NIFA

Nassau County Interim Finance Authority

May 2, 2007

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 April 1, 2007 Revision of the Nassau County Multi-Year Financial Plan for Fiscal Years 2007-2010. The Revision 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 and comments on several significant challenges that could negatively impact the County's fiscal recovery. In particular NIFA is concerned about the rapid reduction of reserve balances and the financial condition of the Nassau Health Care Corporation.

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

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 APRIL 1, 2007 NASSAU COUNTY MULTI-YEAR FINANCIAL PLAN REVISION FISCAL 2007 – 2010

May 2, 2007

NASSAU COUNTY
INTERIM FINANCE AUTHORITY

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When NIFA approved the County's Multi – Year Financial Plan for Fiscal Years 2007 – 2010 (hereinafter, the "Plan"), the Directors were concerned about a number of issues that could affect the County's financial plan and as a result required that the County Executive submit a revised plan to NIFA no later than April 1, 2007 (hereinafter, the "Revision"). The Revision was delivered to NIFA on April 2, 2007.

What follows is a review and analysis of those parts of the revised plan where substantive changes have occurred, or where NIFA felt that the revisions would be predictive of the County's future financial position. This report only comments upon the major changes to the Plan; therefore it needs to be read in conjunction with NIFA's October 17, 2006 report on the Plan, since we have not repeated all of the concerns raised in that report.

This report is divided into five sections: (1) summary of findings, (2) status of the FY 2007 operating results, (3) the baseline, (4) the gap-closing program, and (5) issues that require further scrutiny.

SUMMARY OF FINDINGS AND RECOMMENDATIONS

1) The County has fulfilled NIFA's request that it submit a revised Plan. However, NIFA remains concerned that the revised plan does nothing to mitigate the recent pattern of using increasingly larger amounts of non-recurring resources to balance the Plan. In fact, the County plans to use an additional $20 million of non-recurring tobacco proceeds from the 1999 tobacco securitization to help balance the Plan. This will exhaust the proceeds of this securitization.

2) The Plan continues to rely on labor concessions from the PBA, DAI and ShOA of $30.9 million beginning in FY 2007, and new concessions from CSEA and SOA of $23.4 million beginning in FY 2008. NIFA remains concerned because with one-third of the Year already completed the FY 2007 concessions are yet to be achieved. If the the targeted concessions are not achieved the County must ensure that sufficient actions are taken to balance the Plan.

3) According to the revised plan, the baseline gap, which is the difference between recurring revenues and expenditures, has decreased by approximately $22 million in FY 2008, $12.9 million in FY 2009, and $15.1 million in FY 2010, because of reduced health insurance rates and revised assumptions concerning State aid in the outyears. The out-year gaps are now projected to be $142.0 million in FY 2008, $196.3 million in FY 2009, and $241.0 million in FY 2010.

4) The County has appropriately reduced its projected FY 2007 sales tax revenues because FY 2006 receipts were less than budgeted and the gap closing program no longer presumes that sales tax will return to historical levels.

5) The County's backlog of tax certiorari claims remains substantially unchanged from $131 million at the end of FY 2005 to $133.5 million at the end of FY 2006 despite the fact that the County expensed $70 million for refunds, or $20 million

more than budgeted. Therefore we question whether the annual expenditure of approximately $50 million will be sufficient to ensure that the backlog does not increase over time.

6) We need to understand the financial relationship and flow of funds between the Sewer and Storm Water Finance Authority and the Sewer and Storm Water Resources District. Consequently, we recommend that the NIFA Directors require that the County submit a financial plan for the District, including gap closing measures.

7) NIFA and the County will need to continue to work together to resolve several outstanding challenges, including the Nassau County Health Care Corporation ("NHCC") and, in particular how the County will prudently use the $120 million of tobacco proceeds that was borrowed in April 2006 and remains largely unspent.

