Plan Objectives for Fiscal Restoration of Modoc County

Dated October 25, 2011

Background:

This plan is intended as an update to the "Assessment and Strategic Plan Relative to County of Modoc Financial Condition" as outlined in a letter to the State Controller's office dated April 13, 2010. The current plan to address the treasury deficit was submitted to the State Controller's Office in a letter, dated April 13, 2010. The letter was reviewed and approved by the Board of Supervisors on April 13, 2010. The letter states that the County is "pursuing a plan to issue Certificates of Participation … If the County is unable to sell the full amount of Certificates of Participation we will notify your office. Other possible options will be considered such as a partial re-funding of the treasury by a lesser amount of bond proceeds. We would consider other pay-down plans that your office, other state and federal agencies, and other County treasury participants could form an agreement on terms, conditions, and amounts. Also, we would consider the potential of drafting special legislation to allow Modoc County Treasury cash deficits until repayment of cash deficits is accomplished."

Approximately 19 months have transpired since this letter was approved and sent to the Controller's office. To date the County still is in the process of approval of its audits, and a financing through securitization of county assets has not occurred to address the treasury deficit. The county has worked towards meeting this goal, and in the process it has been found that a full financing with its associated levels of debt service is not sustainable. There have been additional pressures placed upon the county due to the economy such as declines in tax revenue, increases in interest costs, challenges of the reduced staffing levels, and costs associated with meeting audit requirements. The county continues to have a hospital fund in which there is projected approximate $13,500,000 negative balance. A hospital district was voted in by the voters, and the terms of that vote leave the county with this negative balance. The hospital facilities were transferred to the district.

It is often stated that the simplest solution to a complex problem is a complex solution. The following is a list of objectives in order to continue further progress on the goal to restore the Modoc County Treasury. This list lays out a complex multifaceted approach to restoration of the treasury. In order to meet the objectives outlined below the county is reliant upon both revenue enhancements and cost reductions in an environment that challenges the county with many revenue declines and cost increases. This multifaceted approach to restore the treasury relies heavily on a partial financing preceded by the sale of fixed assets. To assist in reducing the par value of the financing, it will necessitate not only the sale of fixed assets, but diligent pursuit of the supporting objectives following these two primary goals.

Sale of Fixed Assets:

The FY11/12 Modoc County adopted budget was approved on September 30, 2011. This budget includes an estimated sale of fixed assets in the amount of $3,448,083. It is necessary to move forward with such alternatives such as sale of fixed assets because the county cannot support debt service of a full restoration of treasury through Certificates of Participation. A budgeted sale of fixed assets is anticipated to reduce the total par value of the Certificates of Participation to a level of annual debt service that the County general fund can support. In addition to assisting in the reduction of the PAR amount of the bond proceeds, the sale of fixed assets will serve as an essential measure to ensure a back-up plan to finance cash flow needs. The county has identified essential cash flow needs that require attention prior to moving into the FY 12/13 budget year in order to meet deadlines correlated with restricted funds. Provided the high estimates and uncertainty of a partial financing through Certificates of Participation and combined with the unapproved status of county audits, the county must ensure alternative measures are in place to support cash flow needs of FY12/13.

The concept of selling buildings in such short order by the end of the fiscal year is an aggressive schedule; however, there is a ready market for facilities with secure government leases given the current adverse climate for commercial real estate. The budget incorporates professional and specialized budget capacity in order to conduct necessary work such as appraisals, pest reports, toxic reports, and legal assistance for negotiation of capital leases. The current revenue estimates in the budget were arrived by utilizing 70% of replacement value until such appraisals can be conducted. The facilities include buildings that are currently not on the list, or at the end of the list that has been indicated for utilization in the draft Private Placement Memorandum.

Securitization of County Assets:

The original plan called for a full securitization. In the previous year the budgeted set aside for debt service was $1,500,000. The county was not able to set aside the full $1,500,000 in FY 10/11. The figure was slightly in excess of $900,000. Further the county had to finance outlays for audit costs in the previous fiscal year. After a rigorous budget process for FY11/12, it again appears that the county can support a debt service level in the order of $800,000 to just under a million.

