October 7, 2002

Hon. Thomas Suozzi
Nassau County Executive
Office of the County Executive
One West Street
Mineola, NY 11501-4895

Hon. County Executive Suozzi:

Pursuant to Chapter 84 of the Laws of 2000, the Nassau County Interim Finance Authority ("NIFA") has completed its review of the proposed Multi-Year Financial Plan For Fiscal Years 2003-2006 ("Plan"). Our review is transmitted to you in the attached report entitled, "Nassau County Interim Finance Authority Review of Proposed Financial Plan – Fiscal Years 2003-2006" ("Report").

The Report is an evaluation of the short- and long-term financial plans of Nassau County as proposed by the County Executive. It has been reviewed and adopted by the NIFA Directors.

The Report comments in detail on many key aspects of the Plan. Briefly summarized, the Report finds that:

> **FY 2003** - This first year of the Plan, also known as the proposed FY 2003 budget is reasonable and if certain risks are resolved in the County's favor, could produce surpluses in 2003. The major uncertainties facing the County are the risks that: (1) labor settlements exceed budgeted expectations; (2) the State pension system asset value declines by more than the amount anticipated in the County budget; and (3) a slowdown in the economy creates a significant decline in sales tax revenue.
>
> The County should intensify efforts to settle labor contracts in a manner supportive of the new budget reality. The County should consider earlier implementation of initiatives such as privatization.
>
> **FY 2004 - FY 2006 -** The gaps projected and the County gap-closing Plan are within ranges deemed to be reasonable based upon the information currently available. However, there are potentially serious

risks including increases in costs for pensions and labor; as well as the ability of the County to effectively deliver services, meet its capital needs, eliminate the cert backlog and update its reassessment.

The County still has a large structural deficit, but we are heartened by the vigor with which the new Administration has attacked the problem. Furthermore, we recognize that they have inherited a difficult situation, which has not improved with the current downturn in the economy.

We all have a responsibility to the people of New York State who created NIFA and who have continued to subsidize the County with State funds. The County must learn to live within its means and take corrective measures that will satisfy NIFA's requirements with a very high level of confidence.

At this time NIFA will continue to be judicious in the use of its powers and play a supportive role. Nevertheless, we will not hesitate to impose hard controls if we believe that they are warranted.

Sincerely,

Frank Zarb
Chairman

cc: Presiding Officer Jacobs
Minority Leader Schmidt
Controller Weitzman
NIFA Directors
Richard Luke

Nassau County Interim Finance Authority

REVIEW OF PROPOSED

MULTI-YEAR FINANCIAL PLAN FOR FISCAL YEARS 2003 – 2006

October 7, 2002

NASSAU COUNTY
INTERIM FINANCE AUTHORITY

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I. EXECUTIVE SUMMARY

In response to a deterioration in the financial condition of Nassau County, in June of 2000 Governor George Pataki and the New York State Legislature created the Nassau County Interim Finance Authority ("NIFA") or ("Authority"). NIFA's mission includes:

- Administering transitional State aid to the County. *To date, this aid has been in excess of $70 million and will total $105 million over five years;*

- Providing budgetary relief through the restructuring of County debt and, when requested, by issuing debt on behalf of the County. *To date, NIFA has issued approximately $190.6 million in bonds to restructure County debt and $469.7 million for other bondable purposes, including payment of certiorari claims. NIFA borrowing is estimated to have saved the County in excess of $58.1 million in debt service of which $38.8 million is attributable to estimated savings from the issuance of variable rate debt;* and

- Overseeing County finances through new financial reporting requirements, which included reviewing and commenting on the County's four-year financial plan. *To date, NIFA has commented on and approved the financial plans for FY 2001-FY 2004 and FY 2002 - FY 2005.*

This report is written in fulfillment of the statutory requirement that the County present its four-year plan to the Authority for comment. It will review and comment upon the FY 2003- FY 2006 financial plan of the County Executive (the "Plan") that was submitted to NIFA on September 17, 2002. An estimate of annual budget gaps and gap-closing initiatives were a centerpiece of the Plan.

On September 26, 2002 the County submitted a preliminary revision of these gaps. On October 1, 2002 we were provided with the final revision with the following gaps: $206.5 million in FY 2003; $146.4 million in FY 2004: $285.2 million in FY 2005; and $362.1 million in FY 2006. The Plan sets forth a series of actions designed to close these projected gaps.

BACKGROUND

The first four-year plan (2001-2004) was accepted by NIFA on December 8, 2000. NIFA accepted year one (2002) of the County's second four-year financial plan on December 7, 2001. Simultaneously, NIFA required that an acceptable plan be submitted to the Authority for the years 2002 to 2005 not later than April 1, 2002. This deferral of action was made to give the new Administration time to mold a plan that incorporated its own policies and visions for the future.

On April 1, 2002 County Executive Thomas Suozzi submitted, and on April 17 NIFA accepted, his plan for the years 2003 to 2005 together with proposed revisions to

2002, the first year of the plan (collectively, the "April Plan"). The April Plan estimated Out-Year gaps of $185.5 million in FY 2003, $278.9 million in FY 2004, and $427.6 million in FY 2005.

At that time, the new Administration felt that it was being conservative in its planning process for the years 2003 to 2005. There was sentiment that the County had developed plans to close the high end of the projected gaps. Everyone hoped that if the actual Out-Year gaps were less than estimated, certain cost cutting initiatives would not have to be implemented.

In fact, budget estimates for all of the years in the April Plan turned out to be overly optimistic. The County's first official recognition of the problem was communicated to NIFA late in August 2002. At that time, the County estimated that it FY 2002 budget had a $17 million shortfall.

NIFA'S RESPONSIBILITY REGARDING THE FOUR YEAR PLAN

NIFA's statutory responsibility is to determine if the 2003 to 2006 financial plan (the "Plan") is complete and complies with the requirements of the Act. Among other requirements, the Plan must:

- "contain projections of revenues and expenditures that are based on reasonable and appropriate assumptions and methods of estimation;" and

- "provide that operations of the county and covered organizations will be conducted within the cash resources available according to the authority's estimates."

Policy decisions, as long as they are not inconsistent with the Act, remain the responsibility and prerogative of those individuals elected by the voters of Nassau County.

DISCUSSION

The April Plan was submitted only five months ago. Consequently, it is understandable that the new Plan is in many respects similar to the April Plan. Many of the well-conceived initiatives have simply been carried forward into the current Plan. Likewise, the Plan continues to be presented in a professional, comprehensive and well thought out fashion. It includes initiatives in several areas (e.g., revenues, workforce reductions, labor concessions, etc.). The Plan discounts initiatives, although not as heavily as in the April Plan, and has not specifically budgeted for any reserves, other than police termination pay.

Unfortunately, fifteen days after submitting the Plan to NIFA, in response to issues NIFA raised, the County submitted a major set of final revised projections which indicated that the County had overstated its gaps and projected savings in each year of the Plan. The revisions were necessary to reflect the impact of actions taken in FY 2002, and those planned actions contained in the FY 2003 budget, along with a correction of certain personal service costs in the out-years.

The table below compares the original and revised gaps:

($ in millions)	FY 03	FY 04	FY 05	FY 06
Original gaps	$266.4	$371.6	$506.3	$650.8
Revised gaps	$206.5	$146.4	$285.2	$362.1

The major **corrective actions** outlined in the Plan are:

- Increases in the property tax in FY 2003 to generate recurring revenues, with no further increases proposed until FY 2006 when it is proposed that there will be an increase that is pegged to the Consumer Price Index. It is important to note that the proposed 20% tax increase represents over 90% of the entire gap-closing proposals in FY 2003. Moving Out-Year initiatives into FY 2003 and FY 2004 could prevent further unanticipated changes from upsetting budgetary balance in future years.

- Reduction in the workforce through an aggressive attrition based program, eliminating up to 1,400 jobs. Much of this is actually through the New York State Early Incentive Retirement Program.

- Smart government initiatives designed to maximize existing resources.

- Labor concessions "by improving productivity, work rules and stabilizing wages and other benefits."

- Debt reform through decreased borrowing, restructuring and creation of a Sewer and Storm Water Authority.

The major **challenges** outlined in the Plan are:

- Based upon current market conditions, the County's estimate of its pension contributions may still be too low.

- The Plan relies, in part, upon the successful attainment of labor concessions. Although the County and the PBA have now scheduled arbitration, its outcome may not favor the County's position and could have a negative ripple effect on negotiations with the other unions.

- Increased estimates of workforce reduction may also increase termination costs and ultimately produce unacceptable declines in the delivery of services.

- Successful reform of assessment practices and elimination of the certiorari backlog still requires a significant influx of qualified personnel and agreement as to the methodology for updating of assessments.

- Capital expenditures for infrastructure remain very low considering the extent of the needs in this area.

- If the Sewer and Storm Water Authority is not adopted by the State Legislature, there will be a $25 million gap in year two of the Plan.

- The Plan does not account for the possibility of the County providing additional financial support to the Nassau Health Care Corporation.

FINDINGS

NIFA is making the following general findings, which should not be misconstrued as an endorsement of every part of every section of the Plan.

FY 2002 – The projected shortfalls in the FY 2002 budget should be successfully filled through the use of monies received in a legal settlement, deferral of borrowing, a freeze on OTPS spending in FY 2002, and other measures.

FY 2003 - This first year of the Plan, also known as the proposed FY 2003 budget (the "Budget") is reasonable and if certain risks are resolved in the County's favor, could produce surpluses in 2003. However, the County still has a structural deficit, as evidenced by the proposed use of $72 million of State and NIFA assistance. The major uncertainties facing the County are the risks that: (1) labor settlements exceed budgeted expectations; (2) the State pension system asset value declines by more than the amount anticipated in the County budget; and (3) a slowdown in the economy creates a significant decline in sales tax revenue.

FY 2004 - FY 2006 (the "Out-Years") - The gaps projected and the County gap-closing Plan are within ranges deemed to be reasonable based upon the information currently available. However, there are potentially serious risks including increases in costs for pensions and labor; as well as the ability of the County to effectively deliver services, meet its capital needs, eliminate the cert backlog and update its reassessment, The County must also be assertive, but realistic in its demands from third parties.

CONCLUSION

Nassau County still has a significant structural deficit even after more than two years of NIFA assistance, as evidenced by the projected use of $72 million of State and NIFA assistance to balance the Budget. The economic problems currently being experienced by many other counties does not vindicate past practices of this County or lessen its current financial dilemma.

However, NIFA believes that the new Administration has brought a sense of discipline and urgency to the fiscal affairs of the County. There has been a good faith effort to explore many, although not all, of the available options. Henceforth, every opportunity should be investigated and no special interest group, whether within or outside of the County government, should be immune from scrutiny.

Short term, the FY 2003 Budget appears to be sound, but going forward the Out-Years could be materially affected (up or down) depending upon circumstances beyond the control of the County. The County must consider earlier implementation of initiatives in order to protect its long term fiscal security.

Long term, NIFA hopes that the County can successfully wean itself from the need for outside intervention. In the interim, modest progress can be seen, but the need for NIFA oversight remains strong.

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The balance of this report provides background information and presents, in more detail, the findings of staff. The report is separated into the following major sections:

- A recap of FY 2002.
- The proposed fiscal year 2003 budget.
- The fiscal years 2004-2006 of the financial plan.
- Other items.
- Covered organizations.

The discussion that follows and transmittal letter constitute the NIFA staff's review and findings regarding the County Executive's proposed FY 2003 Budget and Financial Plan. It is proposed that this document, together with the findings contained herein, be adopted by NIFA as the Report of the Authority and that copies of this document be transmitted to the Nassau County Executive, the Presiding Officer of the Nassau County Legislature, the Minority Leader of the Nassau County Legislature, the Nassau County Comptroller and Clerk of the Nassau County Legislature for distribution to members of the County Legislature.

II. FY 2002 Recap

FY 2002 began with many opportunities for the new Administration. Their initial task was the development of a Financial Plan for FY 2002-2005 for submission to NIFA by April 1, 2002. The Administration took the occasion to re-examine the FY 2002 budget, and projected a deficit of $29.9 million. Of the projected budget gap, $9 million was based upon the County's decision not to use prior year fund balance that had been programmed into the FY 2002 Budget for payment of debt service costs.

The Administration crafted gap-closing measures with a focus on workforce reductions, smart government initiatives, debt reform, cost cutting measures and revenue enhancements. The April Plan proposed a five-part solution to the FY 2002 projected deficit, as shown in Table 1.

(Table 1)
APRIL PLAN GAP-CLOSING MEASURES

($ in millions)	Amount
Reduce Workforce	$10.8
Smart Government Initiatives	$5.0
Debt Reform	$8.3
Revenues – Sales Tax	$2.2
Contingency Appropriations & Other Adjustments	$3.6
Total Impact	**$29.9**

- Workforce Reductions – The three key elements to this reduction plan were: attrition; the early retirement incentive program; and terminations resulting from a new employee appraisal process.

- Smart Government Initiatives – The April Plan focused on such efficiencies as reorganization of all County agencies into five operational verticals; minimization of personal services contracts; and cost allocations and charge-backs. The plan recognized the need for investments to update information technology in areas such as the Assessment Review Commission to improve efficiency.

- Debt Reform – To reduce the FY 2002 debt service expense, the County proposed reduced borrowing levels and NIFA's use of variable rate debt.

- Revenues – The County projected that FY 2002 sales tax income would increase by 3.1% over FY 2001 levels rather than to 2.8% rate initiated budget.

- Contingency Appropriations and Other Adjustments – Savings were expected from certiorari and assessment review reform and from restoring the use of $9 million of fund balance that had been programmed into the FY 2002 Budget for payment of debt service costs, offset by eliminating a draw down of the State aid targeted for reduction of cert backlog.

While the county worked to implement these initiatives it did not modify the adopted budget.

CURRENT FINANCIAL STATUS

NIFA's oversight function includes holding regular monitoring meetings with the County and its leadership, review of quarterly budget reports and if necessary, budget modification requests. The County has continued to actively monitor and manage the FY 2002 budget, including taking actions since the April Plan to keep the budget in balance. As of September 30th, the County and/or NIFA had identified numerous significant changes to the FY 2002 budget picture. The County has now determined that without further remedial action there will be a negative variance in the operations of the five major funds in FY 2002. It submitted a request for budget modification to NIFA on September 16, 2002, but has subsequently advised NIFA that the modification request will be resubmitted. This revised request for budget modification is not yet available.

Important developments in the FY 2002 budget since the date of the April Plan are reviewed below.

Gap Creating Events

- **Lower Sales Tax Revenue**. The Administration revised downward its year-end growth estimate to 2.4% based upon a statistical projection of year-end performance using sales tax receipts through July 15, 2002. Based on the revised projection the County needs to achieve 1.2% growth from the time of this report to the end of the year to achieve their goal. Based on historical information this goal seems achievable.

- **Greater Sworn Officer Retirement**. The Administration has revised its estimate and now believes that 250 sworn officers are departing. The average termination pay per retiree is over $225,000. The adopted budget contains $24.5 million to fund police termination pay in the current fiscal year, significantly less than will be needed.

- **Not Requesting Draw Down of State Aid for Certs**. The County has not requested the State targeted aid appropriated for reduction of the cert backlog, due to the lack of quantifiable progress.

- **Corrections to Budget**. These are adjustments to the Administration's previous salary projections to correct an inappropriate reversal of a collective bargaining accrual, and the inclusion of funds for the compounded effect, in FY 2002, of certain collective bargaining agreements.

Gap Closing Events

- **Workforce Reduction**. The County implemented a hiring freeze for non-essential positions. The County participated in the State's early retirement incentive program to augment natural attrition. Currently, the County expects FY 2002 workforce reductions of 942 employees, including over 500 County staff that have opted into the early retirement incentive program.

- **Smart Government Initiatives.** In the April Plan the County identified initiatives valued at $10 million for FY 2002. Most notable were the ambulance billing, reduced reliance on outside contractors and grant fund surplus. The County's second quarter report projected $11 million for initiatives in FY 2002.

- **Debt Expense.** The County's efforts to reduce debt service expense were aided by NIFA issuing variable rate debt. Additionally, the County has reduced borrowing for capital purposes due to a slow rate of expenditures and an ineffective methodology for determining spending needs. Borrowing for certiorari ("certs") payments has not reached potential levels due to issues discussed in the cert section of this report. Finally, deferral of a November borrowing through NIFA will push back debt service payments to FY 2003.

- **Restore Fund Balance for Debt Service**. The County reinstated the use of $9 million of fund balance as originally programmed to fund FY 2002 debt service costs.

- **Litigation Settlement**. The County will benefit from the settlement of litigation related to the construction at the Community College: the Manshul case is expected to be resolved in FY 2002 for $9.85 million.

- **Spending Freeze**. The freezing of other than personal services spending for the remainder of the year is expected to save $3.5 million.

CONCLUSION

Based on historical data, analysis to date, and discussions with various County officials, NIFA concludes that:

- The County should end FY 2002 within budgetary balance;

- The County's current sales tax estimate of $851.9 million should be met;

- Additional budget balancing actions will be required if more sworn officers retire than currently projected; and

- If the County breaks even for FY 2002 it will still have a structural operating deficit of $77 million without the benefit of $20 million of transitional State aid and $57 million of net budget relief provided by NIFA restructuring.

Due to an accounting change required by the Government Accounting Standards Board (GASB # 34), the County will be required to account in its general fund for capital assets, debt, including certiorari debt, and other long term liabilities such as uncompensated absences, which will result in the County reporting a significant deficit starting in its FY 2002 financial statements.

III. Proposed FY 2003 Budget

This section presents NIFA's analysis and detailed conclusions regarding the proposed FY 2003 Budget and the major underlying initiatives designed to ensure year-end budgetary balance. The County's ability to achieve its fiscal objectives for FY 2003 is directly dependent on the actions that the County takes in the remainder of FY 2002 and its ability to implement the FY 2003 gap-closing actions to help realize their full-year value. The County is projecting that workforce reductions in FY 2002 will yield greater savings than originally planned because of the larger number of individuals taking early retirement, and other attrition. As a result, some of the savings that were originally planned for FY 2003 will already have been realized in FY 2002.

Since any budget or financial plan is a set of estimates, the actual results will differ from initial expenditure and revenue estimates. Risk assessment attempts to identify what these differences will be and whether they will ease or worsen budget pressures. Normally, the emergence of offsets can cover routine risks, but rigorous and timely monitoring can reduce the possibility that risks may break disproportionately against the County and require significant gap-closing actions near the end of a fiscal year. The County is facing a number of significant external risks, most of which have been considered in development of the Plan. These risks, which include concern about the effect of a slowing economy, the possibility of increased pension costs, and a pending binding arbitration proceeding with the PBA, are discussed below. Should these events have a favorable outcome, and produce positive budget variances, these variances should be used in a way that provides benefits in the Out-Years.

The County must ensure that management systems are in place to implement and monitor the large number of initiatives that have been, and will be, part of Nassau County's plan to restore financial stability. Inattention to proper implementation and monitoring of these initiatives could result in the County failing to achieve the planned results.

RISK ASSESSMENT

The County will be confronted with a wide range of fiscal problems to solve during the next several years and there is always the possibility that baseline estimates may prove incorrect or that reasonable gap-closing initiatives will not be achieved. For the purpose of NIFA's analysis, risks have been classified into two major categories.

The *first* category is implementation risks. These have been quantified and identified for the Budget and include items that may be:

- difficult to execute and/or may result in fewer savings or less revenue than assumed; and
- errors or omissions that occurred during preparation of the Budget.

The *second* category of risks includes initiatives or events that are outside the County's control, such as requiring action or approval by a third party. For example, this would include actions or initiatives that require adoption of County or State laws or ordinances, or the agreement of a labor union. These risks are summarized below and are highlighted during our discussion of the specific action or initiative.