STATUS OF FY 2007 OPERATING RESULTS

The County believes that it will end FY 2007 with an operating surplus of $3.1 million. In making this projection the County appropriately reduced its projected sales tax revenues by $5.1 million, benefited from reduced health insurance rates, and projects a number of positive and negative variances, that generally offset each other. In order to achieve its $3.1 million surplus, the County must realize its projected labor concessions of $30.9 million for the year. NIFA remains concerned because with one-third of the year already completed the concessions are yet to be achieved. If the County does not achieve the targeted level of concessions during FY 2007, the County must ensure that sufficient actions are taken to maintain budgetary balance for the year.

Because FY 2006 sales tax receipts were less than budgeted, the County has reduced its FY 2007 sales tax revenue estimate by $5.1 million to $1,025.8 million, an increase of 3.2% from last years receipts. Year-to-date receipts through the April 12th adjustment check are only 0.4% higher than last year, therefore the County needs 4.1% growth in this year's remaining payments to meet its revised target. While the County's action in revising downward sales tax revenue is prudent, we remain concerned whether the current economic environment will be robust enough to generate the necessary growth.

The budget also assumes that the County will receive $3.9 million from the State for reimbursement of tuition payments to the Fashion Institute of Technology, however these funds are not included in the State budget. The County does have currently vacant positions valued at approximately $15 million which can be used to offset any negative variances.

THE BASELINE

The projected gaps have decreased by $22.8 million in FY 2008, $12.9 million in FY 2009, and $15.1 million in FY 2010, and they are now projected to be $164.8 million in FY 2008, $196.3 million in FY 2009, and $241.0 million in FY 2010. While there have been a number of other positive and negative baseline changes that have generally offset each other, the decrease results primarily from reduced health insurance rates, and a revised assumption regarding state aid reimbursement. These positive changes allowed the County to absorb the annual reduction of approximately $5 million in projected sales tax collections because of lower then budgeted sales tax collections in FY 2006.

GAP CLOSING PROGRAM

The County has modified its gap closing program to offset the impact of the recent shortfall in sales tax revenues. The following are the major changes to the gap closing program:

- Reducing its assumption that the sales tax growth will return to historical averages, thereby reducing its estimate by $5.1 million in FY 2008, $10.7 million in FY 2009, and $16.6 million in FY 2010;
- Using an additional $15 million in FY 2009 and $5 million in FY 2010 from the 1999 tobacco securitization to fund operating expenses;
- Reducing workforce management savings by $3 million in FY 2008 and $0.8 million in FY 2009, while increasing them by $4.8 million in 2010;
- Decreasing Smart Government Initiatives by approximately $1.5 million in FY 2008, and increasing them by $2.4 million in FY 2009 and $4.8 million in FY 2010;
- Reducing the value of the proposed cigarette tax by $21.6 million a year; and
- Deferring the start of the residential energy tax from FY 2008 to FY 2009

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

Sales Tax

The County has eliminated the assumption that sales tax growth will return to historical levels of approximately 4%. It presents this change as conservatively dropping the growth rate to only 3.5%; however, as indicated earlier the County now needs growth of 4.1% in FY 2007. While growth has averaged about 4.1% for the last the 10 years, that growth is only 3.5% in the five most recent years. As a result NIFA is concerned about the County's ability to achieve its revised estimate of sales tax collections for FY 2007.

Sewer and Storm Water

NIFA's analysis of the Sewer and Storm Water Finance Authority ("Authority") and the Sewer and Storm Water Resources District ("District") continues to be a problem for the following reasons:

- The County did not provide information about the Authority in its adopted and revised plans; and

- The information that was subsequently provided is inconsistent with prior submissions.

Because the Authority is a Covered Organization under the NIFA Act, the County is required to submit a financial plan for the Authority, but not for the District. Consequently, it is difficult to reconcile the information provided for each entity, and evaluate their financial activities. For example, the County's plan for the District shows gaps of $33.3 million in FY 2008, $31.9 million in FY 2009, and $33.5 million in FY 2010, however, no gap closing plan was provided. The County subsequent stated that these gaps will be closed in part by the Authority restructuring of outstanding debt.