In order to meet this objective to securitize assets, the County has retained an underwriter and bond counsel. The County has a draft Preliminary Private Placement Memorandum Dated May 10, 2011. This document outlines terms for securitization of county assets. The county also has been provided an "Estimated Debt Service Chart for Modoc County (1)". The original proposed par amount of the bond proceeds was $15,000,000 in order to finance underwriting and issuance costs, a debt service reserve fund, and available proceeds in order to restore the treasury. Review of this chart indicates that financing is not available for the $15,000,000 par amount if interest rates exceed 7%. Current quoted rates to the county exceed 7% total interest charge. Additionally, previous fiscal years set aside and this year's budget indicate the county general fund can support debt service below $1,000,000, and practically in the $800,000-$950,000range. If the par amount of the bonds can be reduced to a level where such annual debt service levels is attainable, then a financing may be possible.

The current FY11/12 adopted budget shows proceeds from a partial financing for the treasury based on this chart. In order to reduce the PAR amount of the bonds, the financing assumes that the county saves the debt service reserve fund amount in FY11/12 rather than incorporating this into the PAR amount of the bonds. Similarly, the financing assumes a sale of fixed assets as described above. Since the PAR value of the bonds is reduced by these two measures in the budget, there is a commensurate reduction in the required Debt Service Reserve Fund amount. The estimated amount would be $1,050,000 rather than the previous $1,500,000. This amount is indicated within the FY11/12 budget as a designation under non-general fund expenditures.

In order to fund this designation for debt service reserve fund, the county will have to utilize approximately $800,000 net increase in general fund balance available and deficit spend some of the existing general fund balance which was saved in FY10/11.

The budget assumes a financing in the late spring near the end of the fiscal year. Currently the county is in a dry period. Secondly, if a financing were to occur prior to saving the debt service reserve fund designation, the PAR value of the bonds would require inclusion of the set aside amount to ensure sufficient Fund Balance Available in the treasury for financing needs. This would lead to annual debt service beyond what the county can afford. Similarly, a financing early in the fiscal year would require inclusion within the budget of the first installment of semi-annual interest which would lead to an imbalanced budget.

Finally, the county will continue to evaluate and pursue options that will reduce the cost of securitizing county assets. Options being evaluated beyond the draft preliminary private placement memorandum terms include use of a bond ladder, utilization of a syndicate or individual banks as underwriters for a portion or all of the amount, use of a mixed offering such as incorporating both a taxable and non-taxable transaction, and utilization of a large co-signer in order to reduce interest costs so the county can support the debt service. Also as the county moves closer to a securitization, closure of outstanding audits and continued improvement by the county staff to meet audit findings will continue to be relevant for engaging in such a transaction.

Mitigation of threats to Cash Flow:

A) Compensated Absences Liability:

The county has identified the increase in compensated absence liability as threat to the treasury that must be mitigated. During the early phases of the fiscal crisis, the county had to engage in layoffs of many employees. It had to put restrictions in place on overtime and other near term cash expenditures, but in order to meet work load and mandates with limited staff there was an increase in comp time.

Comp time is a threat to the treasury in the event that a state or federal program is eliminated and any unfunded liability has to be paid out to workers in lump sum. Similarly, a department has been identified that may have a demographic wave of retirees that could lead to an impact on cash flow.

In order to mitigate this, the county has incorporated designations in order to fund comp absence liability where appropriate and possible within FY11/12 adopted budget. Furloughs have also been implemented by the adopted budget in multiple general fund departments, which are also intended to assist in reducing comp time liability in some general fund departments with larger outstanding comp time balances. Finally, the county intends to evaluate by use of a consultant the concept of utilizing a compensated absences liability fund which could be managed on an actuarial basis.

