NASSAU COUNTY INTERIM FINANCE AUTHORITY

RESOLUTION NO. 11

DECLARATION OF A CONTROL PERIOD UPON FINDING LIKELIHOOD AND IMMINENCE OF A DEFICIT OF MORE THAN ONE PERCENT IN THE COUNTY'S FISCAL YEAR 2011 BUDGET

WHEREAS, on September 15, 2010, the County Executive submitted for NIFA's review his Proposed Multi-Year Financial Plan, Fiscal 2011-2014, the first year of which was its Proposed Budget for FY 2011; and

WHEREAS, on September 28, 2010, NIFA concluded in a preliminary review that the County's Proposed Plan, and the FY 2011 Proposed Budget in particular, did not meet the standards necessary to project budget balance because of the degree of risk in various projected revenue sources and cost savings; and

WHEREAS, NIFA further observed, preliminarily, that the County planned to forego the use of operating revenues to fund its certiorari obligations and instead proposed bonding of an additional $364 million over the next two years, including $100 million in Fiscal Year 2011, which borrowing would require approval by a supermajority of the County Legislature; and

WHEREAS, on September 28, 2010, at a public meeting at which the County Executive delivered a presentation on his budget and plan, NIFA Directors stated publicly that the County's proposed budget was not balanced, identified specific projected revenues and cost savings as unduly risky and warned that the County was on the edge of a fiscal abyss; and

WHEREAS, on October 30, 2010, after a one-day recess of its October 29, 2010 meeting, the County Legislature completed enactment of a Multi-Year Financial Plan, including a Budget for FY 2011 (the "Budget"), containing many of the revenue sources and cost savings previously identified as risky by NIFA; and

WHEREAS, the Budget enacted by the County Legislature added new "contingencies" purporting to offset the aforementioned Budget risks; and

WHEREAS, in meetings with County leaders, and by letter of December 13, 2010, Chairman Stack requested from the County documentation supporting various revenue and cost-saving components of the Budget, including contingencies; and

WHEREAS, on December 21, 2010, NIFA convened a public meeting and conducted a lengthy executive session to consult with its outside counsel and its outside accounting advisors; and

WHEREAS, on December 29, 2010, the County Executive delivered a letter to NIFA with, among other things, a list of $157.9 million in new contingencies allegedly available in 2011, but unmentioned by the County in its enacted budget or in earlier meetings with NIFA and NIFA's staff; and

WHEREAS, at a public meeting on December 30, 2010, following a presentation by the County Executive, NIFA conducted another lengthy executive session with its counsel and accounting advisors, and then NIFA publicly announced that, in an abundance of caution, it was providing the County with a final opportunity to provide information by January 20, 2011 to alleviate the strong sense of the Directors that a statutory operating deficit was substantially likely and imminent; and

WHEREAS, NIFA, with the assistance of its counsel and its outside accounting advisors, has conducted a careful analysis of the information provided by the County; and

WHEREAS, by law NIFA shall impose a control period upon its determination that there is a substantial likelihood and imminence of the County incurring a major operating funds deficit of one percent or more in the aggregate results of operations during its fiscal year assuming all revenues and expenditures are reported in accordance with generally accepted accounting principles,

NOW, THEREFORE, BE IT RESOLVED, that with the hope and prospect that representatives of County government will work collaboratively and in good faith with NIFA to achieve a resolution of the County's financial difficulties, and that such resolution will allow the County to meet its financial obligations while providing effective services for County residents, NIFA hereby imposes a control period, effective immediately; and be it further

RESOLVED, that for the reasons in the Determination annexed hereto and made a part of this Resolution, NIFA hereby determines that there exists a substantial

likelihood and imminence of the County incurring a major operating funds deficit of one percent or more in the aggregate results of operations during its Fiscal Year 2011 assuming all revenues and expenditures are reported in accordance with generally accepted accounting principles; and be it further

RESOLVED, that NIFA hereby directs the County, by February 15, 2011, to submit for NIFA's consideration a financial plan for FY 2011 eliminating such revenue, cost-saving and contingency items deemed by NIFA to carry unacceptable risk; and be it further

RESOLVED, that in preparing such financial plan the County shall consult with NIFA and adhere to NIFA's requirements, to be communicated to the County in such consultations, for the form of the financial plan and the supporting information required; and it being further

RESOLVED, that in preparing the financial plan, the County shall be mindful of NIFA's statutory authority to modify the County's financial plan during the control period; and be it further

RESOLVED, that by February 15, 2011, the County Executive shall present to NIFA proposed guidelines respecting the categories and types of contracts and other obligations required to be reviewed by NIFA in carrying out its authority to disapprove contracts.

Ronald Stack
Chairperson

January 26, 2011

Determination of the Nassau County Interim Finance Authority

Pursuant to Section 3669(1) of the N.Y. Public Authority Law, Chapter 43-A (the "NIFA Act"), the Nassau County Interim Finance Authority ("NIFA") determines that there exists a substantial likelihood and imminence that Nassau County (the "County") will incur a major operating funds deficit of more than one percent in the aggregate results of operations during its Fiscal Year 2011 assuming all revenues and expenditures are reported in accordance with generally accepted accounting principles ("GAAP"). As a result, NIFA hereby declares a control period as defined by the Act.

I. Background

Understanding this determination requires important background concerning NIFA, its enabling legislation and its historical experience in overseeing the County's finances for more than a decade.