Implementation Risks

NIFA has identified a number of actions or initiatives that may be at risk and the County must monitor closely. In addition, NIFA has identified a $30 million overestimation of salaries which offsets some of these risks. Table 2 identifies the portion of the item that NIFA believes is unlikely to occur or is in error.

In addition, NIFA has identified a number of risks that are outside the County's control, but which due to their nature cannot be quantified. If certain of these risks are resolved in the County's favor, surpluses could be produced in FY 2003. These surpluses should be used in a way that benefits the Out-Years.

For example, if NIFA believes that a particular expense is incorrect, the amount of understatement will be identified. In those cases where NIFA believes that the full amount of a savings initiative will not be realized, NIFA will identify the amount that it believes will not be realized.

Risks Outside the County's Control

The following are a number of significant risks that the County is facing during FY 2003 and beyond that could affect the County's ability to achieve the results projected in the Plan. Many of these risks cannot be quantified due to their nature.

- Pension costs may exceed budgeted amounts if, on March 31, 2003, the benchmark indicator used by the New York State Common Retirement Fund has declined by more than 10% from its level on March 31, 2002.

- The County and the Police Benevolent Association are in the early stages of reaching a contract agreement through the use of mandatory binding arbitration. The outcome of this process could have a significant retroactive and future impact upon the Plan, since any settlement will affect other unions and the County's ability to achieve planned labor concessions in the Out-Years. Containing labor costs remains one of the County's most important financial challenges.

- The County is in the process of reducing its workforce by 1,400 full time positions during the Plan. Should it be determined that the quality of the services being delivered deteriorates significantly, there may be pressure to hire additional staff beyond levels contemplated in the plan, requiring the appropriation of additional financial resources.

- The Plan does not allocate any resources, nor identify a contingency plan, to provide financial assistance to the Nassau Health Care Corporation should its recovery plans fail.

- If the State Legislature does not authorize the creation of a Sewer and Storm Water Authority the County will need to find substitute actions or implement its contingency plan to offset the loss of projected savings.

- If the reassessment of properties is not accurate this could place stress upon the Out-Years, because of the necessity to pay certiorari judgments beyond those contemplated in the Plan.

- Failure to eliminate the certiorari backlog in a timely manner could require the unplanned use of additional financial resources, particularly in FY 2006 as the County switches to pay-as-you-go financing of these claims.

- Infrastructure needs may not be met by planned capital borrowing over the next several years.

(Table 2)
BUDGET RISKS AND OFFSETS

		Estimated Risk ($ in millions)	**Page**
FY 2003 Budget Risks and Offsets	**Risks**		
	Pension costs	$26.0	23
	Debt service expense error	7.1	51
	Variable rate interest	3.7	55
	Interest penalty on taxes	3.3	18
	Termination pay for hospital employees	3.0	28
	Early retirement cost for hospital employees	1.8	28
	Handicapped parking	0.5	19
	Energy conservation	0.5	35
	Item-pricing exemption	0.3	19
	Capital project chargebacks	0.2	19
	Offsets		
	Salaries	$30.0	21
	Net Risks, FY 2003 Budget	**$16.4**	
FY 2003 – 2006 Financial Plan Non-Quantifiable Risks and Offsets	Out-year pension costs		39
	Contract settlements		48
	Workforce reduction sustainability		24
	Nassau Health Care Corporation		35
	Failure to create Sewer and Storm Water Authority		58
	County-wide property reassessment		67
	Tax certiorari		64
	Infrastructure needs greater than budgeted		53

While NIFA has identified these risks we believe that they are manageable within the context of a budget that exceeds $2 billion. In order to minimize these risks it is important that the County insure prompt implementation and monitoring or all proposed initiatives. In addition, the County should correct certain errors such as under budgeted debt service and termination pay for hospital employees.

REVENUES

The Budget consists of four major revenue sources that total $2.3 billion. As shown in the chart to the right the two primary revenues are sales taxes and property taxes, comprising 70% of total revenues. The other major revenue sources include federal and state aid (14%), and other revenues (16%).

Composition of Revenues ($ in millions)		
Sales taxes	$873.6	38%
Property taxes	$738.7	32%
Federal and State aid	$315.4	14%
Other revenues	$357.2	16%
Total	**$2,284.9**	**100%**

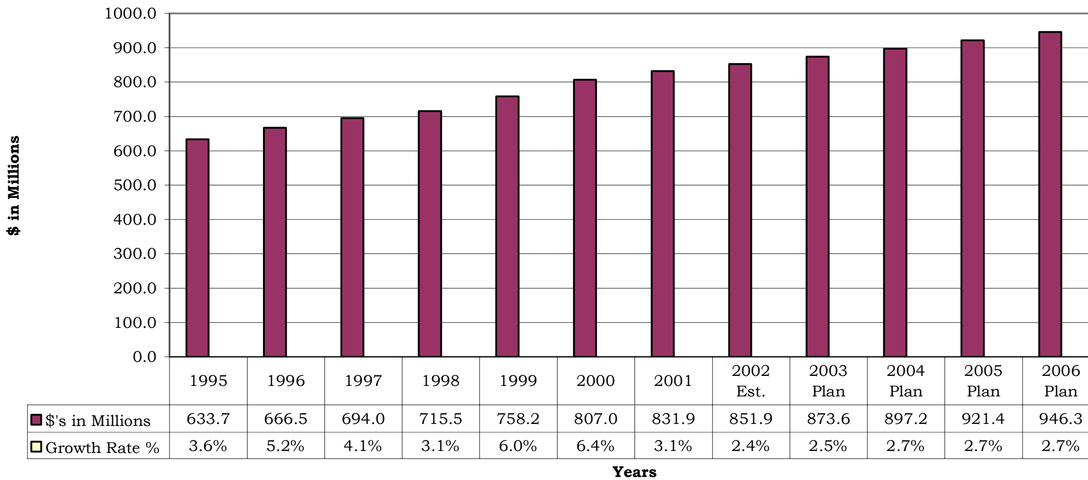
Sales Tax

Sales tax is the largest revenue source for the County, comprising 38% of all revenues covered in this analysis, is budgeted at $873.6 million for FY 2003. The current sales tax rate in Nassau County is 8.5%, of which 4% is the State's share, 4% is the County's share, 0.25% is allocated to the Metropolitan Transportation Authority, and the remaining 0.25% is distributed to the towns and cities in the County.

From a projection of $851.9 million for the current fiscal year, the budget for FY 2003 projects a growth of 2.5%. Subsequent years in the financial Plan are projected to grow by 2.7%. Sales tax growth has averaged 4.5% for the seven-year period 1995 through 2001. In projecting future sales tax growth the County has adopted a conservative position reflecting the current economic uncertainty.

Chart 1 illustrates historical sales tax growth for the County.

(Chart 1)
SALES TAX REVENUE
FY 1995 – FY 2006



	1995	1996	1997	1998	1999	2000	2001	2002 Est.	2003 Plan	2004 Plan	2005 Plan	2006 Plan
$'s in Millions	633.7	666.5	694.0	715.5	758.2	807.0	831.9	851.9	873.6	897.2	921.4	946.3
Growth Rate %	3.6%	5.2%	4.1%	3.1%	6.0%	6.4%	3.1%	2.4%	2.5%	2.7%	2.7%	2.7%

Sales tax receipts through the October 4, 2002 check total $570.3 million. This is $16.8 million, or 3%, ahead of last year's pace. In order to reach the Administration's new estimate of $851.9 million for FY 2002, a growth rate of 1.2% is required for the remainder of the fiscal year. A growth rate of 2.3% is needed to reach the adopted budget estimate of $855 million for FY 2002.

The current slow, but positive growth in Nassau's economy is a testament to its evolution from an economy dependent upon the defense industry to a more varied economic engine. Current conditions contrast greatly with the experience of a decade ago when Nassau was struggling to overcome a recession on the back of a drastic downsizing in the defense industry. The County has diversified its economic base substantially over the past decade bolstered by the growth in technology industries. The growth of information technology, the biosciences, and telecommunications has fueled the region's economy by attracting highly skilled personnel, innovative businesses and a large influx of capital.

However the Plan assumes the continuation of a sluggish economy, with sales tax growth under performing historical averages. To compensate for the projected lack of revenue growth the County is proposing a ¼% increase in their sales tax rate beginning in FY 2004 and the imposition of a residential energy sales tax in FY 2005.

Increasing the sales tax rate by ¼% would raise the aggregate sales tax rate in the County from 8.5% to 8.75%. The plan indicates that this would yield additional revenue of $52.8 million in FY 2004, $54.6 million in FY 2005, and $55.7 million in FY 2006.

This increase in the sales tax rate would require State approval. It is important for the County to determine what level of economic downturn would trigger the need for this sales tax increase.

The Plan also provides for the imposition of a sales tax on residential energy. Items impacted by this sales tax would include fuel, oil, coal, wood (used for the purpose of heating), propane, natural gas, electricity, steam and gas used for residential purposes. Since New York State Tax law allows local governments to impose this tax, the only approval necessary is that of the County Legislature.

The Plan assumes the imposition of the sales tax on residential energy in FY 2005 at the local rate of 4.25%. The County estimates that this would bring in additional revenue of $45.7 million in FY 2005 and $47.5 million in FY 2006 and applies a 50% discount to account for implementation risk.

The purchase of residential energy is, by its nature, not as discretionary as the purchase of many other items. However, as with the ¼% increase in the sales tax rate, it is important for the County to explain what the economic trigger mechanism will be for the implementation of this new tax.

In summary, the County's sales tax estimates are very conservative in the Out-Years and range below historical norms. In the April Plan the County utilized a sales tax growth factor of 3.9%. The Plan lowers the growth rate to a range of 2.5% to 2.7%. If actual receipts were to increase annually by 3.5%, a growth rate still lower than the Administration's April Plan, an additional $35 million of revenue would be realized by FY 2006. In addition, the two new gap-closing initiatives, raising the sales tax rate by ¼% and imposing a sales tax on residential energy, are both heavily discounted. If the County implements these taxes it is likely that they would initially generate an additional $50 million of revenue. Given the amount of potential surpluses that may arise from these initiatives it is important that the County outline the specific economic conditions that would necessitate their need.

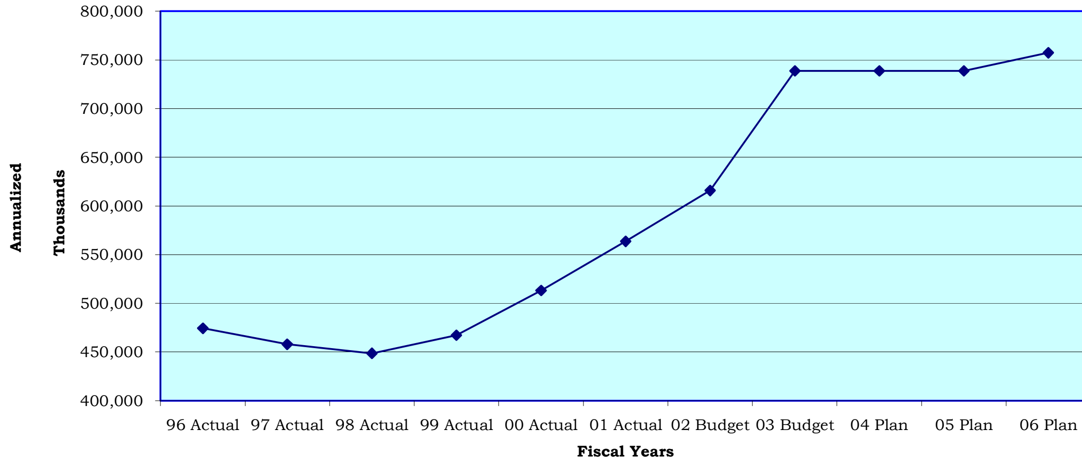
Property Taxes

Property taxes are the second largest revenue source for the County, comprise 32% of total revenue, and are budgeted at $738.7 million for FY 2003. The tax levy for the five major funds totaled $615.7 million in FY 2002. The $738.7 million represents an increase of 20%, as set forth on page 16 of the County's Proposed Budget, or $123 million, from taxes levied in FY 2002.

After accounting for the workforce reduction that took place in the current fiscal year, the County has stated that their gap closing actions in FY 2003 total $134.5 million. As such, the property tax increase accounts for over 90% of the County's new gap-closing actions proposed for FY 2003.

Chart 2 shows property tax growth since 1996 for all major funds.

(Chart 2)
PROPERTY TAX REVENUE
FY 1996 – FY 2006



As evidenced from the graph, property taxes have served as the linchpin in the County's efforts to return to structural balance, with increases totaling 65% over the five-year period FY 1999 – FY 2003. Prior to this, revenues from property taxes actually decreased by nearly 6% from FY 93 through FY 98. While this major revenue source was declining, property tax certiorari refunds were escalating at an alarming rate. This dynamic of increasing expenses coupled with declining revenues significantly contributed to the structural operating gap. As evidenced by Table 3, certiorari payments from 1990 to 2001 exceeded $1 billion.

(Table 3)
HISTORY OF CERTIORARI PAYMENTS

Year	Certiorari Payments
2001	$146,703,307.15
2000	$77,616,421.00
1999	$77,056,775.05
1998	$108,372,087.04
1997	$85,884,856.43
1996	$133,609,874.76
1995	$180,694,550.74
1994	$99,038,542.14
1993	$50,404,916.04
1992	$46,283,008.75
1991	$28,328,609.70
1990	$28,319,875.85
Total	**$1,062,312,824.65**

It is also important to note that under its current assessment system the County did not reassess real property. The County is now finishing a reassessment project, to be completed by December 31, 2002, and it is contemplated that they will periodically perform revaluations to account for changes in total taxable assessed valuations. To the extent that property values increase in the future, the need for property tax rate increases may be mitigated.

The County is also seeking an abatement for senior citizens modeled on the State's Enhanced STAR exemption. The administration has secured the necessary authorizing legislation from the State and they have indicated they will soon introduce the required local legislation to the County legislature. The County indicates that the value of the real estate abatement for low and moderate income senior citizens will be approximately $3.3 million in FY 2003.

In the Out-Years of the Plan property taxes are assumed constant until FY 2006. Beginning in FY 2006, the County is proposing to increase the property tax levy in the five major funds by the growth in the consumer price index ("CPI") for the previous twelve months. The administration estimates a 2.5% CPI in FY 2006. Assuming no growth in the County's property tax levy due to increases in assessed valuation captured by the revalued and updated tax roll, a 2.5% increase would yield an additional $18.5 million in additional property taxes in FY 2006.

NIFA questions the appropriateness of linking increases in property taxes to the CPI, an index that measures changes in the prices paid by consumers for a representative basket of goods and services. It further believes that property taxes are an integral component of the budget that should be determined each year in the context of the County's financial resources and needs. In addition, with the County intending to perform periodic revaluations of property, revenues from property taxes may increase or decrease and make the need for rate changes independent from any automatic linkage to a specific index.

State and Federal Aid

State and Federal aid is budgeted at $315.4 million in FY 2003. This is 14% of all revenues and represents a decrease of 3.9% from the FY 2002 budget. The County is projecting that State and Federal Aid will be $15.6 million less than budget in FY 2002. The County has conservatively projected zero growth in State and Federal aid in its Out-Year baseline assumptions.

State and Federal aid projections are developed on a program basis in conjunction with the County's operating departments and generally parallel anticipated reimbursable expenditures. Since the County has been reducing its expenses it follows that the reimbursement for these expenses will be less. If the County realizes the anticipated savings from workforce reductions, State and Federal aid will be further reduced. This loss of revenue will be more than offset by expense reductions in salaries as the workforce declines, yielding net savings to the County.

Other Revenue

The remaining revenues make up approximately 16% of the Plan. A major component is departmental revenue, which is budgeted at $146.6 million in FY 2003. This represents a 1.5% increase from the FY 2002 budget, which appears largely on target in this area. Of this total, $81 million relates to Medicaid reimbursements received from the Nassau Health Care Corporation, which are actually an offset against County Medicaid expenditures.

The County's estimate for departmental revenues appears to be reasonable. The slight overall increase in departmental revenues for FY 2003 is mainly due to the full annualized value of fee increases in the Department of Parks, Recreation and Museums that were implemented mid-way through the current fiscal year, and enhanced fee collections by the County Clerk to reflect the increased volume in transfer and mortgage taxes. Another significant issue relating to departmental revenues is an increase in ambulance fees by $2.7 million in FY 2003. This revenue, which is discussed separately in the initiatives section, results from a contract with a new billing agency that is focusing on third party reimbursement.

Rents and Recoveries is budgeted at $46.4 million. This revenue results primarily from the recovery of prior year appropriations that is generated by the disencumbrance of old contract and purchase order balances. Historically it has been understated. The FY 2003 budget and out-years of the Plan are increased by approximately $6 million from the FY 2002 budget to more accurately reflect historical experience.

Interest Penalty on Taxes is budgeted at $22.3 million in FY 2003, which represents an increase of $6.5 million (41%) from the FY 2002 projected receipts of $15.8 million. While the FY 2002 projected actuals may be conservative, there are no significant new initiatives to account for this large an increase. This revenue appears overstated by $3.3 million and is at risk.

Revenue Initiatives

The FY 2003 Budget contains three revenue generating "Smart Government Initiatives" totaling $1.5 million. NIFA finds all of these to be at risk or difficult to attain. They are as follows:

Handicapped Parking 02HP01

This initiative would raise the County's share of the handicapped parking fine as follows: from $100 to a range of $225 to $300 for first-time violators, from $350 to $450 for the second offense, and from $450 to $600 for subsequent offenses. In addition to these fines, there is a $30 surcharge for each ticket. This additional revenue also goes to the County. There were 4,655 illegal parking violations with regard to handicapped areas in 2001. In addition, there will be a $20 charge for replacement of a handicapped-parking permit. This initiative was included in the April Plan. Since that time, the revenue projections have been reduced by 50%. While the County has not yet obtained

approval from the State for the replacement fee, the County Legislature has acted to increase the parking fines. However, judicial enforcement of these fines has traditionally been weak. The County must educate the law enforcement community so that the appropriate fines will be levied and collected. The County must also provide a mechanism so that the police and the Traffic and Parking Violations Agency will be aware of a violator's prior handicapped parking history. The FY 2003 projected revenue for this initiative is $500,000. We believe that this may be difficult to achieve and put it at risk.

Item-Pricing Exemption 02CA02

A program is being proposed that will allow all retail grocery stores selling food products and other specified classes of merchandise to apply for an exemption to the existing item-pricing requirements. Compliance with these requirements is expensive and labor intensive. There are 119 supermarkets operating in Nassau County affected by this requirement. The initiative would allow stores, upon paying a non-refundable fee of $5,000, to maintain a dedicated price check scanner in each shopping aisle for customer use. The revenue projected in this initiative, $500,000 for FY 2003, appears to be overly optimistic. This initiative was included in the April Plan. Since that time the number of eligible supermarkets has been reduced from 123 to 119, and the initiative is still awaiting Executive and Legislative review. NIFA believes this is overly optimistic and puts $200,000 of this initiative at risk

Capital Project Chargebacks 02PW 06

The Department of Public Works manages the capital planning and project implementation process involving County-owned roads, buildings, etc. Most capital projects create an asset value with a useful life beyond one year. As such, departmental costs related to this process are re-allocated and charged back to the various funding sources in order to match the useful lives of the assets with costs (debt) on an ongoing, long-term basis. The department, in the past, incurred between $4 million and $5 million for this purpose on an annual basis. This initiative anticipates enhanced tracking of department costs and services. While the County is on course to meet the initiative from an implementation standpoint in FY 2002, we question its ability to meet the revenue projection of $500,000 in FY 2003, even though this projection has been reduced by 50% from the April Plan, because of the significant decrease in capital spending and the retirements in the Department of Public Works, therefore, we put this initiative at risk and believe that the County may realize only $200,000 of projected revenue FY 2003. Sales tax growth has averaged 4.5% for the seven-year period 1995 through 2001. In projecting future sales tax growth the County has adopted a conservative position reflecting the current economic uncertainty.

