

Fiscal Year 2007 Year-End Financial Review



Sharon R. Bock
Clerk & Comptroller
Palm Beach County

Good morning and thank you for your time. A few weeks ago each of you received a copy of the Palm Beach County Comprehensive Annual Financial Report or CAFR. Today, you also received our Popular Annual Financial Report, or PAFR, titled “Checks & Balances” as well as a copy of both Debt and Investment Guide prepared by the Clerk & Comptroller’s office for the fiscal year ended 2007.

Today, this presentation will focus on the CAFR. Just as the budget is a prospective view of county spending, the CAFR is the actual report of the past year’s spending. The CAFR is an audited financial statement of all county operations including the constitutional offices and county enterprises such as the airports and solid waste authority. The CAFR represents the clearest financial picture of our county from which we can draw conclusions about our fiscal health. The CAFR can also act as a guide during our current budget process.

Over the next 15 minutes, we will highlight important fiscal issues by focusing on four key areas for analysis and discussion.

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AREAS OF DISCUSSION

- **Net Asset Review** Carter Hammer, C.F.O.
- **Debt Review** Jim Beard, Treasury Director
- **Investment Review** Felicia Landerman, Investment Manager
- **Fund Balance Review** Richard Iavarone, Accounting Director
- **Recommendations** Sharon Bock, Clerk & Comptroller

They are:

- “Net Asset Review” by Carter Hammer
- “Debt Review” by Jim Beard
- “Investment Review” by Felicia Landerman
- “Fund Balance Review” by Richard Iavarone

We will conclude with a summary and recommendations and answer any questions you may have.

Based on the recommendation of the Government Accounting Standards Board and the Government Finance Officers Association, we chose these areas of discussion, because they are considered the primary indicators of the financial health of our County.

These key financial indicators could also be incorporated into budget and fiscal discussions this year.

We will begin our review with Net Assets, the most useful indicator of a government's financial health.

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NET ASSET REVIEW

	Excess Revenue Total Primary Government Activities			2006-2007
	2005	2006	2007	% Change
Total Revenue	\$1,928,690,000	\$2,200,014,000	\$2,244,595,000	2%
Total Expense	-\$1,657,497,000	-\$1,820,320,000	-\$1,967,089,000	8%
Excess Revenue Over Expense	\$271,193,000	\$379,694,000	\$277,506,000	-27%

“Net assets” represent the amount of assets owned by the County less outstanding obligations. It provides a snapshot of the county’s net worth or financial health.

Net assets grow when the County’s revenues are greater than expenses. For fiscal year ending 2007, the County’s revenues exceeded expenses by \$277 million dollars.

However, is important to note a concerning change: EXPENSES ARE NOW GROWING FASTER THAN REVENUES

As one can see on the far right of this chart, revenue growth was only 2% in 2007, while expenses grew at 8%. This represents a change from prior years, where revenue growth exceeded expense growth.

Revenue growth slowed to 2%, from 14% the prior year, due to economic factors which have decreased impact fees and grant revenues. Increases in ad valorem tax revenues and investment income helped to offset these reductions. However, these two categories of revenue are now under pressure as well.

Expenses grew at 8%, outpacing revenue growth by a factor of 4 to 1. Projects such as Scripps, increases in Sheriff & Fire Rescue operating expenses, and rising transportation costs contributed to this growth.

The net result of expense growth of 8% and revenue growth of only 2%, was a 27% decline in excess revenues from the prior year.

NET ASSET REVIEW

Change in Net Assets
Total Primary Government

THE BOTTOM LINE

	2005	2006	2007	% Change
Beginning Net Assets	\$2,941,896,000	\$3,213,089,000	\$3,560,569,000	
Add: Excess Revenues	\$271,193,000	\$379,694,000	\$277,506,000	-27%
Ending Net Assets	\$3,213,089,000	\$3,560,569,000	\$3,838,075,000	

So what's the bottom line? What impact does this have on our net asset health?

The 27% decrease in excess revenues forewarns a need to cut expenses to avoid further erosion of excess revenues and ultimately, a deteriorating net asset position.

Careful consideration should be given to long-term commitments which contribute to a higher level of ongoing fixed expenses. This may result in greater challenges to reduce expenses during periods of declining revenues.