A. Creation of NIFA

In early 2000, the County was in dire financial straits. Its credit rating had deteriorated to one level above junk status, resulting in huge borrowing costs. Through its uniquely problematic property assessment system, the County had incurred hundreds of millions of dollars in liability for tax certiorari refunds ("Tax

Certs"). Unable to pay its Tax Certs liability with recurring revenues (a fiscally prudent practice known as "PAYGO"), the County embarked on the alternative of excluding Tax Certs from its budget – instead, borrowing in the bond market each year to fund this significant operating expense. Amid ballooning costs of providing services, in particular labor and pension costs, the County's elected officials refused either to raise recurring taxes or to cut recurring expenditures, instead relying on a series of temporary, or "one-shot," fixes, such as sales of County property, tapping financial reserves and more borrowing. With a structural imbalance between recurring revenues and expenditures, coinciding with enormous debt service on some $2.7 billion in borrowing (debt service accounted for nearly one-fourth of budgeted spending) and dwindling cash reserves, the County could no longer maintain fiscal stability. An independent report commissioned by the Governor concluded in May 2000 that the County's budget deficit in FY 2000 alone could not be reduced below $117 million.

The NIFA Act, in June 2000, resulted from a bipartisan effort of the Governor and State Legislature to assist the County in returning to fiscal stability while ensuring reform of its financial practices. The legislative findings recognized not only the needs of the County and its taxpayers, but also the State's important interest in resolving the crisis, as follows: "The impairment of the credit of the county of Nassau may affect the ability of other municipalities in the state to

issue their obligations at normal interest rates. Such effect is a matter of state concern." The then-County Executive proposed, and the County Legislature voted unanimously to approve, a home rule message requesting passage of the NIFA Act as "necessary and in the public interest."[1] In that context the NIFA Act was adopted by the New York State Legislature and signed by the Governor.

NIFA is governed by six independent Directors (a seventh seat is currently vacant). All Directors are appointed by the Governor, including one each upon the recommendation of the Majority Leader of the State Senate, the Speaker of the State Assembly and the State Comptroller. NIFA Directors serve their terms without compensation and are assisted by a small full-time professional staff.[2]

The NIFA Act provided a number of essential financial benefits to the County and its residents. Under the Act, the State directly subsidized the County by paying it $100 million ($25 million per year) in State funds through 2004. NIFA was authorized to borrow funds for the County, which it was able to do at more favorable rates, reducing the County's debt service by millions of

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[1] The current County Executive and the current Majority Leader of the County Legislature were among the legislators voting for this home rule message.

[2] More information about NIFA and its Directors can be found on its website at www.nifa.state.ny.us.

dollars. To date the State has provided the County, through NIFA, with more than $500 million in budgetary relief.

The Act contemplated that, over time, the County would be weaned from this State financial assistance. In particular, recognizing that reform of the Tax Certs problem would require a period of years, the Act set a timetable for transitioning from the use of borrowed funds to PAYGO. The statutory mechanism was a provision in § 3667(1) of the Act which allowed the County to accord special treatment of its Tax Certs borrowing as "operating revenues" – but only through the end of 2007, and at decreasing levels for 2006 and 2007. Beginning in 2008, therefore, the County would need real operating revenues (sources other than borrowing) to offset its annual Tax Certs liability, which in the absence of such offsets would contribute to an operating deficit monitored by NIFA (as described below). The idea was to achieve structural balance between the County's recurring revenues and expenditures (including Tax Certs expenditures), without imprudent borrowing or non-recurring "one-shot" fixes.

B. NIFA Oversight and Controls

In return for the substantial financial relief afforded by the NIFA Act, the County became subject to statutory oversight of its finances, with NIFA monitoring – and, if necessary, *imposing* – fiscal balance.

For Fiscal Years 2001 through 2008, the Act directed NIFA to approve or disapprove the County's budgets and out-year financial plans based on whether or not they met the fiscal balance requirements of the Act, with NIFA responsible for certifying the revenue estimates in the County's financial plans. Although this mechanism to impose fiscal balance expired in 2008, NIFA maintained statutory authority to review and comment on budgets and financial plans in Fiscal Year 2009 and beyond. NIFA has done so.

The second mechanism in the Act for imposing balance has no expiration date during the existence of NIFA and is at issue here. It is the so-called "control period," a statutorily defined interval when NIFA's mandate is to stabilize the County's finances by exercising a degree of control over financial planning, spending and borrowing.

As relevant here, the Act provides that NIFA "shall" impose a control period "upon its determination at any time . . . that there exists a substantial likelihood and imminence of . . . a major operating funds deficit of one percent or more in the aggregate results of operations of such funds during its fiscal year assuming all revenues and expenditures are reported in accordance with generally accepted accounting principles, subject to the provisions of this title." Public Authorities Law § 3669(1).

Thus, the Act provides that NIFA Directors must make a predictive judgment as to whether or not the County's projections of revenues and expenditures for a fiscal year are realistic and likely achievable. NIFA by necessity must make its statutorily required determination regarding a likelihood of a deficit by exercising judgment and discretion as to whether predictions in the budget are in fact likely to occur. It would make little sense for the County's own budgeting predictions simply to stand as the final word when the very purpose of NIFA, as directed by the New York State Legislature, is to provide meaningful oversight of the County's finances.

The Act relies upon NIFA's competency and expertise to evaluate the County's financial projections.[3] As noted above, NIFA approved the County's revenue projections in prior years. The Act additionally requires that NIFA make certain notifications "if, in the judgment of" NIFA, the County's financial "plan fails to contain projections of revenues and expenditures that are based on reasonable and appropriate assumptions and methods of estimation." Public

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[3] The experience of NIFA Directors reflects such expertise. Chairman Ronald Stack has been a public finance investment banker for 26 years. George Marlin is a municipal finance expert and author of *The Guidebook to Municipal Bonds*. Leonard Steinman is an experienced litigator and the immediate past Chairman of the Nassau County Industrial Development Agency. Thomas Stokes holds an MBA in corporate finance and earlier in his career served in Nassau County as Deputy County Executive for Operations and Finance. Robert Wild founded and is Chairman of a major Long Island law firm with extensive experience representing hospitals and health care providers. Christopher Wright was a partner at two global accounting firms and is managing director at a New York consulting firm.