EXPENDITURES

Composition of Expenditures		
($ in millions)		
PS	$1,048.2	46%
OTPS	$442.7	20%
Direct Assistance	$459.2	20%
Debt Service	$280.7	12%
Other Charges	$54.1	2%
Total	**$2,284.9**	**100%**

The Budget consists of $2.3 billion of expenditures.[1] As shown in the chart to the right, personal services ("PS") expenditures comprise 46% of the Budget and include the cost of salaries and wages as well as fringe benefits for employees and retirees. Other-than-Personal-Services ("OTPS") expenditures account for 20% of the Budget and include charges for contractual services, pre-school special education, early intervention, utility costs, local government assistance, mass transportation, and payments to the Nassau Health Care Corporation. Direct Assistance comprises 20% of the Budget and includes payments for public assistance, Medicaid, day care programs, and institutional expenses. Debt Service, which represents 12% of the Budget, refers to both principal and interest costs for County and NIFA issued debt, net of $57 million in relief provided by NIFA restructuring assistance. This does not include $10.1 million of retirement debt service reflected in PS as a fringe benefit expense.[2] As discussed in "Debt Service" on page 33, our analysis indicates that the County has understated the required level of debt service by $7.1 million. The County confirmed this shortfall and will correct the appropriation during the adoption process. Finally, Other Charges relate to interfund expenditures which are expenses charged between component funds that are, at the County level, offset by the recognition of interfund revenues.

Personal Services

Elements of PS Spending	
($ in millions)	
Salaries and Wages	$699.1
Fringe Benefits:	
Health Insurance	$143.7
Pension Contributions	$61.4
Social Security	$50.6
Workers' Compensation	$11.1
All Other	$82.3
Subtotal Fringe Benefits	$349.1
Total	**$1,048.2**

Personal services expenditures, which the County projects will exceed $1 billion, are driven by changes in the size of the workforce, changes in contractual salaries and benefits levels, and changes in the underlying cost of providing employee benefits. As shown in the chart to the right, projected expenditures for fringe benefits comprise 33% of the County's proposed PS budget, an increase from FY 2002 wherein these costs represented only 25% of PS spending. It is likely that, even after adjusting salaries and wages to account for collectively bargained raises to be

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[1] The analysis contained in this report is limited to the five major operating funds within the Nassau County budget. These funds consist of the General Fund, Police Headquarters Fund, Police District Fund, Fire Commission Fund, and County Parks Fund.

[2] Retirement debt service refers to payments made for retirement debt that was issued by the County in relation to a 21 month pension system catch-up period between April 1, 1988 and December 21, 1989.

granted under new labor agreements, fringe benefits will continue to command a growing share of the cost of employing County workers due to the rapidly rising costs of pension and health insurance benefits.[3]

Salaries and Wages

Salaries and wages, the largest component of PS expenditures, are projected to fall to $699.1 million in FY 2003, a 4% reduction from projected FY 2002 year-end levels. The County's estimate reflects savings resulting from the County's FY 2002 and FY 2003 workforce reduction program, a projection of significantly reduced terminal leave costs, and anticipated control of overtime expenditures.

As discussed in "Workforce Reduction" beginning on page 24, the County's unforeseen success in reducing its full-time headcount in FY 2002 combined with anticipated attrition in FY 2003 will likely yield salary savings greater than assumed in the Budget. While the Budget already anticipates additional savings from attrition in FY 2003, the County based its projections on a beginning headcount of 8,531 full-time employees. In contrast, the County will likely begin FY 2003 with its headcount below 8,300 due to the overwhelming success of the County's early retirement incentive program, which attracted more than 500 participants. While limited replacement hiring may reduce the number of vacancies, the County will assuredly realize significant FY 2003 budget relief resulting from the accelerated and expanded personnel reductions that accrued in FY 2002. We estimate these savings could reach $30 million.[4]

While our analysis indicates that the County's estimate of salaries provides considerable downside protection against known risks and unforeseen expenses, we remain concerned that pension, terminal leave, and overtime costs could exceed budgeted assumptions. In particular, the County's FY 2003 pension obligation may be significantly higher than assumed in the Plan due to the impact of poor investment performance by the State's Common Retirement Fund, as discussed in "Pension Contributions," beginning on page 23.

In addition, since approximately 28% of the police force is retirement eligible, it is uncertain that Police Department retirement rates will decline as radically as assumed by the County, from a projected 250 officers in FY 2002 to 125 officers in FY 2003.[5]

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[3] County employees represented by each of the police bargaining units are working under collective bargaining agreements that have expired in 2000 and 2001. Similarly, civilian employees represented by the CSEA are working under a contract that will expire on December 31, 2002. Actual PS costs will be impacted by the terms and conditions included in future labor settlements.

[4] After sharing our analysis with the County, the County acknowledged that these resources would likely materialize, but suggested that it would be prudent to keep these excess resources in the budget as a reserve against other wage and pension risks that NIFA has identified throughout this report. The County has suggested that it will properly account for these risks and offsets after the fiscal year ends and actual headcount changes become known.

[5] An average of 196 police officers have separated annually during FYs 2000-02. In contrast, during FYs 1997-99, approximately 62 police officers separated annually. The County believes that its most recent three-year experience, which is skewed by the projected 250 retirements in FY 2002, does not represent a new, higher retirement

Despite the laudable creation of a $7.8 million reserve to mitigate this potential risk, our analysis indicates that the County could incur unfunded termination costs if the number of police retirements in FY 2003 exceeds 150.

We are also cautious in our assessment of the County's ability to constrain overtime spending to budgeted levels. While the County has budgeted $46.2 million for overtime needs in FY 2003, an increase of $6.5 million above the County's FY 2002 Adopted Budget, departmental overtime usage may become increasingly more difficult to limit in light of the County's significant headcount reductions, especially if attrition creates vacancies in traditionally overtime-intensive titles. For example, the sworn headcount in the Police Department is expected to fall from 2,803 at the start of FY 2002 to 2,553 by the end of FY 2002. Since these reductions have occurred throughout FY 2002, the full annualized impact on overtime from these reductions has not been experienced. Nonetheless, the Budget includes only $25.1 million for police overtime in FY 2003, or only slightly more than what is projected to be spent in FY 2002. Furthermore, the County projects that the force will drop by an additional 125 officers during FY 2003, falling to 2,428, thereby further complicating the Police Department's ability to support police operations without resorting to even greater utilization of overtime. In addition, contractual raises granted under new labor agreements will likely exacerbate the County's difficult task of overtime cost control.

<u>Fringe Benefits</u>

Fringe benefits costs, which are projected to reach $349.1 million and are driven primarily by legal requirements and collective bargaining agreements, continue to exert upward pressure on the Budget and Plan. Specifically, escalating expenditures for health insurance benefits combined with rapidly growing pension contribution requirements, resulted in approximately $65 million in new needs being funded in FY 2003 compared with FY 2002.

Health Insurance

For the majority of County employees and retirees, their health insurance benefits are determined through collective bargaining. Since the County currently funds the entire cost of these benefits for both employees and retirees, it must absorb the entire growth in costs resulting from insurance premium rate increases. The County assumes that health insurance costs will grow by 15% annually, with the Budget appropriating $143.6 million in FY 2003 for these expenditures, including $69.7 million for employees and $73.9 million for retirees. Based on discussions with the New York State Department of Civil Service, our analysis indicates that these projections are conservative and should adequately provide sufficient resources to cover the County's obligations assumed in the Plan. Savings may be realized, however, to the extent that premiums do not rise as rapidly as assumed, replacement hiring is delayed, and/or greater attrition occurs for non-

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baseline, but is instead an anomaly caused by September 11th-related overtime earnings. Overtime earnings can increase a police officer's retirement benefit if earned during their final year of active service.

retirement reasons. Savings accrue under this last scenario since there are no ongoing County obligations for health insurance for former employees who have not retired from County service.

Pension Contributions

As NIFA forewarned in previous staff reports, the County's contribution rates to both the Employees' Retirement System ("ERS") and the Police and Fire Retirement System ("PFRS") will likely rise in the coming years as the impact of recent declines in the stock market impact upon State actuarial calculations.[6] Since higher contribution rates, calculated as a percentage of payroll, translate into additional County-funded pension costs, we are pleased by the County's decision to allocate additional resources in the Plan to cover these large and rapidly growing expenditures.[7] The County added $40 million in FY 2003, $55 million in FY 2004, $102 million in FY 2005, and $113 million in FY 2006 to its baseline projections compared with estimates contained in the April Plan.

However, despite these significant modifications, we remain concerned that the County's exposure to higher pension costs may be greater than assumed should the invested assets held in the State's Common Retirement Fund not perform as expected. The County's projections, which were based on a scenario provided by the State Comptroller, assume that the equity component of the State's Common Retirement Fund will decline by 10% during State fiscal year (SFY) 2002-03 and then grow by 9% annually thereafter.[8] Unfortunately, the County's assumptions regarding long-term average annual rates of return on equity investments are above recent experience. In fact, the Russell 3000, an index which represents approximately 98% of the investable U.S. equity market and serves as a proxy for assumptions on which the State Comptroller's scenario was based, fell by an average annual rate of 1.8% over the past 5 years. We are even less sanguine in our assessment of the County's short-term assumptions, a negative 10% rate of return this year, due to the year-to-date decline of 29% in the Russell 3000.[9]

Pension contribution rates are driven substantially by the investment performance of the Common Retirement Fund. The State Comptroller provided guidance to

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[6] The County participates in the New York State and Local Employees' Retirement System ("ERS"), the New York State and Local Police and Fire Retirement System ("PFRS"), and the Public Employees' Group Life Insurance Plan. The local participating employer contribution rates for each retirement system are set by the State Comptroller and billed to the County each December.

[7] The County's baseline projections now assume that these payments, as a percentage of salary, will grow from 1.3% in FY 2002 to almost 11% in FY 2006 for ERS and from 2.9% in FY 2002 to almost 19% in FY 2006 for PFRS.

[8] The retirement systems' contribution rates are based on investment performance of the Common Retirement Fund during the State's fiscal year, which runs from April 1, 2002, through March 31, 2003. These rates will form the basis of the December 2003 pension bill.

[9] The Russell 3000 has fallen by 29% as of September 30, 2002.

participating employers on how their future contribution rates would be impacted based upon three different investment performance scenarios covering SFY 2002-03, if subsequently followed by the Fund's actuarially assumed investment growth rate of 9% thereafter. The first scenario assumed a positive 9% return in SFY 2002-03; the second scenario assumed no return in SFY 2002-03; and the third scenario assumed a negative 10% return in SFY 2002-03. While the County should be commended for utilizing the gloomiest of the three scenarios when developing the Budget and the Plan, our analysis indicates that the County's pension estimates may not be sufficiently conservative since the actual performance of the State Comptroller's benchmark is currently below the level used for this scenario. If the assets on March 31, 2003, remain unchanged from current levels, the County's FY 2003 pension bill could increase by $36 million, creating a $26 million unfunded pension liability.[10]

NIFA is also concerned that the County's contribution rates could be adversely affected by any changes to the economic or demographic actuarial assumptions that may be considered by the retirement systems during the period of the Plan, including a reduction in the assumed actuarial interest rate, which is currently set at 9%. A reduction in this actuarial assumption would result in an increase in the required pension contribution payments from all participating employers.

Since unfavorable investment experience, coupled with more conservative actuarial assumptions, could result in significantly higher pension contributions and a widening of the underlying structural gap between recurring revenues and expenditures, we strongly encourage the County to develop contingency plans which protect against this risk, which the County acknowledges as one of seven basic threats to the success of the Plan. The County should be prepared to quickly implement these contingency gap-closing measures should adverse investment experience be realized.

Workforce Reduction

The County's ability to attain long-term structural balance depends on its capacity for bringing its recurring expenditures in line with its recurring revenues. Since 46% of the County's projected expenditures are for personal services, headcount reduction remains a critical tool within the County's control through which expenditure cuts can be made. Consequently, the County has made workforce reduction a cornerstone of its four-year gap-closing program, confirming its need to reduce the size of its workforce to a level that can be afforded on a recurring basis.

The Plan calls for a permanent reduction of 1,400 full-time positions by the end of FY 2003, an ambitious goal that the County assumes can be facilitated by a strict hiring

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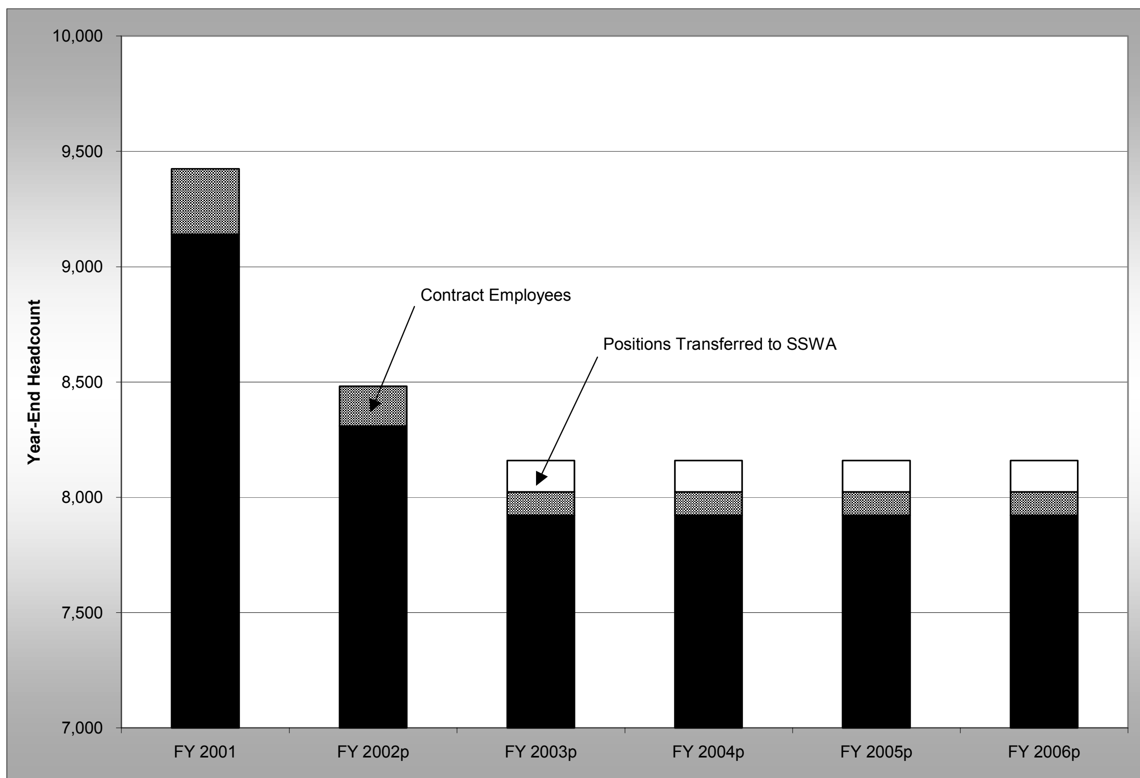
[10] Our analysis indicates that the County's FY 2003 pension costs could increase by approximately $1.9 million for each 1% decline in the Fund's equity investments below the County's negative 10% baseline assumption. However, our analysis also indicates that the Budget contains at least $10 million in resources above what is needed to fund the County's negative 10% investment performance scenario. This arises from the fact that the County's upcoming payment of its December 2002 pension bill includes charges that are allocable to the first quarter of FY 2003. This discrepancy results from the fact that the State and County fiscal years overlap for only nine months.

freeze that permits County departments to replace only one out of ten attritting civilian employees.[11] The County contemplates full attrition in the Police Department, with new hiring not beginning until mid-way through FY 2004. As shown in Chart 3, the County includes in its target the transfer of 136 public works employees from the General Fund to the proposed Sewer and Storm Water Authority ("SSWA") as well as a reduction of 181 contract employees. Excluding contract employees, the Plan assumes that the County's year-end full-time headcount will decline from 9,159 in FY 2001 to 8,309 in FY 2002, and 7,922 in FY 2003, remaining at the FY 2003 level in FY 2004, FY 2005, and FY 2006.

(Chart 3)
FULL-TIME HEADCOUNT
FY 2001 – FY 2006



To achieve its headcount targets, the County implemented a strict hiring control process at the beginning of FY 2002, which allowed limited hiring only in areas deemed critical or targeted for investment. As discussed in "FY 2002 Recap," the County reduced its full-time headcount by 361 employees between January 1, 2002, and August

[11] The County's workforce reduction targets are based on headcount changes relative to its January 1, 2002, staffing level baseline of 9,442 full-time positions. This total includes 283 employees associated with the Federation Employment and Guidance Services (FEGS), Family Children's Association (FCA), and Mental Health Association (MHA).

31, 2002, through a combination of normal attrition and involuntary separations. The County reported that more than 500 additional employees have separated by means of its early retirement incentive program. Furthermore, combined with normal attrition in the remaining 3 months of the fiscal year, the County projects that 942 fewer full-time employees will be on payroll at year-end, which roughly approximates a 10% reduction from its FY 2001 year-end staffing level.

The County anticipates that an additional 450 positions will become vacant in FY 2003 due to normal attrition and personnel transfers to the SSWA. Thereafter, the County expects to maintain aggregate headcount at constant levels, replacing attrition on a one for one basis.

The sizeable "in-hand" staffing reductions serve to jump-start the County's massive workforce reduction program and help to ensure that the County's near-term fiscal goals are reached. In fact, while the Plan assumes an FY 2003 starting headcount of 8,300 full-time employees, the proposed Budget includes sufficient resources to fund more than 8,500 full-time positions, as discussed earlier in "Salaries and Wages," beginning on page 21. Since actual headcount reduction experience in FY 2002 and FY 2003 may more closely mirror the assumptions underlying the Plan, the County may realize unanticipated budget relief in FY 2003 of up to $30 million.

NIFA remains cautious, however, in our assessment of the County's ability to maintain its headcount reduction objectives, its capacity to realize its concomitant out-year savings targets, and the extent to which services or revenue collections are impacted. Our concern is rooted in the fact that County services will be shaped by the arbitrary and random nature of the attrition program. Achieving goals and objectives through attrition requires significant planning and is not usually achieved through a random program in which all employees are targeted. The most talented managers will be handicapped by the allowable 10% backfill rate, an extremely aggressive constraint that will make more difficult the County's ability to ensure that services are delivered unimpaired. Since under any hiring freeze separations occur randomly across time, at some point matching programs targeted for reduction and the separation schedule cannot be achieved. An aggressive redeployment effort could help mitigate some of the likely mismatch, however, the degree of flexibility is partially contingent upon factors outside the County's control, such as Civil Service law and regulation.

While the County recognized the potential impact on services of its planned headcount reductions, the faster pace and greater level of attrition actually experienced by the County in FY 2002 makes the ultimate near-term impact less clear and the long-term impact indeterminate. Quality of services issues notwithstanding, the County must safeguard its revenue generating functions so that the resulting consequences of headcount reductions do not impinge upon its ability to meet budgeted revenue targets. For example, the County must ensure that the reductions proposed for the Department of Parks, Recreation and Museum Services do not jeopardize its capacity for realizing the $17.5 million in departmental revenue underlying the County's revenue forecasts, namely a 10% increase over FY 2002 adopted levels.

