NIFA

Nassau County Interim Finance Authority

June 16, 2005

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

Hon. County Executive Suozzi

Enclosed is NIFA's Review of the June 1, 2005 Update of the Nassau County Multi-Year Financial Plan for Fiscal Years 2005-2008. The Update was submitted at NIFA's request because of the uncertainties that NIFA saw in the Plan.

The Report acknowledges the progress the County has made, notes that the out-year gaps have been reduced because of the benefit of the Medicaid cap enacted by Governor Pataki and the New York State Legislature, and comments on several significant challenges that could negatively impact the County's fiscal recovery.

NIFA looks forward to working with the County to monitor the challenges and resolving outstanding issue.

Sincerely yours,

Ronald A. Stack
Chairman

cc: Presiding Officer Jacobs
Minority Leader Schmitt
Comptroller Weitzman
NIFA Directors
Richard Luke

Nassau County Interim Finance Authority

NIFA

REVIEW OF THE JUNE 1, 2005 NASSAU COUNTY MULTI-YEAR FINANCIAL PLAN UPDATE FISCAL 2005 – 2008

June 16, 2005

NASSAU COUNTY
INTERIM FINANCE AUTHORITY

DIRECTORS

Ronald A. Stack
Chairman

Richard M. Kessel

Robert G. Smith

Martin D. Payson

Robert W. Wallach

STAFF

Richard L. Luke
Executive Director

Laurie A. Leat
Corporate Secretary

Evan L. Cohen
Deputy Director

Susan Rich
Treasurer

Jane F. Cunneen
Deputy Treasurer

Jeremy A. Wise
General Counsel

When NIFA approved the County's Multi – Year Financial Plan for Fiscal Years 2005 – 2008 (hereinafter, the "Plan"), the Directors also mandated that the County Executive submit to NIFA an update of the Plan no later than June 1, 2005 (hereinafter, the "Update"). The Update was delivered to NIFA on June 1, 2005.

What follows is a review and analysis of those parts of the Update where substantive changes have occurred, or where NIFA felt that the Update would be predictive of the County's future financial position. NIFA is not commenting on the level or quality of services provided by the County.

This report is divided into five sections: (1) summary of findings, (2) status of the FY 2005 operating results, (3) the baseline, (4) the gap-closing program, and (5) issues that require further scrutiny.

SUMMARY OF FINDINGS

1) The County has fulfilled the request of NIFA that it submit an update to the Plan. The Update demonstrates continued progress toward resolving the County's financial difficulties in FY 2005 and FY 2006, as evidenced by the increasing level of reserves, the elimination of cash flow borrowings in 2004, and the expectation that a cash flow borrowing will not be necessary in 2005. This progress has been noted by the recent upgrade of the County by Fitch Ratings, as well as prior upgrades by Moody's and Standard & Poor's.

2) According to the Update, the baseline gap, which is the difference between recurring revenues and expenditures, has decreased by $225 million through the life of the Plan, because of the Medicaid cap enacted by Governor Pataki and the New York State Legislature, and the County's use of a lower projected Medicaid growth rate in the out years of the Plan.

3) The County has shifted some of its future gap-closing efforts from tax increases, and replaced them with one-time resources to serve as a bridge until savings from the Medicaid cap provide greater relief in the out years of the Plan.

4) The County has reduced its projected FY 2005 sales tax revenues because receipts to-date are less than budgeted, and increased its projection of public safety overtime. As the year progresses, these items need to be monitored closely; however, the County has identified several resources that can be used to maintain budgetary balance during 2005.

5) The County continues to make significant progress toward financial stability and structural integrity. NIFA and the County will need to continue to work together to resolve several outstanding challenges, including: the Nassau County Health Care Corporation ("NHCC"); and elimination of the certiorari backlog.

STATUS OF FY 2005 OPERATING RESULTS

The County believes that it will end FY 2005 with a modest $284,163 operating surplus for the current fiscal year. In making this projection the County has recognized a number of positive and negative variances which generally offset each other. The County also acknowledges two major threats to the County's fiscal performance in 2005: the threat that sales tax revenues will not meet budget; and the possibility that $7.5 million of State transitional assistance may not be available because of new language contained in this year's adopted State budget. NIFA also believes that despite the significant increase in overtime funding included in the Update, there is a risk that public safety costs will exceed budget. NIFA and the County will need to monitor these items closely.