Authorities Law § 3667(e)(ii). In the event of a control period, the Act provides, NIFA will "certify to the county the revenue estimates approved" in any approved financial plan, and NIFA may "exercise the rights of approval, disapproval and modification with respect to the financial plan, *including but not limited to the revenue estimates contained therein*." Public Authorities Law § 3669(2)(a)(iii) (emphasis added).

In addition to the predictive judgment of likelihood and imminence described above, the statute also directs NIFA to "assume[e] revenues and expenditures are reported in accordance with" GAAP. Public Authorities Law § 3669(1). GAAP rules are generally applied to events that already have occurred in order to prepare historical financial statements. Where NIFA is evaluating *budgeted* revenues and expenditures, GAAP is applied to test whether anticipated sources and uses of funds in the budget qualify as revenues and expenditures as defined by GAAP. Giving effect to the words of the statute – as NIFA must – if a particular budgeted revenue source does not in fact qualify as revenue under GAAP, NIFA cannot include such revenue when determining whether a deficit is substantially likely.

By law, once it determines that the statutory criteria exist, NIFA cannot allow the County to incur a deficit pursuant to an unachievable financial plan. By directing NIFA to act upon likelihood and imminence (as opposed to

actual historical results), the Act contemplates imposition of controls *before* the opportunity for corrective measures has passed. Likewise, the Act provides that NIFA "shall terminate any such control period when it determines that none of the conditions which would permit [NIFA] to impose a control period exist." Public Authorities Law § 3669(1). The Act uses mandatory language requiring NIFA to terminate upon its finding of the absence of a supporting condition for the control period.

In a control period, the County's elected officials continue to make policy decisions and maintain direct responsibility for County operations and the delivery of services within the limits imposed by a NIFA-approved financial plan. NIFA's limited function is to exercise a degree of financial control in order to restore fiscal balance. The primary powers that become available to NIFA during a control period are (i) to direct the County to prepare a revised financial plan in a form acceptable to NIFA, (ii) to modify the revised financial plan if NIFA chooses (and to issue orders compelling County officials to comply with the NIFA-approved plan), (iii) to approve contracts, (iv) to approve borrowing, and (v) if necessary, to impose a wage freeze upon declaration of a fiscal crisis.

C. NIFA's Experience with the County Through 2010

For more than a decade, NIFA's monitoring and assessment of the County's financial challenges has been detailed and well documented. Before

turning to an analysis of Fiscal Year 2011, it is instructive briefly to note four pertinent elements of NIFA's experience with the County in those prior years.

First, NIFA has actively warned the County on several occasions of deficiencies that might trigger the imposition of controls, and the County historically has taken corrective action to obtain NIFA's approval of its budget and avert a control period. For example:

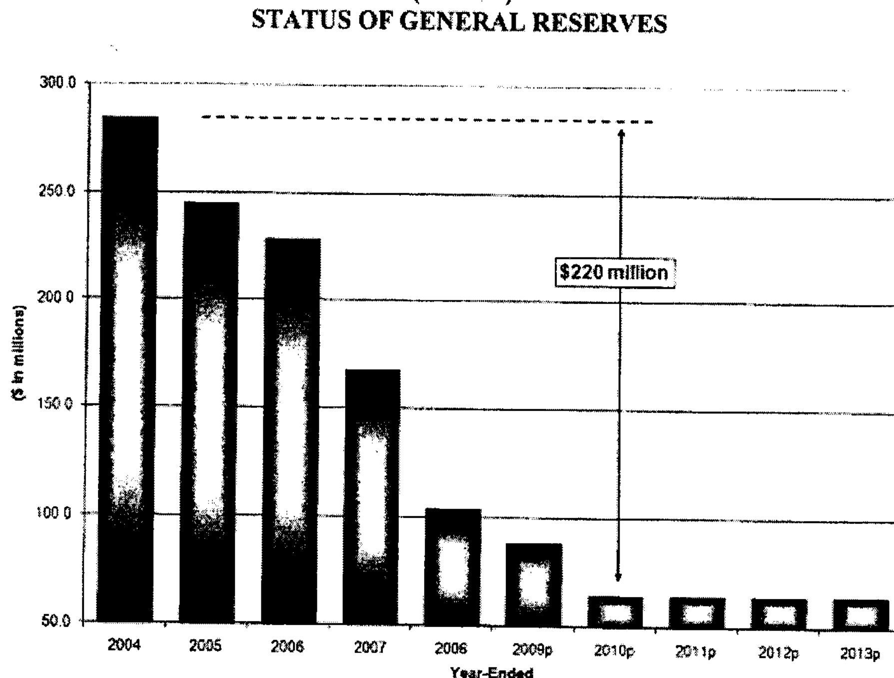
- NIFA rejected the County's initial budget proposal for FY 2001 because it contained an unacceptable level of risk totaling $81.7 million, but the County reduced the risk to $6.3 million and won NIFA approval.
- Again for FY 2002, NIFA deemed the County's initial budget proposal "unacceptable" because of $55 million in risk, prompting the County to reduce the risks and win NIFA approval.
- For FY 2009, NIFA found an unacceptable level of $125 million in risk, but the County Legislature reduced the risk to $53 million, which NIFA found manageable given contingencies identified and available for immediate use as required.

In this way, NIFA and the County have worked cooperatively to avoid the imposition of controls, with NIFA signaling undue risk and the County acting to address the problem.

Second, in October 2000 NIFA made clear that the characterization of surplus Fund Balance as an operating revenue violates the NIFA Act.[4]

Third, from 2000 through 2004, the County successfully executed a plan to build reserves of approximately $285 million, an essential cushion if financial projections proved inaccurate.[5] However, pursuant to the County's financial plan, the trend reversed and reserves were reduced to approximately $65 million by the close of 2010. NIFA's October 2, 2009 report charted this decline:

STATUS OF GENERAL RESERVES



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4 Fund Balance does note equate to cash, but is an accounting determination of the extent to which assets exceed liabilities. NIFA concluded that the use of surplus Fund Balance to prepay a *future* year debt service obligation was an acceptable method under the NIFA Act to achieve budget relief in the *future* year. The County has made such use of Fund Balance.