Since the County did not prepare a four-year headcount plan or financial plan by department, it is difficult to decipher what long-term policy choices have been made. NIFA encourages the County to develop department-level four-year plans in order to enumerate its long-term strategic plans. The planning process should include proactive and explicit County Executive decisions concerning which services to continue, scale back, and/or eliminate immediately and in the future. The level of authorized staffing and resources provided in each year of the Plan should then be made consistent with these decisions.

Other Than Personal Services

The County projects that it will spend $442.7 million on OTPS costs in FY 2003, or $2.4 million more than appropriated in the FY 2002 Adopted Budget. As shown in the chart to the right, these expenditures are composed of several large categories of spending: pre-school special education, local government assistance, mass transportation, early intervention services, payments to the Nassau Health Care Corporation, and utility costs. In general, the County has reasonably estimated these costs, although the underlying assumptions must be monitored closely throughout FY 2003 to ensure that potential budget variances are recognized immediately and that corrective actions are implemented in a timely manner.

Elements of OTPS ($ in millions)	
Pre-School Special Education	$73.9
Local Government Assistance	$51.6
Mass Transportation	$41.4
Early Intervention Services	$43.3
Payments to NHCC	$37.3
Utility Costs	$26.4
All Other	$168.8
Total	**$442.7**

The Early Intervention program, administered by the Department of Health, provides specialized services to families with children under age three with developmental delays and disabilities. As children get older, they become eligible for partner components of the program, the Pre-School Program for ages 3-5, administered by the Department of Mental Health, and the School-Age Program of the Department of Social Services for ages six and older.

The Budget included an additional $3.5 million for Pre-School Special Education and $500,000 for Early Intervention Services compared with FY 2002. The County assumes that the number of children receiving benefits will remain relatively stable during FY 2003 with rate increases driving program costs.

The County remits to the towns and cities sales tax revenue resulting from the 0.25% portion of the sales tax charged on purchases made within Nassau County borders. The payments to these local governments, projected to be $51.6 million in FY 2003, are an expenditure offset to the sales tax revenue collected by the County from its 8.5% sales tax rate.

The County projects that it will spend $41.4 million on mass transportation in FY 2003, or $1.7 million lower than included in the FY 2002 Adopted Budget. These expenditures are composed of $3.9 million in subsidies to the MTA Long Island Bus, which reflects a $2 million reduction from FY 2002, $21.5 million in payments for Long

Island Railroad station maintenance, which includes a $0.3 million increase, and $11.6 million for MTA operating assistance and $4.5 million for Able Ride, its handicap transportation service, both of which remain unchanged.

The County estimates that its FY 2003 payments to the Nassau Health Care Corporation ("NHCC") will be $37.3 million, a $2.2 million increase over the amount included in the FY 2002 Adopted Budget. These expenditures include $13 million in historic mission payments and $5 million in Article 6 Public Health Activities costs as well the cost of retiree health insurance, retiree debt service, longevity payments, and termination pay for certain employees of the NHCC.[12] We are concerned that the County may incur greater terminal leave costs than assumed, a potential exposure of $3 million in FY 2003, since the NHCC's FY 2002 workforce reduction program included approximately 350 layoffs and 250 early retirement incentive participants, levels which exceed historical attrition patterns. Likewise, it is currently unclear whether the County or the NHCC is ultimately responsible for, and whether either has funded, the additional pension costs related to the NHCC's early retirement incentive program. This could result in additional costs of $9 million, or $1.8 million if paid over a five-year period.[13]

The County has budgeted $26.4 million for utility costs in FY 2003, or about $977,000 less than it included in the FY 2002 Adopted Budget. The Budget reduces appropriations for telephones by $614,000, heat, light and power by $198,000, and fuel by $269,000. These reductions are offset by a projected increase in the cost of water by $104,000. While savings will accrue due to the removal of 3,000 telephone lines in FY 2002, the County's assumptions for the savings in fuel and other utility costs is not without risk. For example, energy prices, which can be extremely volatile and hard to forecast, have risen by more than 40% this year, partly in response to elevated tensions in the Middle East. The County's energy awareness program involving conservation and alternative energy sources must be monitored closely during FY 2003 and be revisited in the Out-Years should the County's efforts be unsuccessful and/or factors beyond the County's control drive these costs higher.

The County projects that all other OTPS expenditures will reach $168.8 million, including expenditures for contractual services in areas such as legal, medical and psychiatric services in the Correctional Center, the Assessment Review Commission, and program agencies such as Senior Citizens Affairs and the Youth Board.

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[12] Retiree debt service refers to payments made for retirement debt that was issued by the County in relation to a 21 month catch-up period between April 1, 1988 and December 21, 1989.

[13] The County has chosen to ask NIFA to finance the cost of its own early retirement incentive program, as discussed in "Bond for Early Retirement Expense in 2003" on page 58.

Direct Assistance

Elements of Direct Assistance	
($ in millions)	
Medicaid	$321.5
TANF	$28.5
Safety Net Assistance	$15.5
Title XX	$40.4
All Other	$53.3
Total	**$459.2**

The County projects that it will spend $459.2 million on direct assistance in FY 2003, or one out of every five dollars appropriated in the Budget. These costs cover social service entitlement benefits for clients enrolled in a variety of support programs within the County. As shown in the chart to the right, these expenditures are made within four major categories: Medicaid, Title XX, Temporary Assistance to Needy Families ("TANF"), and Safety Net Assistance ("SNA"). The remaining expenditures, grouped in All Other, consist of spending on the County's other major social service program areas, including foster care, children in institutions, education for handicapped children, and juvenile delinquents. As discussed below, NIFA's analysis indicates that the County has conservatively estimated these costs, but that each program should be monitored closely should a deterioration of the local economy result in increased demand for social service programs and direct assistance spending.

Medical Assistance

Medical Assistance ("MA") expenditures, which account for 70% of direct assistance spending, cover a wide range of services, including payments for nursing homes, hospitals, home health care, and pharmaceuticals. In aggregate, these costs comprise 14% of the County's entire budget and have been rising steadily in recent years. The County assumes that this growth will continue in FY 2003 and the Out-Years, driven by rising caseloads and rate enhancements. Two dynamics act to drive caseload higher: effects from economic downturns, causing more people to become eligible for Medicaid, and expansions in eligibility and outreach undertaken in recent years.

The County appropriated $321.5 million for MA in FY 2003, including an $87.5 million intergovernmental transfer (IGT) payment to the State.[14] The County mistakenly overstated the size of the IGT appropriation by $6.8 million and understated the projected size of its local share of Medicaid spending by an equivalent amount. While the eventual correction of this technical error will have no impact budgetarily, it does increase the projected rate of growth in the County's local share of Medicaid to 11.7%, a projection NIFA believes to be reasonable. The County assumes this growth may accelerate, conservatively embedding 13% annual growth into its out-year projections. While these growth rates are higher than the County has experienced over the last 10 years, the County stated that the higher growth accounts for rapidly rising medical inflation, changes in trend factor, and continued growth in caseloads. Typical drivers include spending on long-term senior care, hospital reimbursements, and swiftly growing pharmaceutical costs. Caseload is expected to continue its upward climb, due to broader coverage provided by the State's new Family Health Plus program, a new health care

[14] The IGT expenditure is actually a pass-through payment, which is fully recaptured through a reimbursement made to the County by the Nassau Health Care Corporation.

initiative designed to provide health coverage to those who do not have health insurance through their employers, yet have income that disqualifies them from Medicaid.

In an effort to curb this growth, the County began implementing a mandatory Medicaid managed care program in October 2001. Managed care represents a step forward in cost containment since the capitated rates for managed care providers are lower than the traditional fee-for-service rates currently being reimbursed by the County through its local share of the Medicaid program. The County has 24,514 eligibles currently enrolled in the managed care program, penetrating 68% of the targeted population.[15]

The County proposes to augment the managed care savings with a new initiative designed to reduce Medicaid utilization and associated costs by $2 million in FY 2003, $5 million in FY 2004, and $10 million in FY 2005. In addition, the Plan includes an ambitious County proposal that calls for a State cap on Medicaid expenditures in FY 2006, which limits spending to FY 2005 levels, potentially saving the County $39 million in the last year of the Plan. While we find this initiative to be highly speculative, the County includes heavily discounted savings only in the last year of the Plan. We recommend that the County re-examine the viability of this "place holder" in subsequent financial plan submissions.

Public Assistance

As shown in Chart 4, public assistance caseloads rose significantly in the early 1990's, a time of economic contraction, almost doubling from 6,613 recipients in January 1990 to its peak of 12,406 recipients reached in April 1994. Since that time, welfare reforms and a robust economy led to a decline in caseloads by 69%, falling to 3,891 recipients in July 2002.

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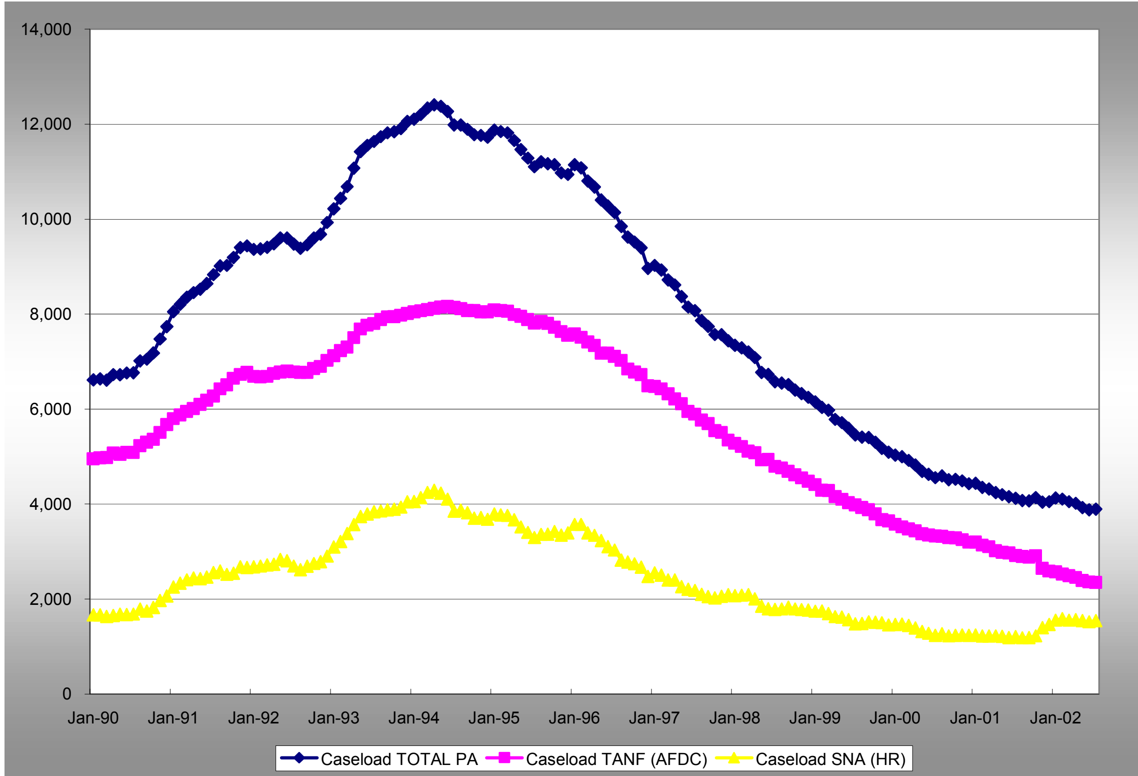
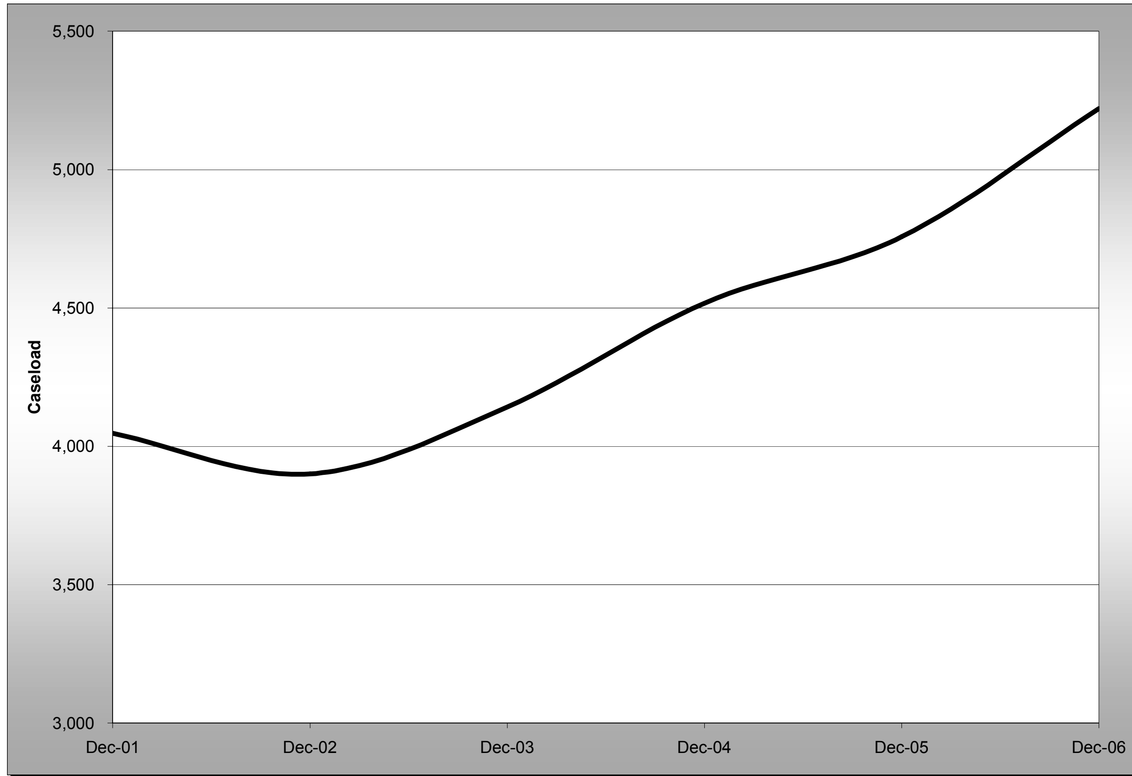
[15] The County is ultimately targeting 92% of the 34,549 non-exempted eligibles, phasing in their enrollment over a 12 to 14 month period. Key exceptions from managed care enrollment goals are residents of nursing homes, psychiatric centers, intermediate-care facilities for mentally disabled people, and recipients eligible for nursing home placement who are receiving home care or community-based services.

(Chart 4)
PUBLIC ASSISTANCE CASELOAD
FY 1990 – FY 2002



The Plan contains $44 million for public assistance expenditures in FY 2003, including $28.5 million for TANF and $15.5 million for SNA, funding levels that are unchanged from the FY 2002 Adopted Budget. Our analysis indicates that these estimates are reasonable based on the County's assumption that after remaining fairly stable for the rest of FY 2002, TANF and SNA caseload will begin to rise in FY 2003, reaching a combined level of 4,142, approximately equal to beginning levels in FY 2002, as shown in Chart 5.

(Chart 5)
PUBLIC ASSISTANCE CASELOAD
FY 2002 – FY 2006



The County estimates that aggregate PA caseloads will continue to grow, increasing by 1,321 during the four years of the Plan. The Plan includes $47.8 million in FY 2004, $50.2 million in FY 2005, and $52.7 million in FY 2006 for associated PA expenditures. Changes in public assistance caseload and costs seem closely linked to fluctuations in the local economy. While predicting a turning point in the near-term direction of PA caseload may seem speculative, it is reasonable to assume that the County will incur increased social services costs during the period of the Plan should there be a prolonged downturn in the local economy.

The County's caseload projections account for the impact of the Federal five-year limit on TANF benefits and the recent rise in local unemployment. The County assumes that time-limited recipients will shift from Federally-funded TANF to State- and County-funded SNA. While aggregate caseloads would not change in this scenario, since there is no Federal participation, the cost of the SNA program to the State and its localities is twice as much as TANF. Compounding this projected growth, is a County assumption that baseline TANF caseload will begin to rise by between 5% and 10% for each percentage point rise in unemployment, lagged by 12-36 months. The County's

projections assume that a rise in the unemployment rate to 4.8% will impact public assistance caseloads over the next three years.

While the County's projections appear conservative, it has not insulated itself completely from the potentially negative consequences resulting from Federal changes to the size of the TANF block grant or the allocation formula, or a sustained increase in the local unemployment rate. The initial TANF block grant expired September 30, 2002. In a stopgap measure, the Federal government temporarily extended the TANF block grant at unreduced levels for three months. It is unclear, however, if the Federal government will seek to alter the block grant funding mechanism or make changes to its funding level when it introduces more permanent legislation at the end of 2002. It is possible that fiscal restraint at the Federal level will result in cuts in the TANF block grant, rationalized by the fact that current levels were set when national caseloads were more than twice what they are today. Counter-arguments include the lack of built-in inflation adjustments, which have already reduced the real value of the block grant by 12% between 1997 and 2002. Reductions in Federal support may translate into increased State and local costs. The County must follow closely this highly uncertain program to guard against adverse changes in caseload and funding levels and be able to respond quickly to offset additional costs with new expenditure reduction and/or revenue enhancement initiatives.

Debt Service

The County projects total FY 2003 County and NIFA debt service of $296.3 million. This figure is net of the requested $57 million of NIFA restructuring for budget relief and of $1.6 million of NIFA debt service for sewer-related NIFA bonds that will be reimbursed to the County from the sewer districts. The Plan also assumes that NIFA will issue about $600 million of bonds in FY 2003, including about $215 million at a variable interest rate, and $250 million of cash flow notes. The County assumes that existing and projected NIFA variable rate debt will bear interest at 3% (including fees), and that fixed rate bonds will be sold at a blended interest cost of about 5.3%. Both of these rate assumptions are somewhat higher than the current market, but the variable rate budgeting is less conservative than presented in the April Plan. That plan, in which the County first asked NIFA to issue variable rate debt, emphasized conservative budgeting for variable interest and used a 4% rate. No debt service savings from creation of the proposed sewer authority are included in 2003.

The $296.3 figure is sufficient for the existing and projected debt service under the County's assumptions. However, due to an error in the budget, there is a $7.1 million shortfall in the funds actually provided. The County is aware of this error and is expected to correct it as the County budget adoption process continues. In addition, NIFA believes the County should stand by the more conservative variable rate budgeting practice it initially proposed. A 1% increase in the assumed cost of interest and fees, from 3% to 4%, would add $3.7 million to the debt service budget. If NIFA determines that the requested 2003 variable rate issuance is not appropriate, an additional $1 million (over the $3.7 million) would be needed.

As detailed in "Debt Service Expense" beginning on page 50, the Plan shares many elements with the April Plan, while removing other elements that NIFA found problematic. In summary, while NIFA does not fully concur with several County assumptions and initiatives, the current Plan is much stronger and more fiscally prudent.

Comments and concerns related to the FY 2003 budget are not easily separated from other years of the Plan. Therefore, all four years of the Plan, including FY 2003, are discussed together in the "Debt Service Expense". Initiatives of concern for the FY 2003 budget include (1) additional variable rate debt; (2) assumed interest rate on variable rate debt; (3) assumed amount of NIFA restructuring, if favorable budget events occur; and (4) assumed amount of bonding for early retirement, if favorable budget events occur. While the County must recognize that NIFA is not, at this time, committing to the amounts, types and timing of borrowing projected in the Plan, budgeted costs are not being placed "at risk" in this budget review except for $3.7 million of variable rate interest.

