambitious plan that only allows for limited backfilling for civil service positions that become vacant.

- The Update presumes projected attrition that may not materialize.

- A number of initiatives need to be successful to reach the budgeted level of overtime. Failure to achieve these initiatives would increase overtime costs.

## THE BASELINE

The projected gaps have increased by approximately $10 million a year, and they are now projected to be $186.1 million in FY 2007, $240.0 million in FY 2008, and $284.4 million in FY 2009. While there have been a number of other positive and negative changes to the baseline that have generally offset each other, the increase results from two significant changes. The County has reduced the projected sales tax growth for FY 2006, which increases the gaps by approximately $18 million a year. To balance the loss in sales tax it has also reduced personal service costs by approximately $14 million a year by planning not to fill many of the funded but vacant positions contained in the Plan. In addition the County has deferred its plan to pay judgments from operations rather than borrow. The Update also presumes that sales tax growth returns to historical levels, with growth of 3.5% in FY 2007, and 3.9% in FY 2008 and FY 2009.

## GAP CLOSING PROGRAM

The County has modified its gap closing program to offset the impact of the recent shortfall in sales tax revenues. The primary changes are increased savings from workforce management, additional Smart Government Initiatives, and additional use of non-recurring resources to offset pension costs. The following are the major changes to the gap closing program:

- Reducing its assumption that the sales tax growth will return to historical averages, thereby reducing its estimate by $12.0 million in FY 2007, $14.9 million in FY 2008, and $15.2 million in FY 2009;
- Increasing workforce management savings to recognize that fewer positions will be refilled;
- Increasing Smart Government Initiatives by approximately $5.7 million in FY 2008, and $5.2 million in FY 2009;
- Using an additional $19 million of pension reserves to fund operating costs; and
- Increasing by $12.1 million the amount of judgments and settlements that will be borrowed rather than being paid from operating funds as originally planned.

A number of the more significant changes to the gap closing program are discussed below.

### Workforce Management

The County anticipates significant savings in personal services expenditures through a substantial reduction in its planned full-time headcount, which was already 338 full-time positions below its budgeted headcount level of 9,163 on March 2, 2006.

Although the County grew its workforce by more than 500 positions since the beginning of 2004, the County's two-pronged headcount reduction effort will capture savings available from budgeted vacancies as well as from anticipated future attrition and turnover savings not accounted for in its baseline projections. During FY 2006, the County plans to reduce its on-board full-time headcount by 71 positions to 8,754. It anticipates that reductions of 98 civil service positions and 55 ordinance positions will be offset by net increases of 66 police officers and 16 correction officers. Thereafter, the County projects that its full-time headcount will contract further through attrition, falling to 8,334 by the end of FY 2009.

The County's revised baseline reflects almost $11 million in salary and wage savings and $3 million in reduced fringe benefit costs from budgeted but unfilled vacancies. As discussed in our October 2005 Report, this implicit reserve had been providing a level of budgetary conservatism which will now be missing from the multi-year Plan. In addition, the Update does not articulate how the County's ability to deliver the services provided for in the Plan will be impacted by the removal of these budgeted positions. For example, Information Technology, Probation, Public Works, and Social Services will lose 23, 28, 30, and 14 authorized full-time positions, respectively, before subsequent attrition thins their ranks even further.

The County plans to augment the savings captured from budgeted vacancies with additional headcount-related savings it expects to generate from an aggressive attrition program. The workforce management gap-closing initiative calls for a strict hiring control process which limits replacement hiring to only one out of every three separating CSEA-represented employees. The County estimates that the immediate implementation of this policy will generate additional attrition and turnover savings of $14.1 million in FY 2006, $35.1 million in FY 2007, $49.4 million in FY 2008, and $63.6 million in FY 2009. The revised out-year savings estimates are approximately $10 million higher than those delineated in the Plan, reflecting the out-year impact of back-filling only 30 CSEA-represented positions and 10 ordinance positions during the remainder of FY 2006. This works out to a replacement rate of less than one out of every five CSEA and less than one out of every six ordinance employees that separate from County service in the current year.