5 The NIFA Act required the County's financial plans to include adequate reserves "to maintain essential programs in the event revenues have been overestimated or expenditures underestimated for any period." Public Authorities Law § 3667(4)(c).

NIFA noted that the County's proposed Fund Balance and Reserve Policy called for replenishment of its unreserved Fund Balance by direct appropriation if it fell, for two successive years, below 4% of its General Fund and the County-wide Special Revenue Funds. Yet no such appropriations were made, and the County's financial cushion stands at a fraction of what is required by the policy. An additional result of the diminished reserves is the County's growing need to borrow annually against anticipated revenues to meet its cash flow needs, creating still another debt service obligation.[6]

Fourth, NIFA has monitored the County's various efforts to solve the Tax Certs problem. Tax Certs are the Gordian Knot of the County's finances and the leading cause of the fiscal emergency which precipitated NIFA's creation.[7] As authorized by the Act, NIFA issued $800 million in bonds on the County's behalf for the payment of Tax Certs settlements and judgments, and granted $5 million in State aid to assist the County in streamlining its claims process. Yet following

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[6] NIFA analyzed this phenomenon in its October 2, 2009 report as follows: "The County is continuing a high level of cash flow borrowing, which it recommenced in FY 2005. The borrowings have increased steadily such that they are budgeted for approximately $280 million for FY 2010. These cash flow borrowings are estimated to cost the County $4.0 million in FY 2010 and $7.7 million in FY 2011, an increased expense of almost $12 million compared to FY 2005. In prior years, these borrowings were not necessary because the County had sufficient cash reserves."

[7] As NIFA warned in its June 18, 2008 report: "The County has returned to its former practice of bonding tax certiorari refunds, a fiscally imprudent practice, which led to the creation of NIFA."

several County reform efforts, the County still struggles to pay its Tax Certs liability out of current operating expenditures and the backlog of unpaid Tax Certs remains and, as recently as 2009, grew.

The Act initially contemplated the elimination of borrowing to fund Tax Certs liability, and full transition to PAYGO, beginning in 2005. The mechanism in the Act was a provision stating that "[f]or purposes of determining operating revenues" through Fiscal Year 2004, the County's financial plan "may assume" that certain levels of borrowing to pay Tax Certs judgments and settlements "may be counted as operating revenues." Public Authorities Law § 3667(1). This provided the County for a limited duration with an exception to the GAAP rule that such borrowing did not constitute operating revenue. In the absence of this exception, the County would have been unable to achieve balance under the Act because it would have insufficient operating revenues to offset its annual Tax Certs liability. At the County's request, the Act was amended by the State Legislature on three occasions to extend the duration of the exception (in decreasing amounts) through Fiscal Year 2007. Thus, by 2008 the exception had expired, and borrowed funds used to pay Tax Certs settlements and judgments could no longer be treated as operating revenues. Going forward, such use of borrowed funds would contribute, dollar-for-dollar, to the major operating funds deficit that would, at one percent or more, trigger a control period.

Beginning in 2006, the County's plan to address the problem was a commitment to pay at least $50 million of its Tax Certs liability each year through operating expenditures, while using borrowed funds for excess payments and working to reduce the backlog of unpaid claims. The County also renewed this commitment in 2008, and in its October 21, 2008 report, NIFA concluded the County's strategy "appears to be a feasible plan." The County's commitment to $50 million of PAYGO was important to NIFA and was referred to by NIFA as a "promise" and an "obligation" of the County. The budget for Fiscal Year 2010 included an expenditure of $50 million in PAYGO, and estimated that its backlog of Tax Certs claims was $139 million.[8] (October 2, 2009 Report at 28.)

II. Fiscal Year 2011 Budget

As regression to the pre-NIFA landscape neared fruition, the County in Fall 2010 faced the challenge of developing a balanced budget for Fiscal Year 2011 (and accompanying financial plan for 2011 – 2014).[9] At least four realities of 2011 brought this challenge to the breaking point:

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[8] The cost of carrying existing Tax Certs debt was enormous, with $150.6 million budgeted for such debt service costs in Fiscal Year 2009, nearly 6 percent of the budget for major operating funds. (May 28, 2009 Report at 27.)

[9] On May 20, 2010, NIFA concluded in a review of the County's Multi-Year Financial Plan Update Fiscal 2010-2013 that the County did not have a well-defined roadmap to solve its budgetary problems or to achieve projected savings, even after factoring in the County's large borrowing program.

- First, federal stimulus funding, which had provided essential budgetary relief of approximately $40 million in each of Fiscal Years 2009 and 2010, was reduced to approximately $20 million in FY 2011.
- Second, viable one-shot revenue sources of significant size were not readily available.
- Third, elected officials of both parties were unwilling to propose (much less enact) a property tax or other tax increase, or program cuts; to the contrary, the energy tax projected to yield more than $40 million annually was repealed in 2010.[10]
- Fourth, existing collective bargaining agreements (approved by the County Executive and the County Legislature) were in place through 2015, and labor agreements with many County employees prohibited layoffs through the end of 2011.

[10] On January 5, 2010, NIFA wrote to the County Executive, copying County Legislative leaders, regarding challenges posed by (i) the County's bipartisan repeal of the energy tax, which, by NIFA's estimate, will reduce the County's revenues by more than $40 million annually in Fiscal Year 2011 and subsequent years, and (ii) unlikely State authorization for a budgeted cigarette tax projected to raise $16 million annually.

A. Budget Proposal and NIFA Review

On September 15, 2010, the County submitted its proposed budget for Fiscal Year 2011. On September 28, 2010, NIFA concluded in a preliminary review that the County's proposed 2011 budget did not meet the standards necessary to project budget balance because of the degree of risk in various projected revenue sources and cost saving, including:

- labor savings not secured ($61 million),
- red light camera expansion ($17.3 million),
- Long Island Expressway patrol surcharge ($5 million), and
- housing Suffolk County inmates ($3.4 million).