In order to be fiscally prudent, the County has reduced its FY 2005 sales tax revenue estimate by $7 million to $957.7 million, which represents an increase of 1.89% from last years receipts. Since year to date receipts are 0.8% less than last year, the County needs 3.3% growth in the remaining payments due this year to meet its revised target. This is not unreasonable in light of historical sales tax collections.

The County has not adjusted its budget for the possible loss of the $7.5 million of State transitional aid. However, they are consulting with the Governor's Office and NIFA to determine the options available to help secure these funds and remain optimistic that they will be received.

The County raised its projection of salaries and wages by $12.6 million in FY 2005. This increase is driven by higher projected expenditures for overtime in the Police Department and Correctional Center, where the County's efforts to rein in spending have so far been unsuccessful. The Update provides funding to cover $12 million in unbudgeted Police overtime and $3 million in unbudgeted Correctional Center overtime. While the County's strategy of conservatively funding vacant positions has provided mitigating savings to date, the unbridled growth of these costs will continue to exert upward pressure on the budget and the out years of the financial Plan. In fact, our analysis indicates that overtime spending may exceed the County's revised targets by approximately $8 million unless significant new management reforms are introduced in the second half of this year.

The County has identified several resources that can be used to maintain budgetary balance during FY 2005. These items include: $24.9 million of closed out capital projects that can be used for debt service purposes; $15.1 million of prior year recoveries attributable to storm water costs; and potential savings of up to $14.4 million from no longer needing to make an annual Medicaid accrual. As a result, the County should end the year with an excess of revenues over expenditures.

THE BASELINE

The projected gaps for FY 06 – FY 08 have been reduced by $225 million. While there have been a number of changes to the baseline in several different areas that have generally offset each other, the reduction results from two significant changes. The County has reduced the projected Medicaid growth rate which reduces the baseline by $79 million, reflecting the Medicaid cap enacted by Governor Pataki and the State Legislature. The benefit of the Medicaid cap grows over time, with projected savings of $23.4 million in FY 06, $49.6 million in FY 07, and $73.8 million in FY 08, for total savings of $146.8 million.

The County has used, with several exceptions that will be discussed later, many of the same growth rates that were used to prepare the adopted Plan. The County has reduced its growth rate assumption for Medicaid. In the past, the County's projected growth rate was more conservative, which had the effect of overstating projected costs. Now the County has used a growth rate that is closer to historical averages. The County also reduced its growth rates for health insurance costs, and the early intervention program, based upon more recent history.

GAP CLOSING PROGRAM

The enactment of the Medicaid cap has allowed the County to modify its gap closing program. The County has eliminated some taxes, and delayed the imposition of other taxes for one year. In certain cases the County substituted one time resources for previously planned recurring actions. These one time resources will be used as a bridge while the savings from the Medicaid cap ramps up. The FY 2006 gap has been reduced by $55.9 million to $148.6 million, and the County has adjusted its FY 2006 gap closing program by

- Reducing or eliminating the following items:
    - eliminating the residential fuel tax with a value of $46.1 million in FY 06;
    - moving back an annual 3.9% CPI property tax increase to start in FY 07 rather than FY 06, with a value of $29.3 million in FY 07, and $60 million in FY 08;
    - reducing its assumption that in FY 06 that the sales tax growth will return to historical averages, having a value of $17.9 million;
    - reducing its workforce management savings by $16.5 million in FY 06; and
    - reducing the value of its Smart Government initiatives by $1.85 million.

- Adding the following items:
    - using non-recurring revenues of $50 million in FY 06, $25 million in FY 07, and $15 million in FY 08, as a transition to PAYGO cert settlements;

- increasing the property tax levy by $10 million to capture the inherent value of new construction since 2002; and
- recognizing the value of a new State enacted Medicaid Part D subsidy of $8.6 million.