Expenditure Initiatives

The FY 2003 Budget contains expenditure "Smart Government Initiatives" totaling $5.5 million. Of these expenditure initiatives, NIFA believes that only one Energy Conservation is at risk. We are providing detailed explanations of only those FY 2003 initiatives that will impact the FY 2003 Budget by $500,000 or more. The expenditure managerial initiatives are as follows:

Medicaid Utilization 02SS01

The County is in the process of developing a state-of-the-art warehouse of Medicaid claim records to allow for closer analysis and evaluation of claims to identify and eliminate fraud and abuse, influence Medicare Part A and B maximization, and increase third party billing and recovery. The County is on schedule with regard to the implementation of this initiative. Since the assumed savings are modest, the County's target of saving $2 million in FY 2003 seems reasonable.

Homemaker Program Reductions 02SS04

The County provides non-mandated homemaker services to certain County residents, primarily to senior citizens with incomes below 150% of the federal poverty level. Eligible persons receive assisted living assistance in the form of housekeeping, cooking, etc. at an annual cost of $2.8 million. The County proposes to reduce its funding of this program by 25% beginning in FY 2003 to save $700,000. The County hopes to compensate for these cuts by attempting to transition eligible clients into Medicaid or an enhanced version of the Expanded In-Home Services for the Elderly (EISIP) program, thereby leveraging non-County resources. The County has made significant progress with this initiative, and the projected expenditure reduction appears feasible for FY 2003.

Program Reduction (YB/SC) 02YB01

This initiative involves discretionary spending in the Department of Senior Citizen Affairs and the Youth Board. The County has begun the process of identifying the programs to be targeted for reduction in these areas. In FY 2002, the County budgeted $11.4 million for programs in the Department of Senior Citizen Affairs and $6.6 million for programs in the Youth Board. In FY 2003, the Senior Citizen program budget is $10.5 million, and the Youth Board program budget is $6 million. If the County proceeds to implement the planned cuts under this initiative, it will meet the targeted savings of $1 million in FY 2003.

Energy Conservation 02PW09

This initiative involves both conservation to save on the County's $27 million annual bill for public utilities and recycling of the County's trash**.** The work on this initiative has not yet begun. While the County has reduced its savings projections for this initiative since the April Plan, we find even this reduced projection of $937,172 in FY 2003 to be overly optimistic. With regard to recycling, other municipalities, such as New York City, are scaling back their recycling efforts since they have proved to be unprofitable. NIFA believes that the County is only likely to achieve $500,000 of these projected savings.

RESERVES

The NIFA Act requires that the Authority monitor the "fiscal management" of the County. As part of this responsibility, when reviewing the County's financial Plan, the Authority must ensure that "adequate reserves are provided to maintain essential programs in the event that revenues have been overestimated or expenditures underestimated for any period."

In this discussion we note that there remain significant risks, especially in the Out-Years. However, there is no reserve that has been budgeted to address these risks. In the April Plan the County had included a $12.5 million reserve for unexpected needs, which has been completely removed from the current Plan. Based upon the County's financial condition, the potential risks in the Out-Years, and the minimal amount of available fund balance, we would have expected to see money budgeted for a reserve fund. It would be fiscally prudent for the County to establish reserves particularly in the Out-Years. Such reserves can help protect or mitigate against any unplanned events.

In regard to the Nassau Health Care Corporation ("NHCC") the County Executive has publicly stated that, "the hospital contract has all kinds of capital requirements that we are just in no position to pay." Unfortunately for the County, it agreed to assume many liabilities at the NHCC in return for receipt of $82 million at closing. Unless established to the contrary, we see these as unfunded liabilities of the County for which there is no contingency in the Plan.

Even if NHCC closed, the County would have continuing liabilities to bondholders and for the delivery of certain essential services. To date, we have seen no accounting for the possibility of this doomsday scenario.

In the past it was necessary for the County to bond for unforeseen events because adequate reserves were not budgeted. That pattern of not living within its budget and borrowing for every contingency was a contributing factor in the deterioration of the County's fiscal health and the need to create NIFA. Even the best-run household leaves something for a rainy day; we urge the County to do the same.

IV. FY's 2004-2006 FINANCIAL PLAN

This section discusses the growth rates that were used by the County for revenues and expenditures in the Plan as well as the out-year gap-closing actions proposed by the County. In the County's original submission of the Plan on September 17, 2002, the County stated that the out-year gaps were $371.6 million in FY 2004, $506.3 million in FY 2005, and $650.8 million in FY 2006.

On September 26, 2002, the County submitted a preliminary revision of the Plan. On October 1, 2002, we were provided with a final revision, with the following gaps of $146.4 million in FY 2004, $285.2 million in FY 2005, and $362.1 million in FY 2006. The reason for the changes is that the Out-Year gaps, as stated in the original submission, did not properly reflect the recurring impact of actions that will be taken to balance the FY 2003 budget. The growth rates used are prior to the implementation of any major policy changes and Out-Year initiatives contained in the Plan. NIFA's analysis is based upon information contained in both submissions.

OUT-YEAR REVENUE GROWTH

For purposes of projecting revenues in the Out-Years of the Plan (FY 2004 – FY 2006), the County used the following growth rates:

- After the 20% property tax increase in the FY 2003 budget, property taxes are not projected to increase until FY 2006 where there is a proposal for an increase equal to the CPI, estimated to be 2.5%.
- Sales taxes are projected to grow 2.5% in FY 2003, and 2.7% in FY 2004, FY 2005 and FY 2006.
- State Aid growth is projected to remain flat from FY 2003 levels.
- Federal Aid is projected to remain flat from FY 2003 levels.
- Departmental Revenues are projected to remain flat from FY 2003 levels.

OUT-YEAR EXPENDITURE GROWTH

The following is a discussion of the growth rates used in the Out-Years of the Plan for the more significant expenditure categories.

Personal Services Costs

Personal Services ("PS") expenditures comprise 46% of the budget and include the cost of salaries and wages as well as fringe benefits for employees and retirees.

Salaries and Wages

Salaries and wages represent the single largest expenditure category, representing approximately 30% of spending in the Plan. The County projects that baseline salaries and wages will grow by an average of 5.4% annually. However, the Plan contemplates reducing this rate of growth through a number of major gap-closing actions, including workforce reductions, labor concessions, and other contractual reductions, as discussed elsewhere in this report.

Fringe Benefits

The County projects that baseline fringe benefit costs will grow by an average of 12.9% annually during the Plan, accelerating from 11.9% growth in FY 2004 to 19.4% growth in FY 2005 before slowing to 7.5% growth in FY 2006. These projections translate into $152.7 million in additional fringe benefit expenditures that are included in the Plan by FY 2006, as shown in Table 4.

(Table 4)
GROWTH IN FRINGE BENEFITS
FY 2003- FY 2006

($ in millions)	FY 2003	FY 2006	Change
Health Insurance	$143.7	$218.5	$74.8
Pension Contributions	61.4	136.2	74.8
Social Security	50.6	54.5	3.9
Workers' Compensation	11.1	13.4	2.3
Other Fringe Benefits	82.3	79.2	(3.1)
Total Fringe Benefits	**$349.1**	**$501.8**	**$152.7**

Health Insurance

The largest element of fringe benefits is spending on health insurance. The County projects that health insurance costs will grow by 15% annually, on average, for employees and retirees, adding $74.8 million in new fringe benefit costs by FY 2006. As discussed earlier in "Health Insurance" on page 22, we find these assumptions to be conservative based on discussions with the State Department of Civil Service. The County may realize financial plan relief to the extent that premiums do not rise as rapidly as assumed, replacement hiring is delayed, and/or greater attrition occurs for non-retirement reasons. Savings accrue to the County under this last scenario since there are no ongoing health insurance costs for former employees who have not retired from County service. In addition, the County has stated that it will seek to reduce its exposure to this rapidly rising expense as part of its labor concession gap-closing initiative, as discussed in "Labor Concessions" on page 48.

Pensions

After years of declining costs due to favorable pension investment earnings, it is anticipated that the County's contribution rates to the retirement systems (New York State Employees' Retirement System and New York State and Local Police and Fire Retirement System) will rise in the coming years as the impact of recent declines in the stock market impact upon State actuarial calculations. The County's baseline projections now assume that these payments, as a percentage of salary, will grow from 1.3% in FY 2002 to 10.8% in FY 2006 for civilians and from 2.9% in FY 2002 to 18.9% in FY 2006 for police. Combined, these assumptions translate into an additional $74.8 million in required new spending by FY 2006.

NIFA remains concerned that, despite the County's recognition of these significantly higher projected pension obligations, the County's contribution rates to the retirement systems may rise more quickly than assumed, creating unfunded pension costs in the Plan, as discussed earlier in "Pension Contributions," beginning on page 23. The County must monitor these costs carefully and make appropriate adjustments to the Plan as its pension projections change.

Social Security

The County assumes that growth in Social Security costs will closely track growth in employee wages. The County has no control over the level or growth in these expenditures outside of its ability to limit collective bargaining increases and manage workforce levels, as discussed earlier in "Workforce Reduction" beginning on page 24 and "Labor Concessions" beginning on page 48.

Workers' Compensation

Workers' Compensation is projected to grow by 6.7% annually over the term of the financial plan. The County believes that it can reduce these costs by implementing a series of reforms in its Workers' Compensation program, as discussed on page 44.

Other Fringe Benefits

The County assumes that its remaining fringe benefit costs, in aggregate, grow by 1.9% in FY 2004, 2.1% in FY 2005, and then fall by 7.6% in FY 2006. These expenditures include spending on items such as unemployment insurance, dental, and optical benefits. The large decrease in FY 2006 results from the final maturity for retirement debt service in FY 2005. This retirement debt was issued by the County in relation to a 21-month catch-up period between April 1, 1988, and December 31, 1989. This results in $10.4 million of financial plan relief in FY 2006. Since the Plan calls for significant labor concessions, spending for employee dental and optical programs may change as a result of future negotiations.

Other than Personal Services Costs

The County projects that baseline other-than-personal services (OTPS) expenditures, including spending on direct assistance, but excluding debt service, will grow by an average of 5.6% annually during the Plan, as shown in Table 5. These costs are driven by spending on Medicaid, which is projected to grow by 10% each year, resulting in $106.7 million of the additional $159.8 million in OTPS expenditures projected in FY 2006. As discussed in "Medical Assistance," beginning on page 29, the County's projections conservatively assume an underlying annual growth rate of 13% in the County's local share of Medicaid expenditures, a rate which exceeds the County's recent experience.[16] The County justifies the need for conservatism by highlighting continued program expansion, accelerating medical inflation, and anticipated provider rate enhancements expected during the Plan.

(Table 5)
GROWTH IN OTPS
FY 2003- FY 2006

($ in millions)	FY 2003	FY 2006	Change
Medicaid	$321.5	$428.2	$106.7
All Other	580.4	633.5	53.1
Total OTPS	**$901.9**	**$1,061.7**	**$159.8**

Since the County lacks the authority to unilaterally limit Medicaid coverage provisions and associated costs, it must continue to aggressively pursue all measures designed to increase efficiencies and curb growth in these expenditures. The County proposed in its gap-closing program, an initiative designed to reduce Medicaid utilization and associated costs by $2 million in FY 2003, $5 million in FY 2004, and $10 million in FY 2005 and FY 2006. In addition, the Plan includes an ambitious County proposal that calls for a State cap on Medicaid expenditures in FY 2006, which limits spending to FY 2005 levels, potentially saving the County $39 million in the last year of the Plan. While we find this initiative to be highly speculative, the County includes heavily discounted savings only in the last year of the Plan. We recommend that the County re-examine the viability of this initiative in subsequent financial plan submissions.

The Other OTPS costs are projected to grow by 3% annually, or slightly above inflation. These expenditures are driven, in part, by expected spending growth in the County's public assistance programs, including TANF and Safety Net Assistance. The costs of these programs are projected to rise by 6.2% annually, as discussed in "Public Assistance," beginning on page 30.

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[16] The Plan assumes that the size of the County's IGT payment will not change. While this expenditure is actually a pass-through payment, which is fully recaptured through a reimbursement made to the County by the Nassau Health Care Corporation, it serves to deflate the calculated growth in total Medicaid spending.

Debt Service

The County projects that baseline debt service costs, prior to NIFA restructuring, but inclusive of other FY 2003 initiatives, will grow by 5.6% in FY 2004, fall by 6.4% in FY 2005, and fall by 1.7% in FY 2006. This would result in $10 million in lower debt service payments by FY 2006 absent additional initiatives in FY 2004 – FY 2006. As discussed in "Debt Service Expense" on page 50, the inclusion of NIFA restructuring and Out-Year initiatives changes these figures.

Pay-As-You-Go Certiorari

In FY 2006, the Plan projects spending $33.84 million on property tax refunds. As of FY 2006, the cost of these refunds will no longer be financed with new certiorari debt, but will be accounted for in the operating budget on a pay-as-you-go basis. However, this amount is net of a gap closing initiative valued at $22.71 million, the amount the County projects will be saved by the efforts of the reorganized Assessment Review Commission. We believe that this tax certiorari spending projection for FY 2006 is too low. The County's tax certiorari history, paying out approximately $100 million annually in recent years, would seem to suggest that even with the proposed County efforts to reduce these claims, the projected spending level may be too low.

OUT-YEAR-GAP CLOSING ACTIONS

Based upon the growth rates we discussed above, the County has identified Out-Year gaps of $146.4 million in FY 2004, $285.5 million in FY 2005 and $362.1 million in FY 2006, before consideration of NIFA debt restructuring and transitional State aid, and before implementation of County actions to close these gaps. These are the Out-Year gaps as stated in the County's revised submission of the Plan on September 26, 2002. The County has identified the following categories of gap-closing measures.

- Managerial Initiatives
- Labor Concessions
- Tax Certiorari Reform
- Debt Service Expense
- Sewer and Storm Water Authority
- New Revenues
- Expenditure Action

Managerial Initiatives

The managerial initiatives as stated on the Summary of Gap-Closing Measures are valued at $31.9 million with a 50% discount in FY 2004, $45.8 million with a 15% discount in FY 2005, and $45.2 million with a 5% discount in FY 2006. Many of these initiatives are well intentioned, but the County does not provide sufficient detail to enable us to properly evaluate the projected results. We have not put these initiatives at risk because the fiscal impact is not significant and is projected for the Out-Years of the Plan.

The Plan provides individual tracking sheets for only those April Plan initiatives that have not yet been fully implemented and for those initiatives identified after the April Plan. While the "Summary of Gap-Closing Measures" provides summary information on the Managerial Initiatives for FY 2006, the monitoring sheets do not include any information on FY 2006. However, there is FY 2006 budgetary impact information for those initiatives that begin in FY 2003. This information was included on the later Plan submission. For purposes of this report, we have assumed that the savings and/or revenues that will result from the individual initiatives in FY 2006, for which we were not provided with specific FY 2006 information, will be the same as for FY 2005 with a 5% discount as indicated on the Summary.

Revenue Initiatives

The following revenue initiatives are projected to produce $1 million or more in each of the Out-Years of the Plan:

E-911 Cell Phone Surcharge 02PD14

Nassau County is seeking a distribution of the portion of the existing E-911 surcharge on cell phones imposed by the State (.70/month per cell phone). Currently, the surcharge goes to the State Police. It is estimated that there are over 700,000 active cell phones in Nassau County. A bill has been passed by the State legislature and signed by the Governor that would add an additional $0.30 to the existing surcharge which could then be distributed to the various counties. The revenue estimates for this initiative seem achievable.

2004 $2,000,000
2005 $3,000,000
2006 $3,000,000

Ambulance Billing 02PD15

The County has contracted with a new outside billing service to handle ambulance billing and collections. This new vendor began billing in April of 2002. The new vendor will use new technologies and will focus on third party reimbursement. The County can reasonably expect a significantly improved collection rate. In addition, the collection of the backlogged bills and the rate increases recently enacted should produce the revenue projected for this initiative.

2004 $2,000,000
2005 $2,000,000
2006 $2,000,000

Grant Funding 02SS02

The County has moved to centralize and coordinate all of its grant writing for health and human services in an effort to tap into the resources of Federal, State, and private foundation grants that are available. The County has also begun an education program for these grant-writing personnel. It is estimated that $500 million in grants is available in the health and human services area. The County's early efforts have already produced results, in FY 2002, a new $350,000 grant was obtained. The Out-Year projections may be difficult to achieve unless the County is aggressive in pursuit of these grant funds.

2004 $5,000,000
2005 $7,500,000
2006 $7,500,000

Family and Children's Block Grant 02SS05

The NYS Office of Children and Family Services has eliminated the cap for funding Child Preventive, Child Protective, Aftercare, Independent Living and Adoption Administrative Services. In the past, every dollar spent on these services above the cap was 100% County funded. With the removal of this cap, the County will receive 65% reimbursement for these services. This initiative has been achieved and is projected to continue through the Out-Years of the Plan.

2004 $1,750,000
2005 $1,750,000
2006 $1,750,000

Expand Grant Consolidation to Non-Human Services 02AC05

The County is proposing the creation of a centralized grant writing office on a countywide basis. Such grants would need to fund existing services rather than incur new costs or establish new programs for the County to benefit. Since the staff is not yet

in place, and since many grants are awarded well in advance of project start dates, we believe it may be difficult to achieve the revenue projected for FY 2004.

2004 $1,000,000
2005 $2,000,000
2006 $2,000,000

Workers' Compensation 02AT04

Since the beginning of FY 2002, the County has dedicated substantial effort to the reorganization of its Workers' Compensation operation. The County has acted to claim previously unclaimed reimbursement from "special funds" monies which are owed to it by the State. The County has also started pursuing third party liens which are owed to the County by claimants who won or settled lawsuits against tortfeasors who caused the injuries. The County is also pursuing lump sum settlements to reduce the cost of long term payouts to claimants. Thus far in FY 2002, these efforts have brought in $1.6 million in special funds reimbursement and third party liens. Unlike the special funds and third party lien initiatives, the lump sum payout initiative will take longer to show results. However, all three initiatives should result in substantial revenue and savings for the County. The County spends approximately $11 million on Workers' Compensation annually. Workers' Compensation cases and the County's payment obligations with regard to those cases last for many years, in some instances for the life of the claimant. Based on these early successes, the revenue projections for this initiative are reasonable.

2004 $1,500,000
2005 $1,500,000
2006 $1,500,000

Affirmative Litigation and Revenue for Legal Services 02AT05

The County plans to initiate recoveries from litigation brought by the County for fees and legal services. The County Attorney has identified affirmative litigation such as collecting unpaid rent, collecting unpaid contract fees, and collecting unpaid franchise taxes. In addition, it is expected that the County will be receiving damage recoveries from vendors, employees, and others who have damaged or stolen County property or taken advantage of commercial and social services contracts. This initiative requires the hiring of three attorneys and two support personnel. Since the hiring has not yet occurred, it is unlikely that the recoveries projected will come to fruition by FY 2004, and the projections for FY 2005 and FY 2006 seen unrealistically high.

2004 $1,500,000
2005 $2,000,000
2006 $2,000,000

Cash and Receivables Management 02TR01

The County plans to create a centralized management oversight function to monitor cash collections and to manage receivables and/or lease collections. In the past, this was handled by multiple departments without any written procedures, standardized forms, or internal controls. It is anticipated that a centralized approach would reduce uncollected amounts significantly. An RFP is being prepared for the retaining of various collection agencies. If the County proceeds with its implementation schedule for this initiative, the revenue projections may be achieved.

2004 $1,500,000
2005 $2,000,000
2006 $2,000,000

Expenditure Initiatives

The following expenditure initiatives are projected to produce savings of $1 million or more in each of the Out-Years of the Plan:

Expand Drug Courts 02DR05

This initiative is projected to produce savings by expanding the use of specialized courts where first time, non-violent offenders are offered treatment in lieu of incarceration. Studies have shown that these courts produce nearly $5 in medical, criminal, and social service savings for every dollar spent. While the actual savings resulting from this type of program are not immediate, the County completed significant aspects of the implementation process for this initiative in FY 2002. The projected savings appear reasonable for the Out-Years of the Plan.