Although the County has had positive increases in net assets, as one can see from the bottom of this chart, this growth has been in the form of long term capital projects.

NET ASSET REVIEW		
Change in Net Assets Total Primary Government		
Where We Started (Net Assets Fiscal Year-End 2006)		\$3,560,569,000
What We Did In 2007:		
Increased Capital Assets	\$429,000,000	
Decreased Debt	-\$66,000,000	
Decreased Investments/Cash	-\$93,000,000	
Other Minor Net Asset Changes	\$7,506,000	
Total Change in Net Assets		\$277,506,000
Where We Ended (Net Assets Fiscal Year-End 2007)		\$3,838,075,000

The \$277 million dollar growth in net assets was in the form of Capital Assets, representing long term commitments with future operating expenses.

We increased our capital assets by \$429 million dollars for projects like:

- Park Ridge Golf Course,
- Therapeutic Recreation Complex
- District Park 'F' in the Acreage
- Jim Brandon Equestrian Center
- Glades Pioneer Park Pool
- The Water Utilities completion of the Northern Region Pipeline
- Solid Waste Authority golf course construction on Lantana landfill
- And construction of the additional parking garage at the Airport

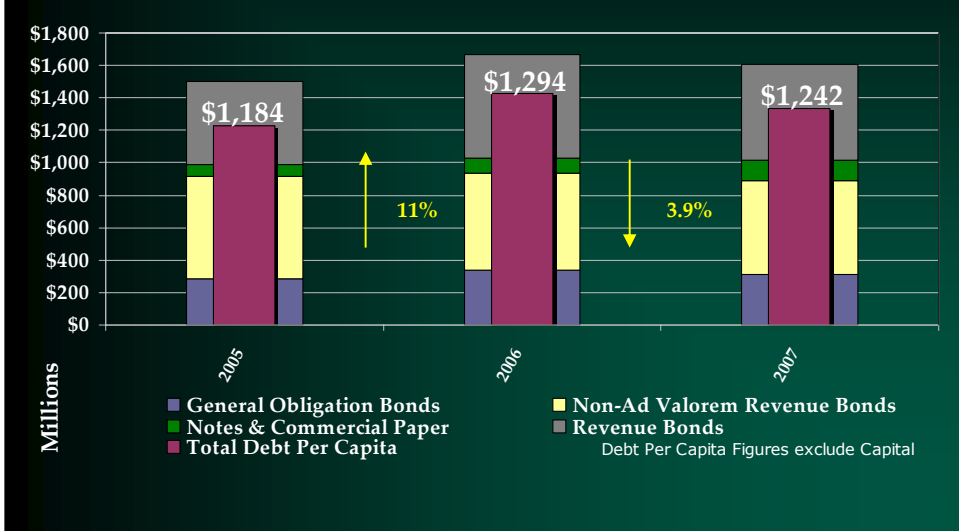
During 2007, we also decreased debt balances by a net \$66 million dollars

However, excess revenues of \$277 million dollars were insufficient to increase capital assets and decrease debt. The shortfall was covered by dipping into cash and investments by \$93 million dollars.

This represents a shift from liquid cash and investments into longer term capital assets. Continuing to reduce liquid assets, without replenishing them from excess revenues, may impact future investment earnings.

Although Net Assets increased to \$3.8 billion dollars, over 60% are in the form of capital assets financed by debt. The significant increase in capital assets with associated operating costs, during periods of declining revenues, may have future implications.