- Substituting non-recurring items valued at $50 million in FY 06, $25 million in FY 07, and $15 million in FY 08 to fund PAYGO certs. While this is a departure from past practice when the County relied more upon recurring actions to achieve budgetary balance it is not unreasonable to tie these items to expected Medicaid cap savings. As shown in the chart below, the following non-recurring actions will be used to close the out year gaps:

Gap closing measure	FY 2006	FY 2007	FY 2008
Pension reserve	$22.7	$20.8	-
Pre-fund debt service	$10.9	$ 7.0	$11.9
PAYGO certs – one-shots	$50.0	$25.0	$15.0
Total non-recurring items	**$83.6**	**$52.8**	**$26.9**
Total gap closing measures	**$148.6**	**$231.6**	**$302.0**

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

The County has indicated that it will use $90 million of one-time non-recurring resources to ease the burden on the operating budget by the required transition to PAYGO certiorari tax refunds. These potential sources include: $24.9 million of closed out capital projects that can be used for debt service purposes; $18 million of future closed out capital projects; $15.1 million of prior year recoveries attributable to storm water services; and potential savings of up to $14.4 million from no longer needing to make an annual Medicaid accrual; $14.1 million from the reserve for bonded indebtedness; and $3.5 million from NIFA's advance refunding of outstanding County indebtedness. Of these items, approximately $58.4 million of the total has also been identified as potential resources to maintain budgetary balance in FY 05. If these resources are used in FY 2005, they will not be available in future years, and the gap closing program would need to be modified.

The County assumes that its property tax levy will increase by $10 million in FY 2006. The County expects that this additional $10 million will come from capturing the value of new construction that occurred within the County since 2002. In addition, the Plan assumes that its property tax levy will increase by an additional $3.3 million annually; beginning in FY 2007, to continually capture prospective economic development. Should prospective economic activity fail to generate the assumed revenue, the County will have to identify replacement initiatives of equal value to balance the Plan.

The County has also modified its Smart Government Initiatives by removing or reducing several initiatives that are no longer expected to achieve their savings, for a net reduction of $1.85 million. While the Plan period is for FY 2005 – FY 2008, the following comments relate more directly to FY 2006, which will be the first year of the new financial plan that will be submitted on September 15, 2005. In particular, we note that for 2006 the County has removed police overtime savings valued at $5 million, reduced parks revenue by $1.4 million and reduced the projected savings from the automated time and leave system by $0.85 million. We concur with these changes, particularly since our October 5, 2004 report raised concerns about the County's ability to achieve projected parks revenues increases, savings from the automated time and leave system and control overtime. Consistent with comments in our previous report, we continue to question whether the County will achieve its projected savings from the e-Government initiative, particularly in light of the fact that the County now estimates that it will realize savings of only $3,500 in FY 2005. Overtime continues to be a problem for the County as evidenced by the elimination of $5 million projected police overtime savings from FY 06 the financial plan, and we are concerned that overtime costs may exceed the County's current estimate of its FY 2005 overtime costs.

The County made a number of assumptions in the Plan regarding its ability to constrain overtime spending, as discussed in our October 2004 report. The Plan called for the County to hire additional police officers to supplement its existing force in an attempt to mitigate overtime needs and ensure that public safety would not become compromised due to insufficient staffing caused by attrition. Despite the County's recent efforts to expand the police force, overtime expenditures continue to outpace budgetary assumptions. The County maintains that its efforts will yield savings as new recruits graduate the Police Academy; however, it is unclear how far this initiative will drive down overtime usage since we have only recently begun to measure a positive impact on overtime expenditures. At this time it is too early to know if this is the beginning of a trend or only a temporary reduction.

We are also concerned about the County's ability to effectuate its civilianization initiatives in the Police Department and Correctional Center and we continue to question whether the associated overtime savings targets identified by the County when it concluded its new labor agreements with members of the Police Benevolent Association and Sheriffs Officers Association can be achieved.