2004 $1,500,000
2005 $2,000,000
2006 $2,000,000

Close Nassau Case Management Project 02MH01

The County anticipates substantial savings due to the closing of the Nassau Case Management Demonstration Project in the Department of Mental Health and outsourcing the case management responsibilities to an outside contractor, FEGS, under a new less costly contract. In the past, the FEGS employees were successful in a legal action against the County with regard to the contracting out of these services. The FEGS employees had argued that they were in reality County employees and should be paid in accordance with the CSEA contract and Civil Service regulations. The courts agreed. It now appears that the County has executed a new agreement with the FEGS management that will limit the cost of the program to the reimbursement levels set by the NYS Office of Mental Health. Therefore, no additional County funds will be required for this program. While the new FEGS contract purports to offer to the FEGS employees more than they were receiving under the prior contract, this new contract results in expenditure savings for the

County because it keeps the County's costs lower than they would have been if the FEGS employees became County employees. Based on this prior history, we question the viability of these projected savings should there be further legal challenge which appears likely.

2004 $1,500,000
2005 $1,500,000
2006 $1,500,000

Medicaid Utilization 02SS01

The County is in the process of developing a state-of-the-art warehouse of Medicaid claim records to allow for closer analysis and evaluation of claims to identify and eliminate fraud and abuse, influence Medicare Part A and B maximization, and increase third party billing and recovery. The County is on schedule with regard to the implementation of this initiative, however, we question the County's ability to reach the targeted savings levels.

2004 $2,740,000
2005 $7,446,200
2006 $7,114,206

Day Care Centers/Reduced Salary Enhancements 02SS03

The County currently provides discretionary funding to enhance the salaries of certain employees working for childcare providers. The childcare providers use these resources to aid in the recruitment and retention of qualified day care staff through salary enhancement of $5,000 per full time head teacher and $2,500 per fulltime assistant teacher. There are approximately 55 providers that receive nearly $4 million to enhance the salaries of over 1,000 teachers. The County proposes to reduce the level of salary enhancement by 10% in FY 2003 and 25% in FY 2004 and thereafter. Since this is a discretionary program, the County should be able to achieve the projected savings.

2004 $1,000,000
2005 $1,000,000
2006 $1,000,000

Audit Recoveries 02AC01

The County has begun to expand the focus and scope of its internal audit function, targeting large and high-risk contracts and vendors to achieve an average ½% disallowance rate, in addition to requiring a 5% retainage for all contracts in excess of $100,000. The County is in the process of acquiring more sophisticated software in order to take advantage of technological advances that will enable it to become more aggressive in these recovery efforts. Since we know that past efforts at audit recoveries

were thwarted, until these recovery efforts show some results, we will question the feasibility of the recovery amounts.

2004 $1,500,000
2005 $1,500,000
2006 $1,500,000

Telecommunications 02AC03

The County currently expends in excess of $6 million annually on various telecommunication systems. The proposed savings can be achieved from the aggressive rate negotiations and elimination of under-utilized, unnecessary, or non-existent phone lines. In FY 2002, the County reduced telephone costs by $614,000. Based on these initial efforts, the savings projections for this initiative seem feasible.

2004 $1,000,000
2005 $1,250,000
2006 $1,250,000

Fraud Hotline 02AC07

The County plans to establish a Department of Investigations in order to recoup losses due to fraud, theft, abuse, and other actions. While fraud does undoubtedly exist in the County, as in all organizations to some extent, we seriously question the ability of the County to recoup the amounts projected.

2004 $1,500,000
2005 $1,500,000
2006 $1,500,000

Reduced Reliance on Outside Counsel 02AT02

Beginning in FY 2002, the County Attorney ceased the practice of routinely sending litigation to outside law firms. The County Attorney has brought cases back to the office for in-house handling and has renegotiated the rates paid to private attorneys. Since the implementation of this initiative appears to be on schedule and is within the discretion of the County, the projected savings appear feasible. However, the projected savings amounts will be reduced by the cost of hiring staff attorneys.

2004 $5,907,000
2005 $6,180,000
2006 $6,180,000

Risk Mitigation 02AT03

This initiative involves the implementation of a comprehensive proactive system for risk management that will include policies and procedures, controls, reports, rapid response, education, training, compliance and third party oversight. The major tool for

the implementation of this program is a case management system in the County Attorney's office. The County is in the process of procuring that system for this and other purposes. Since the County incurs annual losses of approximately $40 million, the projected savings should be achievable.

2004 $1,500,000
2005 $2,000,000
2006 $2,000,000

Cost Allocation 02CO01

This initiative deals with bringing in the methodology and oversight to be able to charge back direct and indirect costs to County departments. An appropriation has already been approved to procure a cost allocation consultant. An RFP has been prepared which is expected to be released shortly. If this initiative stays on schedule, the projected savings should be feasible.

2004 $1,000,000
2005 $1,000,000
2006 $1,000,000

Labor Concessions

With personal service costs, including salaries and wages, comprising approximately 46% of the FY 2003 budget and Plan, labor agreements are an integral component in achieving structural balance. Of the five unions that represent the workforce covered in the Plan, three have expired contracts, one union contract is expiring on December 31, 2002, and the last union is in the middle of a long term agreement. The end result is that going forward there is little cost certainty for nearly 90% of the labor force.

The three police unions are currently working without a contract. Contracts with the Police Benevolent Association ("PBA") and Detectives Association Incorporated ("DAI") both expired on December 31, 2000, while the contract with the Superior Officers Association ("SOA") expired on December 31, 2001.

The largest union in the County is the Civil Service Employees Association ("CSEA") which represents more than half of the total workforce. The contract for the CSEA expires on December 31, 2002. Uniformed Correctional Center personnel, formerly represented by the CSEA are now represented by the Sheriff's Officers Association ("ShOA"). The contract for ShOA runs through FY 2004.

The County envisions a change from the "business as usual" policy with respect to prospective contract settlements. As referenced in the County's plan, NIFA previously recognized the importance of a break from the "business as usual" policy when it issued labor guidelines in May 2001. The guidelines promulgated cost containment in collective bargaining as a key ingredient to fiscal recovery.

The Plan includes a total of $65 million in concessions in FY 2004 with a 50% discount, and $65 million in FY 2005 with a 15% discount. The savings are to be realized from the PBA ($30 million), DAI ($2 million), SOA ($5 million), ShOA ($3 million) and the CSEA ($25 million). The Plan also envisions extending the savings target for an additional year, FY 2006, which it has projected will raise the savings to $78 million.

The County puts forward a concerted effort to not only reduce the size of the workforce, but also to contain spending on a per employee basis. They argue that this is an area that is controllable, unlike the mandated expenses set forth in the Plan. However, to date, no savings of any significance have been attained from any union.

The Plan chronicles recent settlements for these unions and argues that they have been far in excess of inflation and comparable unions in the region. A key component to achieve this level of savings will be the substantial reduction of future wage increases, with the possibility of a wage freeze. Other forms of compensation (e.g., paid holidays, longevity, shift differential, work rules, equipment and clothing allowances, leave accumulations, reduced employer health contributions, meal stipends, etc.) will be areas considered for potential savings. While the Plan allows for flexibility and givebacks in these other areas, the desired level of savings ($78 million) cannot be achieved without significant wage moderation and/or wage freezes.

In FY 2006, the Plan assumes employee contributions to the cost of health insurance coverage of $21.1 million in addition to the other labor concessions discussed above. This assumes that all employees and retirees would be required to contribute 10% of their premium costs. Even though the Plan discounts this initiative by 50%, this would be a major departure from existing union contract health insurance provisions.

The Plan also indicates that the County is seeking State support for changes to the Taylor Law and its impasse resolution procedures that will provide a more favorable balance for collective bargaining with uniformed employees. The County is seeking to require that for a local government in fiscal distress, the employer's ability to pay for compensation increases be granted consideration.

To the extent that the County cannot achieve undiscounted savings of $40.3 million through collective bargaining, the Plan proposes that equivalent cuts to discretionary expenses in the Health and Human Services Vertical and in the Department of Recreation, Parks and Museum Services will have to be made. Also under consideration, if labor concessions are not forthcoming or are insufficient, would be the discontinuance of the County's remaining subsidy to Long Island Bus, $3.8 million in the FY 2003 Budget.

Tax Certiorari Reform

Tax Certiorari Reform is discussed in detail in the VI. Certiorari section.

Debt Service Expense

The County presents a Debt Reduction and Reform Program (DRRP) to contain debt service expense at affordable levels and provide a road map for long term credit improvement. The DRRP shares many elements with the April Plan, while removing certain elements of the April Plan that NIFA found problematic. Overall the Plan is stronger, more fiscally prudent, and better presented. This section of the NIFA Report will recap the proposed debt issuance during the Plan period and then review and evaluate the County program to reduce debt to the levels presented. For completeness and coherence, it includes discussion of the FY 2003 budget year as well as Out-Years of the Plan.

Debt Issuance and Debt Service Expense, FY 2003 – FY 2006

Debt Issuance. As currently configured, the Plan proposes NIFA issuance of $924.4 million of bonds and $825 million in cash flow notes for FY 2003 – FY 2005, with the County starting to issue its own debt again in FY 2006. NIFA bond issuance during the Plan period would fund the following categories of costs:

PROJECTED NIFA BOND ISSUANCE, FY 2003 – FY 2005*

Capital Projects	$ 246.2 million
Tax Certiorari Payments	460.0 million
Other Settlements and Judgments	107.2 million
Restructuring of County Debt for Budgetary Relief	87.0 million
County Property Reassessment Contract	1.0 million
Early Retirement Program (2002) Pension Contributions	23.0 million
Total Proposed NIFA Bond Issuance, 2003-2005	$924.4 million

** Including take out of 2002 bond anticipation note*

The County projects re-entering the debt markets under its own credit in FY 2006, borrowing $70 million for capital and $30 million for non-cert judgments. The County will not borrow for cert refunds after FY 2005, instead adding the cost of such refunds to the annual operating budget as the NIFA legislation requires.

In the Plan, NIFA's total FY 2003 bond issuance, about $600 million, is projected to take place over three bond sales, in February, May and November. NIFA will work with the County on an issuance schedule based on County financial needs and ability to promptly expend NIFA bond proceeds. The final issuance schedule and number of issues may vary from the County's Plan.

Issuance in the Out-Years is also subject to review at the time of sale, and may be more or less than currently projected by the County. In particular, it appears that the County has programmed more NIFA restructuring in FY 2004 than is permitted under the NIFA Act; see "NIFA Restructuring" below.

Debt Service Expense. Annual combined NIFA and County debt service would peak in 2005 at $336 million, after all NIFA restructuring and County initiatives:

PROJECTED NET DEBT SERVICE EXPENSE, 2003-2006 ($ MILLIONS)*
(Net of NIFA Restructuring and Proposed County Initiatives)

Fiscal Year	County Debt Service	NIFA Debt Service	Total
2003	$ 226.8	$ 69.5	$ 296.3
2004	$ 229.4	$ 95.1	$ 324.5
2005	$ 222.1	$ 113.9	$ 336.0
2006	$189.8	$ 130.5	$ 320.3

** Not including corrected TAN interest or correction of double-counted sewer authority debt service savings, discussed below.*

The FY 2005 peak occurs because of increasing NIFA debt service, as more bonds are issued, and because no NIFA restructuring of County debt for budgetary relief is provided beyond FY 2004. The FY 2005 expense peak would be higher were it not for several County proposals, detailed below, that target FY 2005 debt service expense.

It should be noted that the FY 2003 Budget, as submitted, contains errors that led budgeted debt service to be understated by about $7 million. The County is correcting these errors and expects to budget the $296.3 million amount shown above in FY 2003, subject to other NIFA and County Legislature actions.

The Plan also erroneously double-counts the debt service savings from creation of the proposed sewer and storm water authority, crediting it to both debt service and authority initiatives. If the savings are credited to the authority initiative, debt service will increase by $8.4 million in FY 2004, $7.2 million in FY 2005 and $6.2 million in FY 2006.

County Debt Initiatives

Nassau County's debt proposals aim both to reduce overall debt issuance and debt service expense, and to target savings to particular budget years in which resources are needed. The County initiatives that call for reductions in issuance refer to reductions from the County's "baseline" projections of April 2002.

Initiatives that Reduce Ongoing County Debt Expense:

- Reduce borrowing for tax certs through better management of tax cert process. This process is detailed in the cert chapter of the Plan.

- Reduce borrowing for capital projects, through project prioritization and better management and controls.

- Request additional NIFA issuance of variable rate debt, which is expected to have an overall lower interest expense.

- Reduce issuance of annual cash flow notes as County financial position improves.

- Transfer expense of water resource-related General Fund debt service to proposed Sewer and Storm Water Authority (starting in 2004).

Initiatives that Target Debt Service Savings to Specific Budget Years:

- Postpone Fall FY 2002 bond issue to FY 2003 to keep FY 2002 budget in balance. A short-term Bond Anticipation Note (BAN) to fund pressing costs would be sold instead. The BAN would be retired in early FY 2003.

- Provide NIFA restructuring of County debt for budget relief of $57 million in 2003 and $30 million in FY 2004.

- Start amortization of NIFA restructuring debt in FY 2007 (sinking fund deposits would begin in FY 2006), saving about $500,000 in FY 2004, $1.7 million in FY 2005 and $1.1 million in FY 2006, and raising costs in the Out-Years by about $425,000/year.

- Skip principal amortization in FY 2005 on NIFA cert debt issued in FY 2003 and FY 2004. This would save about $5 million in FY 2004 and $9.5 million in FY 2005, and raise costs about $800,000/year in the Out-Years.

- Issue bonds to fund the cost of early retirements taken under the FY 2002 early retirement plan. Bonding spreads the projected $23 million cost over up to 20 years, instead of the County paying out-of-pocket in FY 2003 or using a five year payment plan at higher interest rates from the State. Annual debt service on the bonds will be about $2 million.

As discussed below, NIFA will deploy any targeted savings initiatives on a flexible, rolling basis so that longer term expenses are minimized.

The balance of this section will evaluate these County initiatives.

Borrowing for Certiorari Payments

The County expects overhaul of County tax certiorari and assessment review procedures and the County-wide reassessment to substantially reduce the amount of debt issued for tax cert payments. However, most of the expected reduction is not reflected in the County's projected debt issuance. For FY 2003 to FY 2005, the only years in the Plan period when the County can fund cert payments from bond proceeds without counting the expense in its operating budget, the County projects cert borrowing of $460 million (page 224 of the Plan). This includes a new $42 million borrowing in FY 2005 as was authorized in an amendment to the NIFA statute that was passed by the State Legislature this summer. By contrast, in the tax cert section of the Plan (page 173), the total FY 2003- FY 2005 tax cert refund liability is identified as $323.5 million, or $136.5 million less than built into the debt plan. The lower figure reflects the County's intended outcome, while the higher amount protects the Plan from failure to achieve the hoped-for reductions in cert liability.

However, the County's conservatism forces other budget choices. If the lower $323.5 million cert liability calculation is correct, debt issuance will be lower and NIFA debt service reduced by up to $11 million/year. The need for other initiatives that target debt service savings to specific years could be reduced or eliminated by cert borrowing at the lower $323.5 million level. NIFA is further concerned that planning for bonding at the higher level may reduce pressure on the County to devote the necessary attention to solving the cert problems.

It should also be noted that projected FY 2002 - FY 2004 cert borrowing has increased by about $19 million since the April Plan, in addition to the new $42 million in FY 2005. This increase was based on projections from the County Attorney's office.

The County and NIFA need to monitor the cert and assessment reforms closely to determine their success and adjust borrowing projections accordingly.

Borrowing for Capital Projects

The April Plan significantly reduced planned capital expenditures, and those lower levels are maintained in the current Plan. The County believes that better management of the capital budgeting and spending process will enable it to apply lesser resources with greater effect. The County's first capital Budget under new County Charter provisions was adopted in May 2002, in conformance with the lower spending levels.

NIFA and the County share concerns over the County's deteriorated physical infrastructure. A total of $246 million NIFA debt in FY 2003 - FY 2005 and $770 million County debt in FY 2006 - FY 2013 is programmed for capital needs. The County also plans a modest pay-as-you-go funding of capital needs, using $11 million of fund balance starting in FY 2003 to set up a revolving fund for projects that will receive some grant reimbursement. Finally, there are NIFA bond proceeds on hand that may be

reprogrammed to fund higher priority projects, and unspent County bond proceeds that are available for existing projects.

The various prioritization, management and control improvements identified in the April Plan, and reiterated in the current Plan, remain important goals. Whether these improvements can be attained or, if attained, will be sufficient to allow the County to maintain its facilities and properties with lower capital funding, will be known over time. The County has not yet demonstrated mastery of its capital process, so for the FY 2003 budget, NIFA is comfortable with lower levels of spending as being more realistic regardless of County needs. Taking a longer term view we believe there is a risk that additional capital spending will be required to meet the County's infrastructure needs.

Variable Rate Debt

NIFA implemented its first variable rate debt issue, at the request of the County, in July 2002. The Plan requests that NIFA issue its next series of bonds, in February 2003, at a variable interest rate. This would bring NIFA's total variable rate exposure to about $440 million. At the time of issue, NIFA would thus have about 50% floating rate debt, a proportion that would fall to 25-30% as the remainder of NIFA's planned debt was issued on a fixed rate basis. Taking NIFA and County debt together, the total variable rate exposure would be lower than 20%.

The primary rationale for variable rate debt remains the lower anticipated cost of funds over the life of the bond issue, compared to fixed rate bonds. The Plan assumes all-in interest rate including fees of 3% in FY 2003, 4% in FY 2004 and 4.25% in FY 2005 and FY 2006. (Note that the Plan itself presents lower assumed rates of 2.5% and 3.5% respectively in FY 2003 and FY 2004, but we are advised that debt service was calculated on the basis of the higher rates).

The Plan's interest expense budgeting is less conservative than in the April Plan, when the County initially requested variable rate issuance by NIFA and budgeted 4% in FY 2003 and 4.1% in FY 2004. The 3% rate now budgeted for FY 2003 is not unreasonable as an estimate, but it does not provide a cushion if rates rise beyond forecasted levels. NIFA believes a 4% rate assumption is better. By way of comparison, the New York State Comptroller's Office programs a 5% interest rate in its budget for variable rate obligations of the State and the Local Government Assistance Corporation, although like NIFA they are experiencing much lower interest rates.

NIFA must examine the impact of additional variable rate exposure on its own credit ratings, including stress tests on its cash flows under various interest rate and accelerated amortization scenarios. NIFA would then need to work with the ratings agencies to ensure acceptance of additional floating rate exposure, especially since the requested issuance brings NIFA above the 20% threshold that has become a commonly used industry standard. NIFA will also consider market conditions as the bond issue approaches and the benefits of locking in the fixed-rate portion of its capital structure at low long term rates. For these reasons, NIFA cannot commit in this context to executing

additional variable rate for the County, but it will consider the request seriously within the context of ratings and the market environment at the time of issuance.

Given uncertainty about FY 2003 interest rates and about whether NIFA will issue additional variable rate debt in FY 2003, NIFA considers additional interest expense of $3.7 million to be a risk in this budget.

Annual Cash Flow Borrowings

The County projects continued reduction in its annual cash flow borrowings, as illustrated below. Amounts in italics are Nassau County public note offerings issued before NIFA or planned to be issued after NIFA borrowing ends; the others are issues financed through NIFA. Subsequent to submission of the Plan, the County revised the TAN sizing for the December 2003 and December 2004 TAN issues upwards by $25 million each. This reflects the transfer of sewer district fund balances, which are currently mingled with County funds for cash flow purposes, to the proposed sewer authority. The corrected borrowing levels are shown in the chart. The correction raises interest expense in FY 2004 and FY 2005 by about $900,000 per year.