LONG-TERM DEBT OUTSTANDING



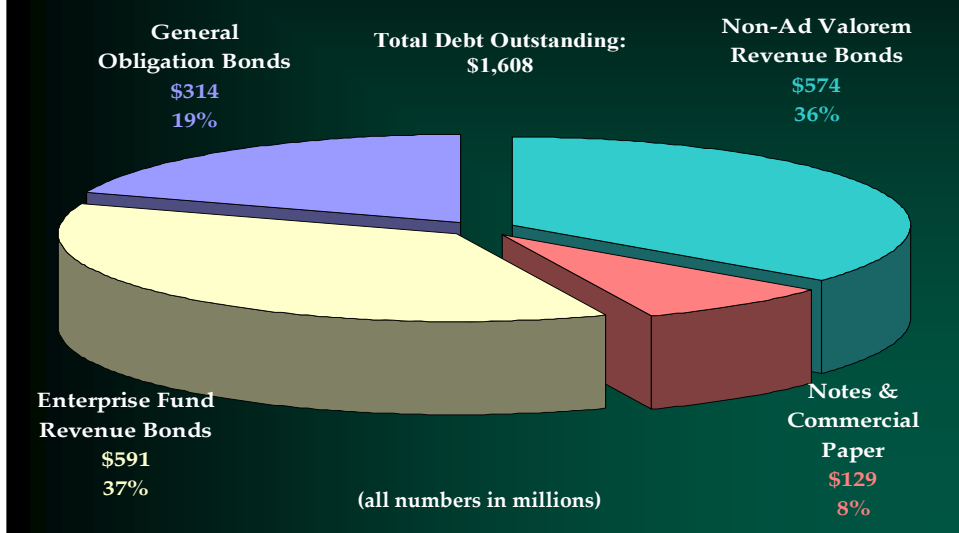
The County maintained its triple-A bond rating from all of the major rating agencies throughout the fiscal year.

As you can see in this graph, the total debt – which for the purposes of this presentation include bonded debt, notes, commercial paper and loans – had a net decrease of 3.9%, down to a total of \$1.6 billion. In addition, the total debt per capita decreased from \$1,294 in 2006 to \$1,242 per capita in 2007.

The County did limit borrowing during fiscal year 2007 with the bulk of the borrowing centered on refinancing or increasing short term debt.

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DEBT OUTSTANDING



As of September 30, 2007 the total outstanding bonded debt was 1.6 billion dollars, a net decrease of \$66 million dollars in total debt from last year.

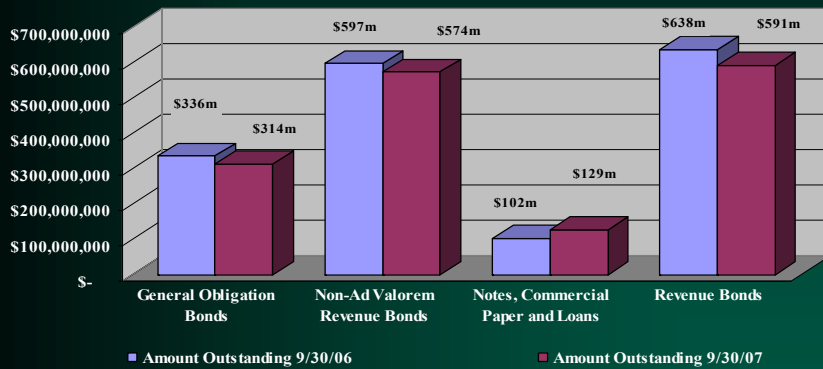
The composition of the debt is depicted in the chart and consists of:

- \$591 million dollars in Enterprise Fund Bonds representing debt for the Solid Waste Authority, Water Utilities Department as well as the Airport Department,
- \$574 million in Non-Ad Valorem Revenue Bonds
- \$314 million in General Obligation Bonds and
- \$129 million in notes, commercial paper and other short term instruments.

This slide also shows that the majority of the debt outstanding is Non-Ad Valorem Revenue Debt and Enterprise Fund Debt which shifts the bulk of the repayment burden to the users of the various facilities avoiding the need for voter approval required for General Obligation.

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DEBT OUTSTANDING



Major changes in the debt composition between fiscal year 2006 and fiscal year 2007 are depicted in this graph.

GO Bonds were reduced by \$22 million dollars through regularly scheduled principal payments. With no new GO bonds issued during the fiscal year.

Non-Ad Valorem Revenue Bonds were reduced by \$38 million through regularly scheduled principal payments. Part of this reduction was offset by the County issuance \$15 million in non-ad valorem debt for the expansion of the Judicial Center parking garage for a net decrease of \$23 million in non-ad valorem debt.