NIFA further observed, preliminarily, that the County planned to forego the use of operating revenues to fund its Tax Certs obligations and instead proposed bonding of an additional $364 million over the next two years (a proposal requiring approval of a supermajority of the County Legislature), including all Tax Certs expenditures in 2011. In other words, the County, as it had prior to enactment of the NIFA Act, removed its substantial Tax Certs liability from its budget altogether, the very practice that precipitated the 2000 crisis NIFA was created to address. In a real sense, the County turned the NIFA Act on its head: Whereas a fundamental tenet of the statute is to eliminate borrowing in favor of PAYGO, the 2011 budget eliminated PAYGO in favor of borrowing. The County

thus abandoned the commitment it had made to NIFA to budget $50 million in PAYGO each year under a plan – which NIFA found "feasible" in 2008 – to reduce imprudent borrowing and slowly reduce the Tax Certs backlog.

The total budgetary risk identified in NIFA's report was $244.4 million, a figure more than *twice* the level of risk NIFA had found unacceptable in 2009 (the 2009 budget proposal was released amid the financial crisis), prompting substantial corrective action by the County Legislature. NIFA was not alone. The County Comptroller subsequently issued his own report quantifying the risk items at a comparable level, $258.1 million. The independent Office of Legislative Budget and Review followed suit, identifying budget risks totaling $245.7 million. An itemized chart of these three analyses is annexed as Exhibit 1.

At a public meeting on September 28, 2010, NIFA granted the County Executive's request to appear in person and make a presentation on his budget proposal. He began by presenting a slide stating: "Despite being one of the wealthiest counties in the nation, Nassau's fiscal problems are bankrupting us." He explained that the County had more than $1.5 billion in existing debt relating to Tax Certs and a backlog of $164 million in claims.[11] He emphasized that because his plan to reform Tax Certs would not have an effect until 2013, "the public

[11] After failed attempts to correct the Tax Certs system, the County passed legislation to eliminate the County Guarantee. This change would reduce the County's responsibility for payment of Tax Certs refunds by shifting a large portion to local taxing jurisdictions.

should know" that Tax Certs would create liability of an additional $100 million per year in 2011 and 2012 "that we can't do anything about."[12] His plan proposed new borrowing $364 million in 2011-12 to pay the $164 million Tax Certs backlog and the $200 million in new liabilities incurred in 2011-12. He presented as his top money-saving action in the budget proposal his ordering (in the absence of voluntary labor concessions) $61 million in labor cost savings pursuant to his newly proposed legislation empowering him to make unilateral cuts in labor payments under existing labor agreements. He indicated that his proposal "obviously" did not use Fund Balance, and that his Administration intended to find ways to re-establish the reserve funds that had been depleted between 2005 - 2010.

In response, NIFA Directors stated publicly that the County's budget as proposed was not balanced, identified specific projected revenues and cost savings as unduly risky and warned that the County was on the edge of a fiscal abyss. The Directors conducted an executive session to discuss legal matters and then, in public session, passed a resolution authorizing retention of outside counsel, former Chief Judge Judith S. Kaye of Skadden, Arps, Slate, Meagher & Flom LLP.

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[12] A slide critiquing the County Guarantee read as follows: "FACT: Creates $100 million per year in new liability in 2011 & 2012."

B. Adopted Budget and Downgrade

On October 30, 2010, after a one-day recess of its October 29, 2010 meeting, the County Legislature completed enactment of a Multi-Year Financial Plan, including the 2011 budget, containing many of the revenue sources and cost savings previously identified as risky by NIFA, the County Comptroller and the Nassau County Office of Legislative Budget Review, including those listed above. The Budget enacted by the County Legislature added "contingencies" purporting to offset the aforementioned Budget risks (in particular the $61 million in proposed labor savings), including:

- securitization of Mitchel Field leases ($30 million),
- County land sales ($25 million), and
- various expense reductions ($5.3 million).

On November 4, 2010, for the first time in more than a decade, one of the three major ratings agencies, Moody's, downgraded the County's credit ratings, both short-term and long-term. Addressing only a portion of the risks analyzed by NIFA and others, Moody's found that "approximately $158 million (8.4% of the County's budget) of both revenues and expenditures to be risky." The two other major ratings agencies, Standards & Poor's and Fitch, maintained the County's credit rating.

In meetings with County leaders, and by letter of December 13, 2010, the NIFA Chairman requested from the County documentation supporting various revenue and cost-saving components of the budget, including the contingencies added by the Legislature. In response, the County provided a two-page memorandum with minimal information. At a public meeting on December 21, 2010, NIFA passed a resolution to engage an outside accounting firm, Grant Thornton LLP. The NIFA Directors then conducted a lengthy executive session with their lawyers and accountants and scheduled NIFA's next public meeting for the morning of December 30, 2010.

C. Newly Proposed Contingencies

On December 29, 2010, the afternoon before NIFA's scheduled public meeting, the County Executive delivered a three-page letter (dated December 28) to NIFA asserting that the budget adopted by the County Legislature "is balanced!" (Emphasis in original.) The letter asserted that the County Executive had reached an agreement with the County Legislature on the Tax Certs problem such that "tax certiorari expenditures for 2011 should no longer be considered a risk by NIFA." Following up on a press release and press conference earlier in the week, the letter asserted that the County Executive had ordered $23 million in additional 2011 budget cuts, including a hiring freeze, to mitigate concern that budgeted revenue sources (such as the red light cameras and Long Island Expressway surcharge)

required State authorization not yet obtained. Finally, the letter identified a list of $157.9 million in *new* contingencies allegedly available in 2011. These contingencies were unmentioned by the County in its enacted budget or in earlier meetings with NIFA and NIFA's staff.