Annual Cash Flow Borrowings, FY 2000 – FY 2006

Fiscal Year for Which Notes Issued (1)	Tax Anticipation Notes (TANs) Related to County Property Taxes	Revenue Anticipation Notes (RANs) Related to County Sales Tax	Total Cash Flow Borrowing on Behalf of Fiscal Year
FY 2000 actual	*125,000,000*	*245,000,000*	370,000,000
FY 2001 actual	224,360,000	180,920,000	405,280,000
FY 2002 actual	159,150,000	109,145,000	268,295,000
FY 2003	150,000,000	125,000,000	275,000,000
FY 2004	125,000,000	100,000,000	225,000,000
FY 2005	125,000,000	100,000,000	225,000,000
FY 2006	100,000,000	*100,000,000*	200,000,000

(1) TANs are generally issued in December in anticipation of the following year's property taxes, so are allocated in this chart to that latter year, e.g., the TANs issued in December 1999 were for the benefit of the fiscal year 2000 and are shown in 2000. The County Plan presents TANs differently, allocating them to the year in which they are issued. RANs are issued mid-year for the benefit of the year in which they are issued.

Cash flow borrowings decrease as the County's financial position improves, and must be sized in accordance with Internal Revenue Service regulations and cash flow forecasts at the time of sale. Therefore actual amounts of borrowings will be determined at the time of sale, and are dictated by circumstances and regulations more than County policy. NIFA received the cash flow projections that were used to project the future borrowings shown above 10 days after the Plan submission due date; consequently, NIFA has only completed a preliminary review. The interest rate assumptions are reasonable.

Expense Transfer to Sewer and Storm Water Authority

Upon creation of the proposed Sewer and Storm Water Authority ("SSWA"), the County will transfer liability for water resource-related General Improvement debt from the County to the SSWA. The SSWA is discussed elsewhere in this report. The Plan assumes creation of the SSWA to be effective as of FY 2004, when $8.4 million of debt service benefit to the general fund is projected. This amount drops to $7.2 million in FY 2005 and $6.2 million in FY 2006. If the SSWA is not created, these costs must remain in the County budget and County debt service expense will rise from projected levels. As noted above, these savings were also counted as savings in the SSWA section of the Plan. Elimination of this double counting will raise County expenses.

Fall 2002 Bonds / Bond Anticipation Notes

Nassau County's FY 2002 adopted budget provided $289.1 million for County and NIFA debt service, and an additional $10.1 million of fund balance was earmarked, though not budgeted, for debt service expense, for total resources of $299.2 million. Actual County and NIFA debt service for FY 2002, before any additional NIFA issuance, is now projected at $294.2 million, leaving $5 million in the budget for additional FY 2002 NIFA debt service. While this amount would cover the FY 2002 expense of the County borrowing previously planned for November 2002, budget pressures on the FY 2002 budget and uncertain funding needs have led the County and NIFA to agree to defer the proposed bond issue to February of 2003. A small new money bond anticipation note will instead be sold in December in conjunction with the planned cash flow note sale. This will fund immediate County needs at a low cost and help the County close its FY 2002 budget gap, without materially affecting County expenses in FY 2003 or beyond.

NIFA Restructuring

The Plan proposes NIFA restructuring for budget relief of $57 million in FY 2003 – an increase from the $27 million proposed in the April Plan – and $30 million in FY 2004. The FY 2003 amount appears to be acceptable within the legislative parameters for restructuring assistance, which require the County to close 60-65% of its FY 2003 budget gap with recurring measures. However, as discussed elsewhere in this report, NIFA believes there are significant external events – sales tax revenues, pension costs and PBA arbitration – that could materially affect the FY 2003 budget. If the favorable outcome of these or other events creates positive budget variances, it would be inappropriate for NIFA to provide the full restructuring amount. The County recognizes

this in the Plan by dividing the FY 2003 restructuring between the first and second NIFA bond issues, with the intent to eliminate the second tranche if budget conditions permit.

NIFA will make a final decision on the amount of FY 2003 restructuring based on information as of the time of the bond issues. Benchmarks for reducing restructuring assistance may include labor contracts that provide budget relief, pension contributions within budgeted amounts, and sales tax growth greater than the budgeted 2.5%.

For FY 2004, the County appears to have programmed greater NIFA restructuring than is permitted. The NIFA Act requires the County to close at least 80-85% of the FY 2004 gap with recurring gap-closing measures, while the remaining 15-20% can be closed with NIFA assistance. The County's estimated FY 2004 gap (revised) is $146.4 million. At that size, NIFA assistance (restructuring plus $15 million of State transitional assistance) could total no more than $29.3, assuming all the County's other gap-closing initiatives were recurring. The $45 million of NIFA assistance, including $30 million of restructuring, therefore appears excessive. Assuming the State provides the anticipated $15 million transitional assistance, the NIFA restructuring could be no more than $14.3 million.

Amortization Adjustments

NIFA's policy on debt amortization is to structure essentially level debt service for each bond issue. The County proposes two adjustments to this amortization policy in order to reduce debt service in the peak year of FY 2005. First, it seeks a two year deferral of amortization on NIFA restructuring debt sold in FY 2003 and FY 2004, from NIFA's current practice of starting in FY 2005 to a FY 2007 start. NIFA set-asides for the FY 2007 principal would begin in the FY 2006 budget year, where the restructurings would otherwise begin principal set-asides in FY 2004. The deferral will save about $1.7 million in FY 2005, with smaller savings in FY 2004 and FY 2006. The Out-Years cost of the deferral is small, approximately $300,000/year for the FY 2003 issue (assuming the full $57 million is issued) and $125,000/year for the FY 2004 issue.

The second adjustment in the Plan is also targeted to FY 2005. The County would like NIFA to eliminate that year's principal payment on the cert-related borrowings in FY 2003 and FY 2004, to create approximately $9.5 million headroom in that peak debt service year. About $5 million of savings would also be realized in FY 2004, because the FY 2005 principal set-asides would otherwise begin in that year. Again, this is not a large adjustment. Its impact on the later years would be to raise debt service by roughly $800,000 per year, not a terribly significant amount in a $300+ million debt service budget.

However, NIFA needs to be sure this headroom is truly necessary before incorporating these adjustments in our borrowings. For example, as noted above, if the County's cert reform program produces the desired results, there will be a substantial reduction in debt service, reducing or eliminating the need for these adjustments in order to reach targeted debt service expense in FY 2005. Furthermore, NIFA does not intend

its debt structure decisions to provide a safety net or replace other, harder choices for the County.

Finally, while the County would like to use the FY 2005 principal skip on the tax cert portion of NIFA's debt issue, from a financial point of view it doesn't matter which NIFA debt is used. It would be preferable to consider all NIFA debt and reserve the principal skip, if any, for the later issues, when better information is available as to whether the skip is needed and to what extent.

Bond for Early Retirement Expense in FY 2003

Nassau County employees were offered early retirement pursuant to State Legislation, and over 500 employees enrolled. While the employees retire in FY 2002, the additional pension cost to the County is billed in FY 2003. Based on the total retiree base salaries and an estimate of pensionable additional salary expenses (overtime, shift differential, holiday pay, etc.), and in consultation with the Office of the State Comptroller, the County estimated the total cost to be $23 million.

The County has three options for paying the $23 million bill: (1) pay in full in FY 2003 out of revenues or fund balances; (2) pay in five annual installments, at 8% interest, of about $5.76 million per year; or (3) request NIFA bonding of the $23 million. The County has chosen to ask NIFA to bond the cost, to be repaid over the 20 year term of a NIFA bond issue. This bonding was authorized by an amendment to NIFA's statute that was secured by the County earlier in 2002. The County projects NIFA bonding for this cost in November 2003, at which time the State pension system bill will have been received.

While it is less expensive to finance the cost through NIFA then through the State Comptroller, it is less desirable to spread the cost out over such a long time period. Annual debt service on the borrowing will be about $2 million. NIFA would like the County to explore other options for paying some or all of the expense, including applying any available budget surpluses. If other sources of payment are not reasonably available, NIFA will consider bonding for the expense.

Sewer and Storm Water Authority

Nassau County's Plan continues to advocate for creation of an Sewer and Storm Water Authority ("SSWA") to assume responsibility for all County wastewater and storm water functions. The County's current plan is more thoughtful, straightforward and comprehensive than the April Plan. Incorporating elements that were first added after the April NIFA Report, it addresses many of the concerns raised by NIFA and in the legislative negotiations process. Several "threshold" questions, such as the transfer of resources from the sewer districts to the County general fund, and the creation of a new authority, may still be problematic to some.

The County hopes to have legislation creating the SSWA introduced and passed in a November-December 2002 State legislation session, if one is called. The County is

optimistic that the legislation will pass. However, to be conservative the Plan includes no General Fund benefit from the SSWA in the 2003 budget. Savings of $27.5 million are projected to begin in FY 2004. (Note that a portion of these savings, between $6 million and $8 million per year, are also counted as savings in debt section of the Plan. The County has confirmed this double-counting error, which raises the gap to be closed in the years 2004-2006.)

Key elements include:

- Consolidation of 3 sewer disposal districts and 27 sewer collection districts into one County-wide entity. This is expected to provide management and operating efficiencies and to enhance compliance with current and expected environmental and accounting mandates.

- Refunding of related County G.O. debt with authority debt issued through the New York State Environmental facilities Corporation (EFC). An EFC refunding will provide economic (present value or PV) savings, through the EFC interest subsidy, and cash flow savings by extending the maturity of the debt to match the useful lives of the underlying projects. For the period FY 2003 - FY 2010, the County projects PV savings of about $28 million and cash flow savings of $155 million (the change in cash flow goes negative from FY 2011 to the FY 2027 final maturity). If the SSWA is not created and the refunding not executed until FY 2004, the savings will diminish somewhat.

- Permanent benefit for the County's general fund of at least $25 million per year, realized through cost savings from expenses transferred to the SSWA, and rent payments from the SSWA to the County. Rents have been capped in the legislation at $5.7 million per year plus CPI.

- Governance by a non-salaried board of directors. The September 15th plan does not detail the board appointment process, but draft legislation furnished by the County calls for a five member board, approved by the County legislature, with one each appointed on the recommendation of the County legislature Majority and Minority Leaders, and three by the County Executive. A supermajority vote of the SSWA board will be required for debt issuance, contracts over $50,000, and exempt hiring.

- Existing ratepayer "hold harmless" provision for three or four years. However, there will be a new ad valorum tax assessed on County taxpayers who are not in the existing sewer districts to cover their share of the costs of water-related services to all County residents.

- Transfer of the various sewer district fund balances to the new SSWA, where the monies will provide fund balance for the benefit of all SSWA customers. Note that the County does not budget any sewer district fund balance for use

in FY 2003, prior to creation of the SSWA, in order to preserve it for transfer to the SSWA if and when created.

- A legal structure the County believes will garner "A" level ratings. One of NIFA's prerequisites for supporting the legislation in June was that the SSWA be publicly rated and investment grade.

- Explicit recognition of the new SSWA as a "covered organization" as defined in the NIFA Act. As such, it will be required to submit its annual budget to NIFA and be subject to such additional oversight and review as NIFA deems appropriate.

While the Plan presented is substantially better than the initial April version, there are several risks:

- The present value savings and some of the cash flow savings depend on EFC debt issuance. While the County has received positive indications from EFC, the refinancings take place over five or six years, and the County will have to compete with other municipalities that need EFC resources.

- The "A" level ratings envisioned will require revenue setting and collection mechanisms that are sufficiently strong to shift the credit rating analysis away from the County's credit and to a revenue quality and service area-based rating. It is not clear that the SSWA plan and legislation, as currently drafted, will accomplish this shift. The County needs to put additional thought and planning into the credit structuring

- Transferring fund balances from the dissolved sewer districts to the new authority, while helpful to the SSWA, may raise taxpayer equity concerns.

- Implementation remains a large challenge, though the Plan has addressed some of the broader concerns NIFA expressed in April.

- As before, with the creation the SSWA, the County captures for itself the financial benefit of refunding and stretching out debt service.

NIFA is comfortable with the SSWA idea on a conceptual level and believes it is a County management prerogative to select and advocate for the sewer and storm water system it believes best for the County. Based on the important improvements the County has made in the Plan since April, NIFA supports the County effort.

New Revenues

A major component of the Plan to restore fiscal balance to the County relates to revenue enhancements to meet the growth of expenditures. The following are specific initiatives that are designed to increase revenues.

Property Taxes

Property taxes are the second largest revenue source for the County, comprise 32% of the total budget and are budgeted for $738.7 million in FY 2003. The $738.7 million represents an increase of 20% or $123 million from FY 2002. The Plan does not proposes property tax increases in either FY 2004 or FY 2005.

Beginning in FY 2006, the County is proposing to increase the property tax levy in the five major funds by at least the growth in the Consumer Price Index (CPI) for the previous twelve months. This proposal is highly controversial and may not be adopted. This is projected to increase by 2.5% in FY 2006. The County believes that this increase will be adequate to accommodate the effects of inflation. This CPI increase, or an increase based upon another appropriate index, may be sufficient depending upon the increase/decrease in the County's property tax levy due to any increases/decreases in assessed valuation in the tax roll, which the County plans to update on an annual basis. However, the County must explore all other options, including expense reductions, which may mitigate the need for a tax increase.

Sales Tax

Sales tax is the largest revenue source for the County. The Plan assumes that the County will receive $851.9 million in sales tax revenues in FY 2002, a reduction from the $855 million in the County's FY 2002 budget. The Plan projects that sales tax growth rates, from $851.9, will be 2.5% in FY 2003, and 2.7% in FY 2004, FY 2005 and FY 2006. These growth rates appear to be conservative since sales tax growth has averaged 4.5% for the seven year period, 1995-2001. The County has no control over sales tax receipts, but has included a ¼% sales tax increase in the Plan as a gap-closing measure in FY 2004 if economic activity has not improved. This would raise the aggregate sales tax rate in the County from 8.5% to 8.75%. This sales tax increase would require State approval. It is important for the County to determine as part of their Plan projections what level of economic downturn or what decline in which economic indicators would trigger the need for this sales tax percentage increase.

Residential Energy Sales Tax

The Plan proposes the imposition of a Residential Energy Sales Tax in FY 2005 of 4.25% if economic activity does not improve. The Plan projects that this new tax would bring in $45.7 million in FY 2005 and $47.5 million in FY 2006. The Plan discounts the revenue to be received from this tax by 50%. This sales tax would be imposed on the retail sale or use of fuel, oil, coal, wood (used for heating purposes), propane, natural gas, electricity, steam, and gas used for residential purposes. This tax could be enacted by the County legislature. The purchase of residential fuel is, by its nature, not as discretionary as the purchase of many other items. However, as with the Sales Tax above, it is important for the County to explain what the economic trigger mechanism will be for the implementation of this new tax.

Tobacco Proceeds

After FY 2003 the County will have available $18 million from the securitization of the proceeds from the nationwide tobacco litigation settlement. The County has plans to use these funds in FY 2006, however, the County could choose to use them earlier. Since this is a one-shot revenue, the County should use them to offset a one-shot expense.

Reimbursement from State for Police Costs

The Plan states that in FY 2006, the County will once again seek reimbursement from the State for patrolling the Long Island Expressway and the Seaford Oyster Bay Expressway. The Plan projects revenue of $9.8 million for reimbursement of these costs with a discount of 50%. The County has been attempting to obtain this reimbursement for many years and has been unsuccessful. This new revenue is not projected to be received until FY 2006. It will be necessary for the County to mount a successful lobbying campaign with the State to obtain this revenue.

Expenditure Action

In addition to the expenditure actions detailed above, such as workforce reduction efforts, employee contributions to health insurance, and lobbying for a cap on Medicaid expenditures, the County has identified a number of managerial initiatives to control expenditures.

These include such items as the elimination of TB X-Rays at the Correctional Center for all inmates upon admission. This initiative has already been implemented and is projected to save $500,000 annually.

The Plan identifies specific expenditure cuts that are to be implemented and carried forward into the Out-Years. These include the reduction of the subsidy to Long Island Bus by $2 million in FY 2003. The remaining FY 2003 Budget amount for the Long Island Bus subsidy is $3.8 million for the fixed route portion and $4.5 million for the para-transit operation. The County contemplates eliminating this subsidy if sufficient labor concessions are not obtained from the police unions. Also contemplated is the reduction of outside counsel contracts by the County Attorney. This initiative was begun in FY 2002. It is projected to save $5.5 million in FY 2003, $5.9 million in FY 2004, and $6.2 million in FY 2005 and FY 2006. These projections can reasonably be met if the County hires appropriate personnel in the County Attorney's office and if the policy decision is made to keep litigation in house.

CONCLUSION

The Out-Year gap-closing actions proposed by the County must be realistic, achievable, and part of a coherent effort to resolve the County's structural imbalance between revenues and expenditures.

Based upon our reading of the Plan, our attendance at monitoring meetings, and our discussions with County officials throughout this year, we are comfortable that the County has an accurate understanding of the components of the structural imbalance. While some effort has been made to increase revenues and control expenditures, a great deal more remains to be done. NIFA has particular concerns that some of the more difficult initiatives are being pushed off to the later years to either avoid making the difficult decisions or hoping that an improved economy will render them unnecessary. This is unlikely to occur and the County should consider moving some of these initiatives to FY 2003 and FY 2004. The appropriate actions, in large measure, have been detailed in the Plan. Based upon current conditions, the Out-Years of the Plan appear reasonable with the caveats, concerns, and risks we have outlined above.

However, it is important for the County to review the elements of risk that NIFA has identified and to make substitutions and/or modifications wherever necessary. NIFA believes that the growth projections for salary, employee health insurance costs, Medicaid, and sales tax are conservative. On the other hand, we believe pension costs may be understated, and that spending for tax certiorari refunds will not decrease at the level projected by the County. NIFA also questions the County's ability to obtain the level of labor concessions projected in the Plan. These and other risk elements must be monitored. It is important for the County to continue to identify and implement new initiatives as soon as possible.

V. Other Items

COUNTY CASH FLOW PROJECTIONS, FY 2003- FY 2006

The NIFA statute requires the County to submit a four year Cash Flow Forecast together with the financial Plan. While the Plan was due September 16, 2002, no cash flows were received until the afternoon of September 26th, when an email of the files, labeled "Preliminary Discussion Draft", was received. At that point, the principal architect of the cash flows had to travel out of the country and was not available to review or discuss the cash flows for six days.

NIFA's review has therefore necessarily been truncated. Overall, the forecast appears better than the version submitted last year in connection with the 2002-2005 Plan, which was grossly inadequate. The County's efforts to improve its cash flow forecasting have been a factor in reducing cash flow borrowings. It does not appear, however, that cash flow modeling has been integrated into the County's planning process as suggested by the NIFA Act and financial "best practices".

TAX CERTIORARI AND ASSESSMENT REVIEW

Introduction

As required by the NIFA statute, the County has reported on its progress in streamlining the tax certiorari process and eliminating the backlog. NIFA finds that the County has made progress in this area, but we need to see greater progress before we can feel comfortable that this problem is under control.

State Commitment

From the outset, resolution of the certiorari ("cert") problem has been seen as essential to Nassau County's return to fiscal stability. The State Legislature recognized this problem. It made a commitment to Nassau County by permitting NIFA to borrow up to $800 million for settlements and judgments arising from cert claims, and granted an additional $5 million of State aid to assist the County in streamlining the tax cert claims process.

County Successes

The County has made progress toward building a foundation upon which to attack this problem. This progress includes (1) employment of experienced personnel at the highest levels; (2) new State legislation to expand the powers of the Assessment Review Commission ("ARC"); (3) consolidation of ARC's related functions into a central location; (4) administration of a civil service exam for property valuation experts; (4) speedy settlement of $19 million in claims at the commencement of 2002; and (5) creation of a plan intended to solve the entire cert problem.