The County has also changed its assumption regarding sewer and storm water assessments. In the adopted plan the County assumed that after lowering assessments for FY 2007, it would return them to the previous higher level. The revised plan now assumes that assessments will remain at the current lower level.

When the Authority was created by the New York State Legislature, it mandated that the Authority be a Covered Organization and therefore subject to NIFA's financial oversight. Because we need to understand the financial relationship and flow of funds between the Authority and the District, we recommend that the NIFA Directors require that the County submit a financial plan for the District, including gap closing measures.

Labor Concessions

We continue to be guarded in our assessment of the County's ability to realize the significant level of labor savings anticipated in the Plan. The County expects to effectuate salary and/or fringe benefit savings, beginning in FY 2007, by securing $30.9 million of concessions from members of two of its police unions, the PBA and DAI ($25.8 million), as well as from members of its correction officer union, ShOA ($5.1 million). While an interest arbitration panel is expected to render its decision by June 15th, thereby providing mid-year budgetary certainty, the County has been unable to reach an agreement through collective bargaining with ShOA since the expiration of the old contract at the end of 2004. Furthermore, the Plan calls for additional labor savings of $23.4 million, beginning in FY 2008, from concessions the County must negotiate with members of the CSEA and SOA. We note that these risks are material and emphasize that the County must be prepared to move quickly to mitigate negative variances that may develop in its baseline and gap-closing plan assumptions from either a failure or delay in securing requisite concessions. NIFA will review the County's analysis of the financial impact of the arbitrator's decision on the Financial Plan.

Smart Government Initiatives

The County's gap closing plan includes Smart Government Initiatives (SGI's) in the amount of $10 million in FY 2008, $23 million in FY 2009 and $26.7 million in FY 2010. The Update reduced or removed initiatives totaling $1.5 million in FY 08, while new and/or increased initiatives have been added in the amounts of $2.4 million for FY 2009 and $4.8 million in FY 2010.

The County has reduced and/or removed several initiatives, including $2.1 million of annual Parks Revenue Enhancement Revenue, $2.0 million of police overtime cost savings, $1.0 million in correction center overtime, and, $1.5 million in TPVA re-engineering savings. Capital project sponsor expense reductions of $1.0 million are also shown for FY 2008.

As in prior years, there are several initiatives whose implementation has again been pushed back, further decreasing the likelihood of their future success. These include: 1) HHS program reductions; 2) NYS Empire Zones program, and; 3) automated time and leave system implementation.

Of particular concern is the ongoing delay of implementing an Automated Time and Leave System in light of the five years this SGI has been included and then subsequently pushed back. Factors such as 1) publicized leave monitoring issues reported in the press during the past 12-24 months; 2) concerns about the time system having implications with existing or pending collective bargaining agreements that are still under review by legal counsel; 3) the incidence of employee implementation resistance that will likely be encountered; 4) the availability of scarce IT resources, and 5) the fact that neither a system nor a vendor has yet been selected as of this report, all lend themselves to raising the level of uncertainty for this initiative.

The County has added one new initiative, the ADAPT IT program for use by Real Property Assessment, however, savings have yet to be quantified. OMB indicated that savings would result from the integration of system in various departments which would eliminate redundancy of data entry and resources required, and permit other unspecified efficiencies, however, when asked if clerical staff could be reduced, it was indicated that no changes would be made in this area. OMB has been asked to provide details of how savings will be achieved through this initiative since it only appears that expenses will be incurred at this point.

Savings from the County's Risk Management Program have been increased in the update to $1.6 million in 2008 from the original $0.5 million (a threefold savings projection increase), $3.9 million in 2009 from the initial $0.5 million (a sevenfold savings increase) and $5.9 million in 2010 from the original $0.5 million (an eleven fold savings increase), although there are numerous expected increases in mandates, whose impact cannot yet be determined. OMB has been asked to provide details of these projected savings calculations in light of the significant projection increases surrounding this initiative.