The County Executive asked to address NIFA publicly at the December 30 meeting, and NIFA again granted his request. In his remarks, the County Executive introduced his December 28 letter as an exhibit, provided no details concerning the newly proposed items to ensure balance in 2011 and asked NIFA to dispel rumors of a control period. He stated that there might come a time when he might ask NIFA "to enact [its] powers with respect to assisting the County," but that the time had not yet arrived.

Following another lengthy executive session among Directors and NIFA's counsel and accountants, NIFA announced publicly that, in an abundance of caution, it was providing the County with a final opportunity to provide information by January 20, 2011 that would alleviate the Directors' strong sense that a statutory operating deficit was substantially likely and imminent. In a letter to the County the following day, the NIFA Chairman spelled out specific information required on budgeted and unbudgeted elements of the County Executive's plan to achieve balance. At NIFA's request, the County delivered six narrative descriptions of its position on key issues, together with supporting data.

At NIFA's direction, Grant Thornton engaged in discussion with County staff regarding the County's explanations and support. Grant Thornton requested additional information and data, some of which was provided and some not.

On January 21, 2011, the County Executive initiated a conference call with the Minority Leader of the County Legislature and the NIFA Chairman in an effort to assure NIFA that a real agreement was in place among the County's elected officials to allow sufficient borrowing to cover the County's 2011 Tax Certs liability. Finally, yesterday afternoon, January 25, 2011, the County Executive emailed a four-page letter to the NIFA Directors; NIFA has considered this letter as well in its determination.

III. Substantially Likely and Imminent Deficit

In the context of approximately $2.7 billion budgeted for the County's major operating accounts in 2011, a deficit of one percent, or approximately $27 million, constitutes the statutory trigger amount for imposition of controls. Having reviewed the County's submissions and supporting data in detail, and having consulted extensively with its accountants and counsel, NIFA now concludes that a 2011 deficit of far more than one percent, as defined by the Act, is both substantially likely and imminent. As such, a control period is essential to the preparation of a new fiscal plan directed at restoring balance, as required by law.

A. Identification of Risk Items

NIFA has identified a schedule of primary risk items that are the focus of its analysis. These items are listed in the column labeled "Current Risk" in the schedule annexed hereto as Exhibit 1. As the chart demonstrates, NIFA did not simply rely on risk items identified in its review of the County Executive's initial budget proposal. Rather, NIFA selected the items of most significant risk identified in the three major budget reviews represented in the remaining three columns of the schedule: NIFA's initial review, the Comptroller's review, and the review of the Office of Legislative Budget Review. NIFA eliminated items where risks exist but actions already have been taken to ameliorate their effect. Thus, the remaining items are those which are – at the very least – substantially likely to reduce the County's budgeted revenues or fail to offset certain expenses.

NIFA totaled these risks both with and without the impact of bonding items, which standing alone carry significant implications under GAAP. The Act provides that NIFA "shall" conduct its determination "assuming all revenues and expenses are reported in accordance with" GAAP. Nevertheless, the Directors wished also to examine the impact of the cumulative risks in the absence of GAAP-related bonding items in order to assess the cash impact of identified risks. NIFA found a total of approximately $119.5 million in risk before bonding items, and assigned a range of risk of between $110 to $125 million. With the additional

$100 million in bonding necessary to cover the County's expected 2011 Tax Certs liability, the total assessed risk is $219.5 million, to which NIFA assigned a range of risk between $210 to $225 million.

B. Deficit Offset Items

1. Cash Items

Having calculated a potential deficit associated with the risk items, NIFA evaluated the alleged deficit offset items proposed by the County and, for each, made a determination as to whether the offset item would likely be successful or not in contributing offset. A chart summarizing this analysis is annexed hereto as Exhibit 2. Those offsets which NIFA found to have a high probability of success are in one column, and include the two major contingency items added to the budget by the County Legislature (the Mitchel Field Lease Securitization and the proposed Land Sales). Those offsets which NIFA found to have a low probability of success are in a separate column, and include many (but not all) of the contingencies proposed by the County Executive for the first time in his letter of December 28, 2010.

Subtracting the successful cash offsets from the total assessed risk before bonding items, NIFA calculated its anticipated cash deficit for 2011 of $49 million. This magnitude of cash deficit expected by NIFA approaches *twice* the $27 million figure triggering NIFA's statutory obligation to impose controls. The

fact that this calculation depicts a cash impact shows a real-world reduction in available funds to the County to meet its financial obligations and commitments. In other words, these are not technical accounting entries but dollars that the County likely will be short by the end of 2011 when bills come due.

2. GAAP Items

The additional statutory mandate that NIFA apply GAAP significantly magnifies the deficit further still – in fact, more than *tripling* the statutory deficit to $176 million. Two offset items are at issue. First, harkening back to the pre-2000 era, the County has taken its Tax Certs liability off budget in 2011. The underlying theory is that the County can meet this obligation through borrowing of $100 million. However, GAAP prohibits the County from recognizing borrowed funds as operating revenues for this operating expense, and the statutory exception in the Act (allowing special treatment of Tax Certs bonding proceeds as operating revenues) expired in 2007.

The net effect is to increase the statutory deficit by the full amount of the Tax Certs borrowing, *i.e.*, the full $100 million. This dramatic impact is in no sense artificial, even in the event the County proves able to tap the bond markets and obtain the funds.[13] The drafters of the NIFA Act had especially good reason to

[13] As discussed below, the County Executive's assertion that he had reached an agreement with the Minority Leader of the County Legislature for approval of the bonding turned out to be incorrect.

require NIFA to apply GAAP in this circumstance. A basic tenet of the Act was to wean the County from Tax Certs borrowing in favor of PAYGO. Here, GAAP prevents the County from recognizing borrowed funds as operating revenues to offset this operating expense – foreclosing an imprudent practice that defers current expenses to future periods while incurring growing debt service obligations.[14] There can be no doubt that the drafters of the Act knew and intended this GAAP impact because they carefully crafted a temporary exception to allow some Tax Certs borrowing to count as operating revenues through 2007.