B) Mello Roos Library Deficits:

The Modoc County library has been impacted by a severe reduction in Mello-Roos assessment revenue due to non-payment by property owners of taxes. After the new hospital district formation, there has been a severe impact on secured property tax revenue, many absentee property owners are simply defaulting on their property tax bills. The county could not afford to front tax revenue so the board has authorized a resolution where the county no longer teeters. This reduction in assessment revenue has adversely impacted the library. Second, the library has been running chronic deficits for many years, utilizing the fund balance available that had accumulated from a fixed assessment from 1987. Historically the library relied on interest from the fund balance available, but declining interest rates and deficit spending has decimated such revenue. These three factors have led to a major revenue shortfall that must be addressed in FY11/12.

The library projected cash balance is only $2800 at the end of the year. If costs and services are not drastically reduced or a revenue measure placed in front of the voters, then partial shutdown costs that would remain unfunded could adversely impact the county general fund in FY12/13 and beyond. Therefore a committee has been appointed by the Board of Supervisors in September 2011, and immediate action plan is being worked on.

C) Waste Management Enterprise Fund Deficits:

The Waste Management enterprise fund has been impacted by a severe reduction in special assessment tax revenue. After the new hospital district formation, there has been a severe impact on secured property tax revenue, many absentee property owners are simply defaulting on their property tax bills. The county could not afford to front tax revenue so the board has authorized a resolution where the county no longer teeters. This reduction in assessment revenue has adversely impacted the waste management enterprise fund. The enterprise fund has also seen an increase in costs, and reductions in other forms of revenue. The board has raised gate fees, and this has not filled the shortfalls. Under the current FY11/12 adopted budget, the waste management fund is projected to run out of money in early spring of 2012. The county board made a difficult decision to not assist waste management fund with an infusion of funds from the general fund with no provision for repayment from the enterprise fund. The waste management fund also received severe cuts in certain expenditures, and still has a large deficit spending situation on a relative basis.

Services are mandated, and any corrective action through tipping fees, gate fees, or other revenues will take time to collect. This poses a threat to cash flow of the general fund if and when the enterprise fund utilizes all of its fund balance available.

To address this issue a committee has been appointed by the Board of Supervisors in September 2011 and an immediate action plan is being worked on to resolve the issue.

D) Reduced Secured Tax from Property Taxpayer Non-Payment:

After the new hospital district formation, there has been a severe impact on secured property tax revenue, many absentee property owners are simply defaulting on their property tax bills. The county could not afford to front tax revenue so the board has authorized a resolution where the county no longer teeters. This has lead to a reduction in interest and penalty revenue to the benefit of the general fund. Also, treasury participants such as the two entities listed above and special districts are having to draw down fund balances to make up for revenue shortfalls since they are no longer teetered. The reduction in secured tax revenue has adversely impacted the county general fund, and also late payments affect cash flow.

Given the financial situation, the reduction in property tax revenue could pose a serious threat to the viability of the county. This may not only compromise the ability to meet debt service, but the ability to fund essential services, and the viability of other treasury participants such as select special districts. Clearly, additional taxes have led in some respects to diminishing returns to many treasury participants. However, securing additional tax revenue to support historic tax revenue levels may be necessary. The county general fund is at a minimal staffing level that compromises the ability to meet state and federal mandates. Core general fund revenue from secured role, vlf, and sales taxes is near $5,000,000. Supporting a debt service and meeting such mandates will be difficult at best when declining tax revenue is taken into consideration. Although extremely unpopular, it is recommended that the county evaluate pursuing either special tax or general tax initiatives via sales tax or other methods in order to supplant the declines in the secured roll and delinquency in property tax payments. Preliminary discussions have taken place, and more are expected to occur prior to ballot initiative filing.

E) Increase in Crime:

Crime has increased in Modoc County. A few years ago the County faced its first murder trial in many years. Now the county is facing multiple alleged murder cases coming in the pipeline. The county has seen a huge cost in processing crime cases, and indigent defense costs have risen dramatically. This poses a threat to cash flow. The county recently engaged in a contract for a fixed level of public defender services at a reduced cost compared to prior years. The county is evaluating improving measures to maximize recourse with defendants who have court orders to utilize county resources for defense. The situation is being monitored closely, and the county foresees that it may become necessary for the county to pursue special legislation in order to properly fund costs related to this rise in crime.