Another initiative, commercial tax grievance filing fee increases of $3.4 million in FY 2009 and $3.4 million in FY 2010 have been pushed back from beginning in FY 2008, requires State or local legislative approvals which may not materialize. In addition, the ticket processing surcharge included for $1.5 million of savings for FY 2008-2010, has not yet had approval at the State level as required.

While we commend the County for its creativity in adopting the Smart Government Initiatives approach, we remain concerned about whether their potential for a positive financial impact will ever be fully realized and whether there are many missed opportunities which could be pursued, but have not been included in the plan.

Cigarette Tax

The gap closing program assumes that the New York State Legislature will give the necessary authority to allow the County to increase the sales tax on cigarette by $2.00 a pack, of which the County would retain about 54%. Part of the rationale for the increased taxes is to reduce tobacco consumption. In the revised plan the County has reduced its projection of how much will be received from $50 million a year to $28.4 million. However, because of recent news reports, NIFA is concerned whether sufficient supports exist in the New York State Legislature for the enactment of this tax. The County should provide NIFA with alternative revenues should the tax not be approved.

Tobacco Proceeds

The County plans to use an additional $20 million from the 1999 tobacco securitization to fund operating expenses. Of this, $15 million more will be used in FY 2009, and $5 million more in FY 2010. This represents an increase in the level of non-recurring resources used to balance the financial plan. This will exhaust the proceeds from this borrowing.

ISSUES THAT REQUIRE FURTHER SCRUTINY

Notwithstanding the many accomplishments of the County, a number of major challenges and concerns identified in our previous report remain including the rapid reduction of reserve balances, the Nassau Health Care Corporation, tax certiorari, debt issuance and postemployment benefits.

Reserve Balances

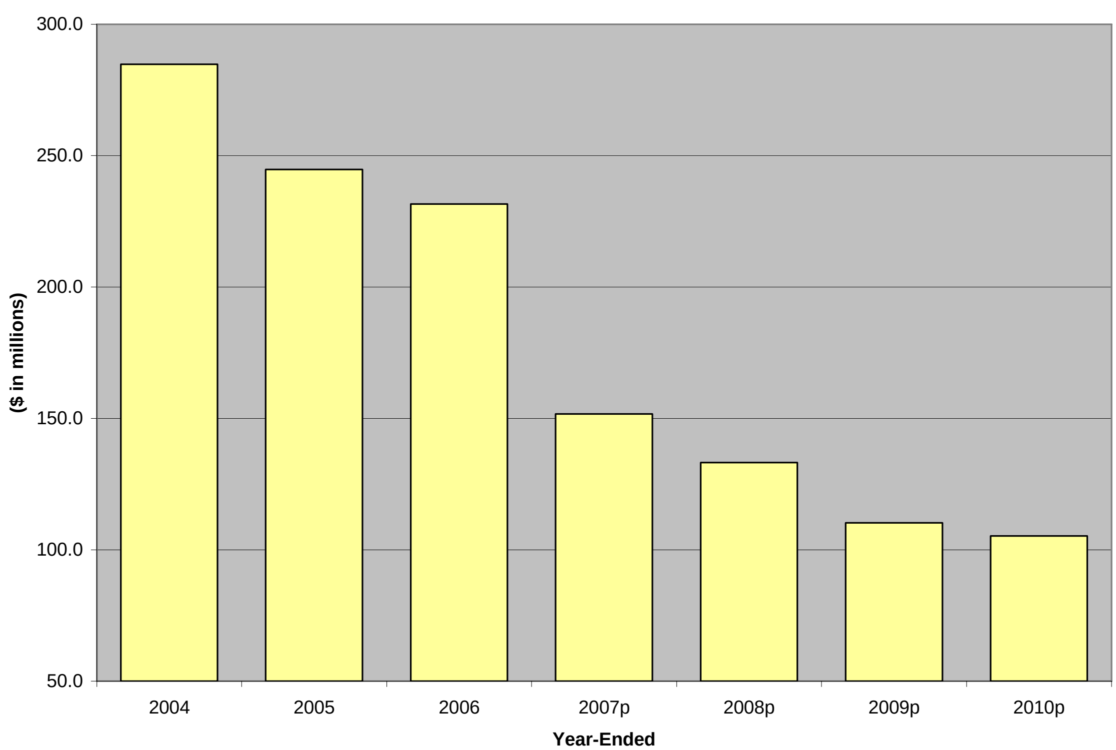
The County articulated its commitment to sound fiscal practices by documenting a number of steps it had taken to, among other achievements, secure a series of bond ratings upgrades, beginning in FY 2002. These steps included “a refusal to utilize non-recurring revenues and prior-year undesignated fund balances to cover current year baseline operating expenses,” “the implementation of appropriate borrowing practices,” and “the establishment of reserves to address contingencies should they arise.”