Second, the County's largest offset item is the Mitchel Field securitization plan, whereby the rights to future income from a series of leases would be sold for a lump sum of cash. Even though this item could result in a $30 million cash payment to the County in 2011, GAAP does not allow the whole of the purported $30 million to be treated as operating revenues in the year the cash is received. Rather, as confirmed by Grant Thornton, GAAP requires the County to amortize the lump sum payment over the term of the lease, with an amount of approximately $3 million of the cash payment qualifying as operating revenue for

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[14] As the NIFA Chairman explained in his public comments at NIFA's meeting on September 28, 2010, the County's practice of borrowing to pay its Tax Certs obligation is the functional equivalent of imposing a tax increase on our children, plus interest. When a Director asked the County Executive whether he agreed with the Chairman's analogy, the County Executive responded by asserting that his plan will allow the County to end Tax Certs borrowing – *in 2013.*

2011. Again, GAAP's function in the context of the NIFA Act is not artificial but rather gets to the heart of the economics of the transaction. The Act seeks to impose on the County the fiscal discipline of balancing recurring revenues against recurring expenses. The Mitchel Field transaction, by contrast, is a classic one-shot, structured deliberately to sacrifice a natural income stream in order to achieve an accelerated, one-time cash jolt. The fact that GAAP calls for a limited operating funds credit to the County for such a transaction cannot be overlooked in applying the words and intent of the NIFA Act.

C. Achievability

NIFA carefully evaluated each risk and each of the County's proposed deficit offset items, studying the County's narrative explanations and supporting data with assistance from Grant Thornton, whose staff engaged in dialogue with the County's Deputy Executive for Finance and other County personnel responsible for the projects. Assessments of these items are necessarily fact specific, and in some cases the assessments turn on professional judgments and experience with municipal finances. Descriptions of NIFA's assessments of two key example items follows.

1. Labor Savings

The County's labor unions enjoy collective bargaining agreements running through 2015, and agreements covering many County employees prohibit

layoffs.[15] Nevertheless, the County Executive proposed $61 million in labor concessions as his signature expenditure savings measure for the 2011 budget. There is no discernible evidence that one dollar of savings will be achieved. Indeed, the union leaders have publicly stated, in no uncertain terms, that no concessions will be given in 2011 – against which the County Executive's repeated assertion of success in "bringing the unions to the table" rings hollow. In response to NIFA's request for some objective evidence of progress, the County's letter of January 7, 2011 could not identify even a single data point to buttress its conclusion that "[t]he County Executive is optimistic that an agreement can be reached." In this letter, the County specifically declined to provide, as requested by NIFA, a schedule of target goals for each union or a timetable for their achievement.

The notion of enacting new County legislation authorizing unilateral cuts by the County Executive (notwithstanding negotiated collective bargaining agreements) remains just that – a notion. The proposed legislation has not been adopted, and its legal validity is questionable. On January 13, 2011, the County Executive and the Majority Leader held a joint press conference to announce that

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15 The ability to order layoffs is an important tool for exacting labor concessions. As NIFA described in its April 17, 2002 Report (at p. 20): "To the extent that the County cannot achieve $65 million in savings through collective bargaining, layoffs will be implemented to achieve a commensurate fiscal impact."

hearings on the legislation would be scheduled by the County Legislature. Yet no dates for hearings were set, and no vote on the proposed law was scheduled.

2. Tax Certs Borrowing

The lack of budgetary relief from applying GAAP to Tax Certs borrowing is described above. In addition, NIFA cannot credit the County Executive's assertion that he has the necessary agreement with County Legislators to achieve such borrowing. Issuing the bonds requires the vote of a supermajority of the County Legislature, and this cannot be achieved without the support of the Democratic minority led by Legislator Diane Yatauro. In his December 28, 2010 letter to NIFA, the County Executive asserted that the necessary agreement was in hand. But when he convened a conference call with the Minority Leader and the NIFA Chairman on January 21, 2011 in order to underscore the existence of this agreement, the Minority Leader made plain that no agreement for new Tax Certs borrowing currently exists.

Indeed, when the County Executive pressed her to tell the NIFA Chairman that her caucus would support Tax Certs borrowing if necessary to avert a one percent deficit and a control period, the Minority Leader pointedly refused. She stated that she understood what the County Executive wanted her to say, but she would not say it and would not issue a blank check to the County Executive. She followed up her remarks on the call with a confirmatory letter to the NIFA

Chairman. In assessing the anticipated cash deficit described above, NIFA wished to be conservative and therefore credited the County on a cash basis with the ability to bond its entire Tax Certs liability in 2011, notwithstanding the lack of any agreement for that course of action by the necessary elected officials.[16] Even so, NIFA's overall assessment of the probability of the County achieving its budget plan must take into account instances where a key assumption of the County Executive proved unfounded.

Exhibit 2 identifies the offsets as to which NIFA, in the exercise of its best judgment, after consultation with its accountants, finds a low probability of success. For example, the County could not provide a detailed plan or supporting data for its departmental consolidation/elimination initiative. Given the substantial headcount reductions in 2009 and 2010, it would be difficult to rely upon consolidations, in the absence of program cuts, to reduce headcount further. Likewise, given OTPS restrictions in 2009, it is unlikely that the County will be able to effect substantial expense reductions in the absence of program cuts. Other examples with a low probability of success include expansion of the red light camera initiative (which, among other challenges, requires State legislation that has not been passed), the Long Island Expressway patrol charge (which also

[16] As noted above, by law NIFA must exclude the bond proceeds from its calculation of a statutory deficit pursuant to applicable GAAP rules.

requires State legislation not yet passed) and police overtime reductions (which are suspect amid police headcount reductions).