NIFA Assistance

NIFA has cooperated in these efforts by (1) meeting with County personnel to review and comment upon their implementation plans; (2) supporting State legislation to broaden ARC's powers and separate State legislation that will allow the County an extra year to borrow for certs; (3) borrowing money for settlement of cert claims; and (4) making available $5 million in State aid to help with the disposition of the cert backlog, of which in excess of $4.8 million remains available.

Data Gathering Problems

Nevertheless, problems remain. For example, despite repeated requests the County has failed to provide meaningful progress reports to NIFA. The County acknowledges this failure in the Plan and has proposed issuing regular progress reports on commercial and residential cases reviewed, value of accepted offers in commercial cases, and the cumulative value of rejected offers in commercial cases. We look forward to receiving those reports.

Despite the County's apparent ability to make predictions based upon standard deviations and coefficients of dispersion it has failed to provide even the most basic data as to its pre- and post- 2000 cert liability. The State Legislature felt that the breakdown was so important that it limited the amount of borrowing that NIFA was permitted into pre- and post- 2000 benchmarks.

This failure to compile meaningful data is a serious shortcoming and has resulted in unintended consequences, such as the inability of the County to accurately match its requests for cert borrowing to its actual needs. It has also contributed to a substantial delay in the County's projection of when it will substantially eliminate the backlog of claims. While we had recently received assurances that the backlog would be eliminated by the end of 2003, we now read in the Plan that the estimate has been moved to the end of 2004.

Prediction Problems

The County cites statistical data from the New York City Tax Commission to help predict its probability of success in reviewing commercial claims. We believe that New York City is not a good predictor of success in Nassau County. The New York City reassessment process, which has recently undergone widespread criticism, operates under a different set of local laws, practices and circumstances. For example, New York City has one school district whereas Nassau County must adapt its rolls to accommodate 56 different districts.

The Plan also makes certain assumptions about the number of reassessment challenges that it will receive after the completion of the initial Cole Layer Trumble reassessment. We do not feel comfortable with the assumptions, as they are not based upon data from similar entities or other kinds of data that NIFA can confirm. In addition, NIFA is not familiar with the individual mentioned as the County's "outside auditor."

Apparently NIFA is not the only entity that is concerned with the reliability of the County's cert forecasting. There is disagreement within internal departments at the County. The debt section of the Plan estimates that cert borrowing for the backlog would amount to $460 million from 2003 through 2005 while projecting in the cert section of the Plan that the backlog would be $323,483,189 from 2003 through 2005.

Personnel Problems

The foremost impediment to solving the cert backlog is still the need to hire, train, mobilize and retain qualified personnel. We were skeptical of the County's ability to make the necessary hires in our April 2002 report and that skepticism continues.

Although the chart on page 169 of the Plan calls for ARC to hire 23 new personnel in 2002, it wasn't until September 16, 2002, that the first two experienced property valuation personnel were provisionally hired. Three additional people who are apparently scheduled to begin working in ARC are merely transfers from the Assessor's Office and we assume that the Assessor will have to replace them. Even the newly reconstituted ARC only has five full-time members and four members who are part-time and expected to work only one-third of a full-time schedule (i.e., the full time equivalent of only 6.33 people).

The April Plan had called for hiring 29 new attorneys in the Legal Department. The Plan now says this was a mistake. After receiving the Plan and making numerous inquiries, we were told that a single new attorney for certs would be starting on September 27, 2002. On a net basis that means the County has a least two fewer attorneys working on certs than at the start of the year since the Chief of the Certiorari and Condemnation Bureau is retiring and two other attorneys in his bureau left this year and have not been replaced. Other inquiries we have made concerning the methodology for deployment of attorneys to work on the cert problem have not been fruitful.

Additionally, the County estimates that only 60% of the open writs, which were filed as of December 31, 2001 and 50% of the writs filed in 2002 have merit and will require County resources or personnel. It appears that no allocation of personnel is allotted to the ultimate disposition of those cases, which the County considers to be without merit. We would like to see a comprehensive list of all cases, both those that have been classified as without merit as well as those that have been successfully resolved. Allocation of personnel to this project would be a logical use of part of the State aid available to clean up the backlog.

The County's estimates to clean up the backlog assume a full staff of experienced personnel. They have already fallen behind in their early estimates of hiring and we urge them to be more realistic or consider seeking other ways to solve the cert problem. Perhaps they should consider borrowing staff from neighboring entities, paying consultants or using headhunters.

Reassessment Problems

At the outset, it is noteworthy that the County Assessor, an independently elected County Official, never reviewed nor was given an opportunity to comment about the sections of the Plan that deal with his Department. Our discussions with him and his staff indicate tremendous concern over the proposals in the Plan. We noted this same criticism in our April report and the situation has apparently not improved.

The County is proceeding under a Court order to complete and subsequently update a revaluation of properties in the County. That Court order, combined with the County's cert backlog problem, make reassessment a problem of unparalleled importance. Consequently, we agree with the Plan when it says that, "The most important step to reducing the County's future refund exposure is keeping the assessment roll updated." Neither past actions nor current proposals appears to adequately support this statement.

We have no way of verifying whether the personnel who are slated to be hired in the Assessor's Office will be sufficient to do a revaluation. We do know that the Assessor believes the number is inadequate and that the personnel will need to be recruited, given office space and specialized training. It appears that little or no planning for these exigencies has been commenced. In fact, a request for $2 million to hire consultants to train these new hires has apparently been removed from the Plan.

We are also not convinced that a statistical update of the rolls will be cost effective or satisfy the Court order concerning yearly revaluation, especially in calendar year 2003. Personnel costs that may be saved by doing a statistical update might be more than offset by a greater probability of errors. These errors could result in a greater number of appeals and increased use of County personnel and resources. We also do not know if a statistical update is as effective in a multi-faceted market where there are great fluctuations in property values.

We also believe that the Plan may have improperly assigned some of the Assessor's responsibilities to ARC. For example, the Plan says that, "ARC will have a full year to review the tentative assessments promulgated by the Department of Assessment" (page 151 and similar language on 152). ARC reviews grievances from assessments, not the assessment roll. In addition, the Plan says that ARC "will purchase residential data…with the estimated cost of $1.6 million to be included in revaluation borrowing" (page 170). The borrowing completed by NIFA was for the Assessor to hire Cole Layer Trumble and was not meant to be a source of funds for ARC.

"[D]espite a proliferation of new mandates imposed by State legislation" (page 162), the Assessment Department's budget seems to have been disproportionately reduced, at a time when we would have thought that it should be increasing. The FY 2003 proposed budget is $4,821,550 less than in the adopted budget for FY 2002 and $9,189,896 less than requested. Some of the change has to do with the transition of "SCARP," small claims review, to ARC. But a better explanation of the reason for

removing other funds would help to decrease NIFA's concerns that the decreases will not have an extremely detrimental affect on the delivery of services.

New Initiative Problems

The Plan refers to a $4.4 million computer system "to allow annual updates and link to the operations of other agencies performing assessment and property tax functions" (page 170). We applaud the investment in and use of technology, but we do not have enough information to comment on the value of the proposed system in resolving the cert problem. Since its purchase is scheduled for 2003, the County should present a detailed description of what it is expected to do, who will run it and what are its anticipated benefits.

The Plan also continues to ignore two suggestions that have been repeatedly made by NIFA. The first suggestion is that there be a fee for cert applications, which fee would be refunded if the applicant were successful. The second suggestion is that the County require the recipient of a commercial refund to prove that their refund was passed along to tenants. In the absence of the proof, the money would escheat back to the County and/or the State.

We acknowledge that a weak attempt was made to include these suggestions in the new ARC legislation; however, they were quickly withdrawn at the first hint of opposition by special interests. Subsequently, NIFA was assured that the County would further explore these matters.

We detect no continuing effort by the County to pursue these options nor are they even mentioned as initiatives in the Plan. Since the amount of revenue that could be generated through these initiatives is significant, we continue to urge the County to pursue them.

Conclusion

We do not wish to rush the County in its efforts to solve its cert problem. We recognize that valuation is complex. We also do not want to sacrifice State or County funds in the interests of expediency. Furthermore, we understand that every change in the assessment rolls has a ripple effect on other properties.

However, it has been over two years since the NIFA legislation was enacted and myriad resources were placed at the disposal of the County. We had hoped that more progress would have been made by this time.

VI. COVERED ORGANIZATIONS

When NIFA reviews the Plan and the Budget, its efforts are primarily concentrated on the major funds in the County which are the general fund, police headquarters fund, police district fund, fire prevention fund, parks and recreation fund and debt service fund. NIFA has the authority, absent a few exceptions, to look at any other entity that receives monies directly, indirectly or contingently from the County. These other funds are called "covered organizations."

To date, the only covered organizations that NIFA felt merited attention were the Nassau Health Care Corporation and the Nassau Community College. This is because of the large infusion of County money to these entities and their potential effect on the overall budget.

During the year, NIFA staff explored the necessity of including the Off-Track Betting Corporation and the Industrial Development Agency as covered organizations. Although both of these entities are important to the economic success of the County, our preliminary review determined that they did not fit the definition of a covered organization.

In the future, NIFA reserves the right to classify the aforementioned or other entities as covered organizations and commence a more detailed review. Currently, the only entity that is likely to become a covered organization by the time of our next review is the proposed Sewer and Storm Water Authority.

The balance of this section discusses the financial plans for the Nassau Health Care Corporation and the Nassau Community College.

NASSAU HEALTH CARE CORPORATION

Chapter 9 of the Laws of 1997 added Article 10-C to the Public Authorities Law creating a new public benefit corporation to be known as the Nassau Health Care Corporation (NHCC). On September 29, 1999 the acquisition "Agreement" between the NHCC and Nassau County was signed. In the Agreement the Nassau Health Care Corporation paid $82 million to the County. In exchange, the NHCC took over possession and operation of the County's principle health care facilities. The main components transferred were the Nassau County Medical Center, the A. Holly Patterson Geriatric Center and the Community Health Centers.

The Agreement also provided that the County would supply various subsidies to NHCC. Among them were payments to subsidize the cost of uncompensated care (approximately $13 million annually during the period covered in this Plan) and payments totaling $5 million annually in consideration of NHCC providing certain contractual services, for some of which the County can receive State reimbursement. Services to be provided include tuberculosis clinical evaluation, family planning, and sexually transmitted disease testing and treatment.

To finance the acquisition and operation of the health care system NHCC issued 30-year revenue bonds in the amount of $259.7 million. These bonds were used to provide working capital, make payment to the County for the purchase of the health care assets, fund reserve accounts, and cover the costs of issuance. As part of the Agreement the County is also responsible for providing credit support for NHCC's bonds in the following manner:

> The Corporation shall maintain an Operating Reserve Account containing an amount at least equal to 10% of the aggregate principal amount of all bonds and notes issued under the General Resolution (approximately $26 million). Included within this account is the Debt Service Reserve Account, which is required to contain an amount equal to the current year's principal and interest due on all bonds and notes outstanding under the General Resolution (averaging approximately $19.8 million). If by August 5th of each year the amount on deposit in the Debt Service Reserve Account is less than required, the Corporation shall issue a Notice of Deficiency to the County Executive, which shall set forth the amount necessary to make up the deficiency.
>
> Upon receipt of such notice, the County Executive shall include in the County budget for the next fiscal year an amount at least equal to the Deficiency Amount. Upon approval of the budget by the legislature, the County agrees to transfer to the Corporation, from the funds appropriated therefore, no later than January 15th of such fiscal year, monies equal to the Deficiency Amount. These funds shall be a general obligation of the Corporation and shall be subject to repayment in accordance with one or more unsecured promissory note(s) bearing an interest rate of zero percent (0%), and be payable only after all Corporation bonds issued under the General Resolution have been fully paid or provided for.
>
> In addition, the County guarantees the full and prompt payment of any principal or interest due on the Bonds of the Corporation when and to the extent monies on deposit in the Debt Service Reserve Account are insufficient, therefore, there has been a payment made by the Bond Insurer under the municipal bond insurance policy guaranteeing payment of principal and interest on the bonds. Provisions shall be made annually by appropriation by the County for the payment of its obligations under this Guaranty. If at any time the governing body of the County shall fail to make such appropriations, a sufficient sum shall be set apart from the first revenues thereafter received and shall be applied to such purpose.

Since no notice of deficiency has been filed with the County Executive, the County is not technically at risk for providing any credit support in FY 2003.

Financial operations at NHCC immediately worsened after the transfer in September 1999. Headcount increased by approximately 400 positions and NHCC had losses totaling $20 million in FY 2000 and $41.9 million in FY 2001. The County's Plan

comments on this deterioration and notes that from December 31, 2000 to December 31, 2001, cash decreased from $116 million to $69.9 million and net patient revenue decreased from $419 million to $410.1 million. While the County's Plan notes the deteriorating finances of NHCC it is important to mention that their review does not factor in current operations in FY 2002 and is therefore somewhat dated.

In FY 2001 NHCC retained Cap Gemini Ernst & Young, a leading consulting firm, to develop strategies to improve the operations. Forecasts from Cap Gemini indicated that without operational improvements NHCC would run out of funding in FY 2003.

In February 2001 NHCC, with their consultant Cap Gemini, outlined a plan built around initiatives that were designed to eliminate the deficit by FY 2003. They mainly consisted of growth or revenue enhancement initiatives coupled with efficiency and effectiveness measures. Some examples of these initiatives include improving the revenue cycle to reduce uncollected patient bills, encouraging private physicians to refer their patients to NHCC, strengthening controls over the approval of overtime, and reducing the costs of certain supplies and services that the Corporation purchases.

Paramount in their efforts to return to fiscal health has been the reduction in the workforce. Twenty-four physicians were terminated in the summer of 2001 and in January 2002 the workforce was reduced by approximately 350 full-time and part-time employees. NHCC indicates that these actions would result in savings in excess of $25 million. However, the Executive Summary for the NHCC's 2002 budget points out that even after the layoffs the Corporation will still have more employees than it had in October 1999, shortly after the transfer from the County. Officials of NHCC also indicate that the Corporation is still more generously staffed than many comparable facilities. NHCC is pursuing further reductions in headcount and it was indicated at their Board meeting held on September 23, 2002 that they are anticipating a net loss of approximately 150 positions through the current early retirement incentive program.

A test of these efforts is to measure the actuals results of operations to budget. Through August 2002 the finances of NHCC are $2.1 million favorable to budget and they are projecting a loss of $15 million for FY 2002, which is an improvement of $27 million from FY 2001 results.

Going forward NHCC anticipates to break even in FY 2003 through continuing cost containment, renegotiations of contracts, and increased patient volumes through service line developments in the areas of orthopedics, general surgery, and medicine. During FY 2002 NHCC entered into an affiliation agreement with Lenox Hill Hospital in New York City. It is believed that doctors from Lenox Hill will help upgrade the cardiology program at the Medical Center. In addition, as the Medical Center is now linked to Lenox Hill's managed care program it is hoped that there will be additional patient referrals from Long Island based physicians participating in the plan.

A major challenge facing NHCC will be to secure a labor agreement that reflects the finances and needs of a health care organization. Currently, employees are members

of the Civil Service Employees Association ("CSEA") and the labor agreement expires on December 31, 2002. The Corporation is seeking a contract with sufficient cost containment to enable them to effectively compete in the difficult healthcare marketplace.

The County also believes that NHCC has seriously underestimated fringe benefit costs. The primary reasons for these increasing costs are escalating State pension contributions and rising health insurance premiums. NHCC employees, like County workers, belong to the State pension system and are covered by Empire for health insurance. The County states its fringe benefit costs will rise by over 32% from FY 2002 to FY 2003 and that NHCC has provided for only a 4.5% increase. Our review indicates that the operating proforma for NHCC that the County is analyzing is outdated as it relates back to the April Plan. In meetings with NHCC officials, we have been informed that NHCC is aware of this problem and that they are planning to increase fringe benefits by nearly 40% in their FY 2003 budget. The County needs to receive an updated financial plan from the Corporation reflecting these modifications.

While NHCC has brought some time through its aggressive cost cutting and various other initiatives, it is too early to tell if its efforts will ensure that the County will not have to step in at some future time to further subsidize the Corporation, or pay debt service on its bonds if NHCC's working capital is depleted. NHCC is planning to grow its revenues in an extremely competitive market. Much of their previous success is attributable to a reduction in the workforce which will be further aided by the early retirement incentive, where they are anticipating the net loss of 150 positions. It remains to be seen how much further the workforce can be reduced before patient care is adversely affected.

There are also some outstanding issues that are unresolved between NHCC and the County. The Corporation believes that the County, as a former employer, is liable for a portion of costs relating to its early retirement incentive program (estimated at $9 million, or $1.8 million if paid over five years), and termination pay (a potential risk of $3 million in FY 2003). In addition, there is disagreement over payment for liabilities relating to potential capital obligations resulting from structural and/or material defects, and deferred repairs.

The County needs to evaluate its exposure to the potential need of providing credit support. The issuance of $259.7 million of revenue bonds at the inception of NHCC results in $568 million in total debt service payments through 2029, for which the County is ultimately responsible. The County does not generally believe it to be prudent to dedicate specific contingency reserves to specific risks when active efforts are underway to mitigate potential County obligations associated with such matters. Given this philosophy of not setting aside reserves, the County should, at minimum, provide a contingency plan describing what actions would be taken should the remedial actions not be successful.

In the Plan the County does not make any provisions to provide any additional relief to the Corporation than they are presently providing. The County argues in its Plan that NHCC must deposit revenues into the debt service reserve account before any

revenues are deposited into accounts established for operating expenses. Since NHCC is a $500 million Corporation they argue that only in a case of fiscal *extremis*, where the Corporation did not have $20 million of revenues from any source, would the County be required to pay the debt service on NHCC's bonds. While this may be the strict legal interpretation of the transfer agreement, it remains to be seen if the County would walk away from a moral obligation of providing health care services to the neediest members of its population.

NASSAU COMMUNITY COLLEGE

The FY 2003 budget for Nassau Community College ("the College") increased by 4.4% from the FY 2002 Adopted budget. Out-year increases are projected to grow at similar rates. Revenue for the College comes from three major sources: tuition, state aid, and funding from the County through property taxes. These three funding sources account for over 87% of total revenues for the College. Property taxes in each year of the Plan increase by 3.9%. Revenues from Tuition and State Aid are projected to increase by over 6% and 3% respectively in each of the Out-Years of the Plan. This translates into annual State aid increases of $50 per FTE and an increase of $125 in the annual tuition rate.

The projected expenditures for the College revolve around salary and fringe benefit costs. The two teaching unions, the Nassau Community College Federation of Teachers ("NCCFT"), and the Adjunct Faculty Association ("AFA") are both now settled into long term contracts providing relative cost certainty for the Plan.

In recent years the College has not experienced the same fiscal stress as the County. Largely this is due to the College maintaining a structurally balanced budget whereby recurring revenues and expenses are matched. This theme is likely to continue as the Plan for the College increases its revenues to account for contractual salary increases and escalating fringe benefit costs.

While the College has made provisions for escalating fringe benefit costs a shortfall is likely to occur due to larger than anticipated increases in health insurance and pension contributions. The College substantially increased these appropriations, however the magnitude of the problem was not fully realized when their budget was adopted in August 2002. Fortunately for the College most of their employees participate in a retirement program that is a defined contribution plan, rather than the New York State Employees Retirement System. The combined shortfall from health insurance and pensions is estimated at $1.5 million and the College indicates that cost savings and revenue enhancements will be made to offset these costs.

Two other areas of potential concern are maintaining and upgrading technology, and the infrastructure of the College. Recent County approvals for capital improvement, which will be substantially matched by the State, should redress these potential problems.