Performance Bond:

A fidelity bond claim has been filed by the county of Modoc. There was a period of little progress related to the claim, but the Board earlier this year chose to move forward with the filing. The claim was signed by the Chair of the Board of Supervisors on February 24, 2011. A loss has occurred, and processing of the claim continues to be ongoing. Lost interest, interest paid, and similar quantification of associated damages are yet to be documented and negotiated. This remedy is not incorporated into the budget, but it is anticipated that processing of the claim will play a role in restoration of the treasury.

Legal Remedy:

The county and its taxpayers have suffered a loss by having to pay to have re-audits conducted. These high costs had to be fronted by the county, and have played a significant role in reducing the ability of the county to move forward in restoration of the larger treasury issue. The county is in process of preparing to pursue legal remedy.

Negotiations for re-payment:

There is a possibility that the projected sale of fixed assets is not forthcoming at the full estimated levels and/or a partial financing is not feasible due to variables such as the larger investor market, interest rates, and the county's rating. The county is working to ensure that cash flow needs for mandated services and restricted fund expenditure deadlines are met. There are funds that are restricted, but constitute local money rather than state, federal, or other outside creditor funds which do not have expenditure timelines. It may become necessary to enter into negotiations for repayment with regulators and creditors as part of the solution. In this regard the county has placed on retainer specialized legal counsel to provide sound advice and a plan to move forward. As of October 25, 2011 a committee is in process of being appointed to work on this issue

Continued Monitoring of Cash Flow:

The county has a cash flow projection from April 2011 that was based on preliminary budget projections. During the budget process key large cash flow needs were identified to ensure the budget has a satisfactory plan in place to expenditure deadlines. The county administrative officer has identified that the county needs to generate cash of a minimum of $2.8 million through some form such as sale of fixed assets or partial financing by the beginning of FY 12/13. The county through assistance of the Treasurer's Office is now in process of developing a detailed cash flow analysis based on the adopted budget that has been put in place.

Engage in Long Term Revenue Enhancement and Cost Saving Measures:

A) Reduce Duplication of Services and Cross Staffing:

As revenue levels decline, a look back in history is a good indicator of how to generate cost savings to meet mandated service requirements. In past decades the County engaged in cross staffing between neighboring counties, city, and other agencies. Staffing levels were reduced dramatically in 2009, and many departments have few staff other than a department head or elected official. Many department heads already manage consolidated departments; however, the opportunity still exists to find efficiencies. The county will continue to pursue opportunities to cross staff or reduce duplication of services where applicable. Working towards this objective, the county has already cross staffed three general fund department heads between a neighboring city or county.

B) Evaluate Use and Participation in Cost Saving and Revenue Sharing JPA's:

The county cannot rely on population growth to supply its needs to support services and the estimated debt service levels in coming years. The census bureau statistics show little growth projection for Modoc. Therefore, in upcoming years the county will have to find additional measures to support budgetary needs. A key area that has been identified is participation and use of cost saving and revenue sharing JPA's. The county currently is involved with a number of non-profits to set a foundation for participation in future projects in order to sustain itself while meeting the needs of the public through its contribution.

Summary:

In summary it took many years for Modoc County to accrue the large negative fund balances in the hospital enterprise fund. The debt service required is substantially more than the county can afford in the best of times. The county is currently faced with a multitude of challenges that complicated any resolution to this process. Recognizing this, the county is implementing a multi-faceted solution simultaneously. This diversified approach will help mitigate the risks associated with delays or challenges in meeting any particular objective outlined above. Finally it is going to take the resolve of the board to educate all the stakeholders including financiers, underwriters, employees, taxpayers, insurance carriers, respective responsible parties, legal counsel, and state/federal regulators and creditor agencies that a collective and integrated solution involving all stakeholders is likely to be the only path forward.