III. Conclusion

The steps statutorily required during a control period do not revise the County's financial plan overnight. Nor does NIFA assume control of the day-to-day operations of the County government. Rather, NIFA must exercise defined statutory powers to impose a degree of control with the goal of restoring balance. Because exercise of those statutory procedures involves preparation of a revised financial plan by the County, as well as review and, if necessary, modification by NIFA, the process of finalizing a plan will take a period of a month or more, to be followed by weeks if not months of implementation to execute the plan. One month of 2011 is already gone, so time is of the essence. NIFA acts today with the hope and prospect that representatives of County government will work collaboratively and in good faith with NIFA to achieve a resolution the County's financial difficulties, and that such resolution will allow the County to meet its financial obligations while providing effective services for County residents.

Dated: January 26, 2011

By the Directors

EXHIBIT 1

Nassau County Interim Finance Authority
Risk Assessment of Nassau County 2011 Budget
as of January 25, 2011

($ in millions)	Nassau County Comptroller[1]	Nassau County Interim Finance Authority [2]	Office of Legislative Budget Review [3]	Current Risk [4]
Revenues				
Red Light Camera Program/Expansion	$37.3	$17.3	$29.6	$17.0
L.I.E. Ticket Surcharge	5.0	5.0	5.0	5.0
Ambulance Fees	9.9	-	-	4.0
County Clerk Fees	7.9	8.3	-	4.0
Parks Revenue	4.3	2.3	1.0	1.0
Housing Suffolk County Inmates	3.6	3.4	3.4	1.5
New Fees Requiring Legislative Approval	-	-	18.3	-
Traffic Parking Violations Agency Fines	9.0	7.3	11.0	-
Other Fines & Forfeitures	0.6	-	-	-
Long Island Bus Subsidy	-	26.0	-	-
Other Departmental Revenue	0.3	-	-	-
FIT Tuition Reimbursement	6.8	-	-	6.0
Investment Income	4.7	-	-	4.0
Sales Tax	2.3	-	-	-
Boot and Tow Initiative	-	1.0	-	-
OTB Profits	1.5	-	1.5	1.5
Total Revenue Risk	93.2	70.6	69.8	44.0
Expenses				
Salary Adjustment/Labor Concessions	61.2	61.0	61.1	61.0
Outsourcing Medical Care for Inmates	5.0	4.8	4.8	4.5
NIFA Restructuring Savings	-	8.0	8.0	8.0
Police Overtime	-	-	2.0	2.0
Other	(1.3)	-	-	-
Total Expense Risk	64.9	73.8	75.9	75.5
Assessed Risk before Bonding Items	158.1	144.4	145.7	119.5
Assumed Range				110.0 to 125.0
Bonding Items[2]				
Bonding of Property Tax Refunds	100.0	100.0	100.0	100.0
Total Assessed at Risk	**$258.1**	**$244.4**	**$245.7**	**$219.5**
Assumed Range				$210.0 to $225.0

Notes:

[1] Based on Budget Review Report dated as of October 6, 2010.

[2] Based on Budget Review Report dated as of September 28, 2010.

[3] Based on Budget Review Report dated as of October 14, 2010.

[4] Current Risk assessment includes only items deemed "at risk" as of the dates of the Budget Review Reports and does not attempt to identify new risks which may have materialized during the period October 2010 to date.

[5] Excludes recent MTA $20 judgment, which the County has indicated they plan to appeal, and all other pending judgments.

EXHIBIT 2

Nassau County Interim Finance Authority
Alleged Deficit Offset Items per Nassau County Executive
as of January 25, 2011

	($ in millions)	Alleged Deficit Offset Items	Revenue/Expense complies w/GAAP: No	Revenue/Expense complies w/GAAP: Yes	Success Factor: High Probability	Success Factor: Low Probability
	Expenses					
To Offset Labor Concessions	Approved 2011 Budget Contingencies					
	Mitchel Field Lease Securitization	$30.0	$27.0	$3.0	$30.0	
	Land Sales[1]	25.0		25.0	25.0	
	Department Reductions	5.3		5.3	0.5	4.8
Per Nassau County Executive	December 2010 County Executive Actions[2]	23.0		23.0	15.0	8.0
	Additional Hiring Freeze	10.0		10.0		10.0
	MTA Subsidy Elimination	9.6		9.6		9.6
	Departmental Consolidation/Elimination	15.0		15.0		15.0
	Additional Real Estate Sales[3]	-		-		-
	Police Overtime Reduction	10.0		10.0		10.0
	Reduce OTPS	10.0		10.0		10.0
	Sales Tax to Villages Elimination	1.3		1.3		1.3
		139.2	27.0	112.2	70.5	68.7
	Use of Cumulative Fund Balance	65.0	65.0			65.0
	Tax Certiorari Loans	100.0	100.0			100.0
		$304.2	$192.0	$112.2	$70.5	$233.7

Budget Risk and Deficit Offsets

Assessed Risk before Bonding Items	($119.5)
"High Probability" Offsets (all cash)	70.5
Cash Deficit	($49.0)
Assessed Risk before Bonding Items	($119.5)
"High Probability" Offsets (GAAP only)	43.5 [4, 5]
	(76.0)
Bonding of Property Tax Refunds	(100.0)
STATUTORY DEFICIT [6]	($176.0)

Notes:

[1] Land Sales are considered a GAAP revenue item only to the extent sales price exceeds historical cost.

[2] An additional $23 million in budget cuts were ordered in December 2010. The $23 million is comprised of $15 million in savings from implementing non-essential employee hiring freeze and $8 million in savings from OTPS. Detailed support for the OTPS cost reductions lacks specificty and appears insufficient as of January 20, 2011.

[3] The $10 million Additional Real Estate Sales contingency relates to 6 of the 8 parcels previously included in the $25 million Land Sales contingency.

[4] GAAP" means "Generally Accepted Accounting Principles".

[5] Total comprised of $25 million Land Sales, $15 million December 2010 County Exectuive Actions, $0.5 Department Reductions and $3 million Mitchel Field Lease Securitization.

[6] Does not include $10 million of "contingency" from original budget.