There is a possibility that the State will enact, and the County will participate in, an early retirement incentive program during FY 2006. While it is likely that the availability of an early retirement incentive program will make it easier for the County to achieve its workforce management targets, the County has made no provision in the Update to pay for the additional termination and pension costs that would result. Moreover, as discussed in our October 2005 report, we remain cautious in our assessment of the County's ability to maintain its workforce reduction objectives, its capacity to realize its out-year savings targets, and the extent to which services or revenue collections may be impacted. NIFA intends to aggressively monitor workforce levels.

While the County projects that more than 40 percent of the workforce management savings will result from turnover in the Police Department, it projects that almost an additional 40 percent of the savings will stem from a combination of turnover and steep reductions in CSEA-represented titles by FY 2009. During this period, CSEA ranks will be thinned by approximately 12 percent. The County expects to realize the remaining savings from turnover in correction officer and ordinance positions. Our analysis of the CSEA headcount-driven savings is hampered by the initiative's lack of specificity and we strongly encourage the County to articulate how the headcount reduction targets will be allocated.

**Smart Government Initiatives**

The County's gap closing plan includes Smart Government Initiatives (SGI's) in the amount of $23.3 million in FY 2007, $43.1 million in FY 2008 and $45.9 million in FY 2009. The Update reduced or removed initiatives totaling $6 million in FY 07, $4.5 million in FY 2008, and $4.5 million in FY 2009, while new initiatives have been added in the amounts of $6.2 million for FY 2007, $10.2 million in FY 2008 and $9.7 million in FY 2009. This represents additional SGI's of $5.7 million in FY 2008, and $5.2 million in FY 2009.

The County has reduced or removed several initiatives, including elimination of $2.6 million of annual Medicaid cost containment savings due to rejection by the State Legislature in March 2006, $1.5 million of lease related revenue from redevelopment of the Nassau Coliseum that is now included in the baseline, $0.5 million of tax certiorari reform savings now included as a debt service cost reduction, and reduction of federal inmate aid by $0.75 million because the County anticipates receiving fewer prisoners than originally projected.

In addition, there are several initiatives whose implementation has already slipped, further decreasing the likelihood of their future success. These include: 1) police civilian hiring to provide overtime savings; 2) program reductions in the parks along with advertising and revenue enhancement; and, 3) automated time and leave system implementation which is undergoing project redefinition for inclusion in an integrated human resource system.

In order to balance the financial plan the County has added several new initiatives. These include reducing annual jail inmate care spending by $4.5 million beginning in FY 2008. We question the viability of this initiative since it is not reflected in NHCC's plan. Other initiatives include $3.9 million of new Fashion Institute of Technology (FIT) reimbursement, ticket processing surcharges of $1.5 million per year, unspecified fee increases of $2.1 million in FY 2007, $3.6 million in FY 2008 and $5.6 million in FY 2009, Police Academy training reimbursements of $1.5 million in FY 2008 and FY 2009 which has been pushed back from beginning in FY 2007, and absentee landlord surcharges of $5.7 million in FY 2008 and FY 2009, all of which require State or local legislative approvals which may not materialize.

While we commend the County for its creativity in finding new Smart Government Initiatives, we remain concerned about whether their potential for a positive financial impact will ever be fully realized.

**Pension Reserve**

The County increased its use of off-budget reserves in the Update to balance the out-years of its multi-year Plan. The County now plans to deplete the $33.9 million in resources currently held in its pension reserve to fund its ordinary pension obligations in FY 2007 and FY 2008, which is an increase of $19 million above reserve usage levels assumed in the Plan. This is occurring at a time when, after several years of rapid growth, the County's pension costs have remained fairly stable since 2005. The County states that the Pension Reserve will be used to mitigate the rapid growth in pension payments caused by successive years of poor stock market performance. In fact, the County's pension contribution rates, as a percent of salary, have actually declined. While the total cost of pensions has risen slightly in recent years, this increase has been caused by higher salaries, increased overtime costs, and higher headcounts.

**Judgments and Settlements**

The County has reduced by $12.1 million the amount that it intends to pay out of operating income for judgments and settlements. This change has been made despite the County's statement at NIFA's last Board meeting that it was "extremely important" that the County continue with its plan to use $5 million in 2007, $10 million in 2008, and $15 million in 2009 for these purposes.

Even if the County had continued with its original plan, it is noteworthy that the County borrowed $88 million from 2003 to 2005 for judgments and settlements. Even under its original plan, the County still intended to borrow most of the money it needed for these purposes. This is a practice that is frowned upon by rating agencies and not usually seen in well managed public entities.