In order to compensate for these reductions, the County has added several new initiatives. In particular, they plan to establish licensing fees for plumbers and electricians with an expected value of $2.3 million, and increase a variety of other fees for a total value of $1.5 million. While we recognize that it is a policy choice of the County, it is important to note that implementation of these fees will require approval by the County Legislature. In addition, the licensing fees for plumbers and electricians require action by the New York State Legislature. Should such action not be taken, the County will have to identify replacement savings of equal value. The program also contains a new initiative, OTPS cost containment, with projected savings of $0.7 million starting in FY 06. In order to achieve this target, the County will have to limit OTPS expenditure growth to 0.6% which may prove difficult even in a low inflationary environment.

ISSUES THAT REQUIRE FURTHER SCRUTINY

Notwithstanding the many accomplishments of the County, many of the major challenges identified in our previous report remain including the Nassau Health Care Corporation; and elimination of the certiorari backlog.

Nassau Health Care Corporation

The NHCC board and management have achieved a number of successes, including recruiting and filling the vacancies of Chief Executive Officer, Vice President for Ambulatory Care, Vice President for Prison Health Services, Director of Patient Care Services/Nursing and Director of Organizational Development. In addition, the recent refunding of NHCC's outstanding debt has released cash reserves that allowed NHCC to pay its 2004 pension bill, and provided temporary cash relief. However, as set forth in their proposed financial plan, they still face projected gaps of $6.7 million in FY 05 after certain planned gap closing actions are taken. In addition, before consideration of its gap closing program, NHCC projects gaps $18.8 million in FY 06, $23.6 million in FY 07, and $31.3 million in FY 08. NHCC has prepared a gap closing program that relies on a combination of State actions which are outside their direct control, revenue enhancements, and reductions in labor costs. Should any of these initiatives not achieve their targeted savings, NHCC will have to identify and implement other actions to eliminate its projected deficits.

While the gap closing program appears credible, the Corporation's long-term financial viability depends upon a robust revenue base. NIFA is concerned that patient revenues have continued to decline. If this trend continues it will negatively impact the Corporation's ability to return to financial stability.

Tax Certiorari and Assessment Review

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 the severity of this problem. Under the legislation that created NIFA in June of 2000, Nassau County was given the ability, until December 31, 2004, to borrow up to $800 million for cert settlements and judgments. The County was also given $5 million of State aid to assist it in streamlining the tax cert claims process.

On two occasions, the State Legislature has extended the County's ability to borrow for tax cert liability through NIFA and include the proceeds as revenue in balancing its budget. In the first instance, the County's right to borrow was extended from 2004 to 2005. In the second instance, the County was permitted to borrow $15 million for certs in 2006 and $10 million in 2007.

In return for the aforesaid dispensations from the State, the County was required to fund its certiorari obligations on a “pay-as-you-go” (“PAYGO”) basis starting in 2006. Due to its anticipated savings from the new Medicaid cap, the County has now elected to fund its liability in 2006 with one time sources of revenue before transitioning to a complete PAYGO program in later years.

Unilateral refunds of tax cert claims in 2005 have also been suggested by the County in order to maximize NIFA’s remaining borrowing authority. The County must still prove that unilateral refunds are “Financeable Costs” under the NIFA statute and that Federal and State laws are consistent with its proposal.

The size of the cert backlog remains unclear. To date, the County has been unable to articulate a methodology to measure the cert backlog. Without such a tool, it is impossible to determine if the problem has improved. In the absence of a methodology that we can use, we will be looking to the Comptroller and Auditor’s estimates

We remain concerned that internal controls at ARC have not kept pace with the amounts of money that have been distributed. We repeat our request that future reports show progress in this area.

Finally, NIFA is still holding $4.8 million which the State gave the County almost five years ago to help streamline it tax certiorari problem. This money is available once the County can prove that it will be used to pay for or reimburse eligible projects.

CONCLUSION

Nassau County continues to make significant progress in resolving its financial problems. Accomplishments of the County, combined with NIFA assistance and guidance, combined with the Medicaid cap savings provided by Governor Pataki and the State Legislature should continue to allow the County to move toward structural balance. NIFA and the County should continue to work together to monitor challenges and resolve outstanding issues. We look forward to receiving the County’s financial plan in September.