We continue to question whether the County has strayed from these prudent fiscal practices in recent years. For example, the County has sharply increased its use of short-term borrowing for cashflow purposes, evidencing deteriorating balances and liquidity, and whose interest costs represents an increasing drain on the County’s operating budget. As discussed in our October 2006 staff report, the County undertook the first of several planned note issuances to fund long-term capital needs. In addition, the County did not provide any economic justification for why note issuances were better than long term borrowing.

Most importantly, the County has continued to utilize non-recurring resources to fund recurring expenditures. This is being carried out, in part, by depleting contingency reserves, which should be tapped only in response to unplanned or extraordinary events rather than during the County's routine financial planning process. The County's proposed Fund Balance and Reserve Policy stipulates that to the extent that the County utilizes its unreserved fund balance, its policy shall be to use these funds either for (i) non-recurring expenditures that promote important policy objectives; or (ii) extraordinary operating and capital purposes that could not be anticipated and which otherwise cannot be financed with current revenues in the annual operating budget. We question whether these threshold questions have been met.

It is noteworthy that the County attributes its past success at securing a series of bond ratings upgrades, in part, to "the accumulation of a growing unreserved undesignated fund balance." As shown in Chart 1, the County has drawn down unrestricted resources from its general reserves since FY 2004, when the County held in reserve $284.8 million, leaving only a projected $151.7 million in FY 2007, $133.2 million in FY 2008, $110.2 million in FY 2009, and $105.2 million in FY 2010.

(Chart 1)
COUNTY GENERAL RESERVES HAVE DECLINED SHARPLY SINCE FY 2004



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

Nassau Health Care Corporation

The financial health of the Nassau Health Care Corporation ("NHCC") and its potential impact on Nassau County has been a major concern for NIFA since its inception. There now appears to be a significant improvement in accountability and general "turn around" activity since 2006. NHCC's budget projects that they will end FY 2007 with a break even result after implementation of its gap closing program. However, the first three months of FY 2007 show an operating loss of $2.6 million versus a budgeted loss of $1.5 million. Monthly net patient service revenue continues to fall short of budgeted targets, with March reflecting a negative variance of $0.7 million and YTD variances reaching negative $2.4 million. This accounts for NHCC's overall YTD operating loss. While expenses appear to have been held in check, revenue has not increased sufficiently to reach fiscal stability. There is concern that should this trend not quickly be reversed and corrected, a year end loss in the area of $6.9 million is possible. Our review of the March 31, 2007 fiscal results indicates that much work remains to bring the hospital to a "break even" status.

According to a recent meeting with NHCC management, the hospital has received the March $51.5 million that it had expected in IGT payments. This has put the institution on more solid footing from a cash flow and working capital stand-point.

However, NHCC recorded an unaudited $8.7 million operating loss for FY 2006 and baseline operating gaps are projected as $10.5 million in 2007, $17.7 million in 2008, $41.8 million in 2009, and $59 million in 2010. While this is an Update gap reduction restatement of $4.2 million in 2007 and $5.1 million in 2008, the baseline gap projection is also increasing by $0.6 million in 2009, and $15 million in 2010.

Recently, it was learned that proposed NY State budget cuts for FY 2007-2010 have moderated and that the initial threatened revenue reduction amounting to $7.9 million now appears to be closer to the more manageable $0.5 million range.