**Certiorari**

The County deserves credit for reducing its certiorari backlog. To that end, since 2000 it has refunded almost $800 million and attracted a professional staff at the Assessment Review Commission ("ARC") of over 40 people. These steps have resulted, according to the County, in lowering the certiorari backlog to $131 million. Furthermore, ARC says that the number should keep decreasing as the assessment system improves.

We hope that the numbers stand up as we have had false starts in the past. The current estimate is almost $100 million less than the County had predicted in its four year plan and for which it had budgeted a payout of $50 million in 2006. Consequently, since the backlog is predicted to be lower, we would also have expected to see the payout lowered lowered – which it has not.

Assuming that the County cannot lower its payout in 2006 below $50 million, at least we hope that the payout will not increase in the out years of the Plan. If the backlog does increase, the County must be prepared to increase its year yearly appropriation and not hide the increase by retaining the current budget estimate of $50 million per year.

## ISSUES THAT REQUIRE FURTHER SCRUTINY

Notwithstanding the many accomplishments of the County, many of the major challenges identified in our previous report remain including the Nassau Health Care Corporation and debt issuance.

### 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. Cash balances have been dropping steadily since the County transferred the health facilities to NHCC on September 29, 1999.

According to a recent report by the Comptroller for the County, as of April 14, 2006 NHCC had a working capital balance of $2 million, was deferring payments to certain vendors, had borrowed $8.6 million from its malpractice account, and had not received $2.3 million that it had expected in IGT payments.

Not only are NHCC's cash balances dropping precipitously but it is also projecting significantly higher baseline gaps. For example at the time of the adopted Plan, NHCC said its baseline gaps were projected as $17.1 million in 2006, $21.6 million in 2007, $28.8 million in 2008, and $31.2 million in 2009. In the Update the gaps have been restated as $32.1 million in 2006, $45.1 million in 2007, $56.3 million in 2008, and $67.8 million in 2009.

Recently, against the advice of NIFA and the State Comptroller, the County completed a tobacco financing from which almost $100 million was earmarked for use by NHCC, primarily to pay for operating expenses. This financing was completed with the expectation that a new turnaround plan would be forthcoming.

Among NIFA's concerns was that long term debt should not be used to fund operating expenses and that any monies spent to help NHCC, subtract from their use for other County purposes. In addition, this is the third financing since NHCC achieved its independence and this will be the third major turnaround plan. We cannot help but remain skeptical as each of the previous plans and financings were justified as the solution to NHCC's problems. NIFA intends to aggressively monitor the situation, and take whatever actions are necessary to protect the financial integrity of the County.

Recently NHCC indicated that it might be receiving additional State funds, some of which would be from the reclassification of its nursing home as hospital based. The Governor's recent veto of a number of measures, of which this was one, makes receipt of this money unlikely. Because we have heard similar assurance of assistance in the past that have not materialized, we must remain skeptical.

Any monies given to NHCC by the County must be carefully monitored and released only upon the attainment of specific goals and not based 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 until the year 2060.

**Debt Issuance**

The County is currently projecting a July 2006 borrowing of $171 million. Of this amount, $103 million is for capital and $23 million is for building consolidation. In addition, the County has reentered the short term market, borrowing $120 million in December 2005, and anticipates borrowing similar amounts each year of the Plan.

NIFA currently is holding $27 million for capital expenditures and $15 million for building consolidation. Most of these funds have remained available to the County for extended periods. Furthermore, the County has $120 million available from its recent tobacco securitization, of which $22 million was earmarked for County capital projects and the remaining $98 million for NHCC. The use of funds for NHCC is discussed in greater detail in the NHCC section of this report.

Based upon the County's prior history of failing to timely draw down bond funds and the consequent arbitrage penalties that it has had to pay to the Federal Government, we urge caution before proceeding with a new financing. The County, in anticipation of possible arbitrage penalties on existing debt, has already reserved approximately $12.5 million.

We suggest that the County consider using some of the surplus money from its debt issuances to: reduce existing debt, rather than continuing to pay debt service for projects whose completion is questionable; avoid a cash flow borrowing similar to the $120 million that was borrowed this past December; or to lessen the amount scheduled to be borrowed in July.