Among NIFA's remaining concerns are the; 1) completion of a long over due Successor Agreement with Nassau County and resolution of the legislative opposition regarding disposition proceeds from the intended sale of AH Patterson property; 2) NYS approval of the bed count at the AH Patterson nursing home, upon which approval of a new CON and construction budget relies; 3) correction of census and utilization patterns throughout the entire system which have still not picked up to the required levels necessary for fiscal stability; and, 4) resolution of open quality of care issues and a successful JCAHO resurvey.

We commend the hospital management for its well developed and intended plan for the new Minority Healthcare Disparities Institute and its impending successful start-up and implementation.

Yet, we reiterate that any monies given to NHCC by the County must be carefully monitored and released only upon the attainment of specific goals and not based only upon projections. The County needs to remember that the money it gives to NHCC, especially those monies raised from the tobacco financing, were raised at very high interest rates and subject to a pledge of future cash flows until the year 2060.

Certiorari

In our October 2006 report we noted that "Because of inflation and increased property taxes, the $50 million that the County has guaranteed to pay each year for cert claims, will constitute an increasingly smaller part of the County's exposure." We are glad to see that the County has revised its estimate of from $50 million for cert refunds in 2007 to $55,521,606 in 2010. We hope that these amounts will be sufficient.

One of the reasons for our concern is that the County expensed $70 million in 2006, which was $20 million more that they had budgeted to keep the backlog stable. We believe that the additional money should have lowered the backlog by $20 million in FY 2006; however, the County has informed us that the backlog has increased from $131 million at the end of FY 2005 to $133.5 million at the end of FY 2006. The Assessment Review Commission ("ARC") has explained this discrepancy by saying that their current system for estimating the backlog is more accurate than in prior years.

Even if the County does plan properly and is able to keep cert refunds contained, the annual payment of over $50 million per year in cert claims, plus administrative costs for the Assessment Review Commission in excess of $5 million per annum, is a significant burden for County taxpayers. We were pleased to see that the County's State Legislative program does have certain new revenue proposals regarding certs and assessments; however, it is unclear how hard the County is pursuing these items. In addition, it is noteworthy that the legislative proposals do not address the fundamental laws which caused the backlog or impose harsher penalties for those who abuse the system.

The slowdown in the housing market and the resultant decrease in property values will affect future certiorari settlements unless the Assessor and ARC are able to act quickly to make the necessary adjustments. We believe that they recognize this problem, but only time will tell if their upgraded staff and equipment will allow them to quickly and accurately make the necessary adjustments.

Debt Issuance

We are glad to see that the County has finally drawn down substantially all of the money that the County had requested in its 2004 and 2005 borrowings.

We recognize that the Finance Department raises money pursuant to the request of other departments, most notably the Department of Public Works ("DPW"). DPW's failure to accurately predict its needs or schedule continue to disrupt County operations and to cost the County money. The foregoing is evidenced by the time it took to draw down the money that NIFA borrowed, the constant changes in the County's borrowing schedule and the list of projects that are ready to be funded, and most notably by the arbitrage liability that the taxpayers must continue to fund.

The tobacco borrowing in March of 2006, which NIFA opposed, also continues to be a source of expense for the County. As of this writing, only $20.77 million of the total proceeds of $119.87 million has been disbursed. Of the original proceeds, $21.8 million was earmarked for the County. $18 million of the $21.8 million was recently proposed for use as a Police and Fire Communications Center.

Postemployment Healthcare

In June 2004, the Governmental Accounting Standards Board issued Statement No. 45, Accounting and Financial Reporting for Employers for Postemployment Benefits Other Than Pensions. This Statement establishes standards for the measurement, recognition, and display of other postemployment benefits expense and related liabilities. The County is currently in the process of evaluating the impact that will result from adopting this new Statement, but has not yet completed the process and can not disclose the potential impact. While the Statement does not require that the liability be funded in the near future, the County will need to decide how to deal with this liability.