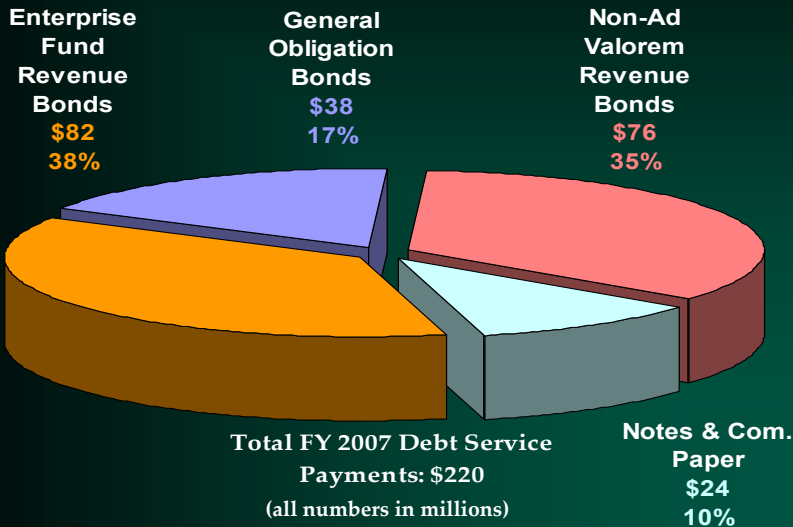
Enterprise Fund Bonds were reduced by \$47 million through regularly scheduled principal payments. No new enterprise bonds were issued during the fiscal year.

During the fiscal year the county reduced its total of notes, commercial paper and loans outstanding by \$38 million but this reduction was more than offset by the issuance of \$64 million in new debt in this category.

This includes four issues totaling approximately \$27 million with the Sunshine State Governmental Financing Commission, a \$24 million in financing related to Biomedical Research Park, a \$12 million Bond Anticipation Note for the Convention Center Hotel Project and related Infrastructure. and \$600,000 for computer equipment. These transactions led to a net increase of just under \$27 million in short term debt.

These short term issues will most likely need to be refunded with longer term debt at some point in the future, at which time the County will have to bear the additional cost of issuance for the longer term debt.

2007 ACTUAL DEBT SERVICE



The debt outstanding requires annual Debt Service Payments. Last years Debt Service Payments – or the principal and interest payments – totaled \$220 million dollars.

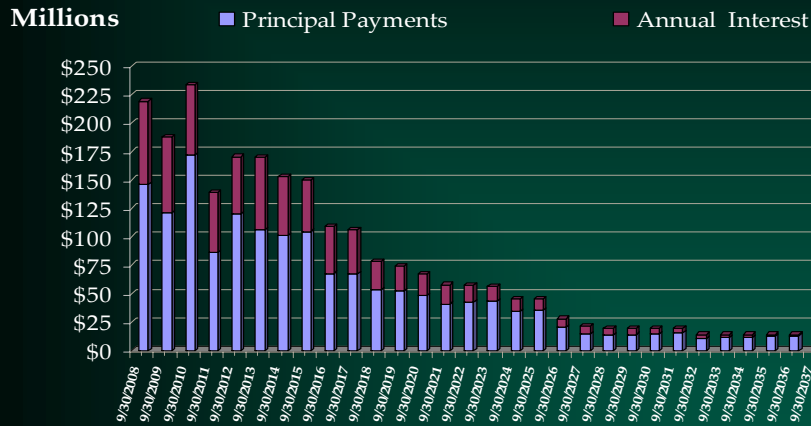
Based on the debt outstanding at the close of the fiscal year, it is projected that Debt Service Payments for FY 2008 will be \$219 million dollars. This is roughly equal to last years Debt Service Payments.

Much of the notes, commercial paper and loans of the County can be refinanced or rolled over during the fiscal year.

However, the non-callable structure of much of the other debt issues precludes the refunding or refinancing of that debt, despite the possibility of lower cost financing and the county's superior credit rating.

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OUTSTANDING DEBT SERVICE PAYMENTS



More importantly, this graph shows the projected Debt Service Payments due on County debt over the next 30 years.

It indicates that, due to the principal and interest payment structure of most of the debt, debt service payments are projected to peak in FY 2010 at \$233 million dollars.

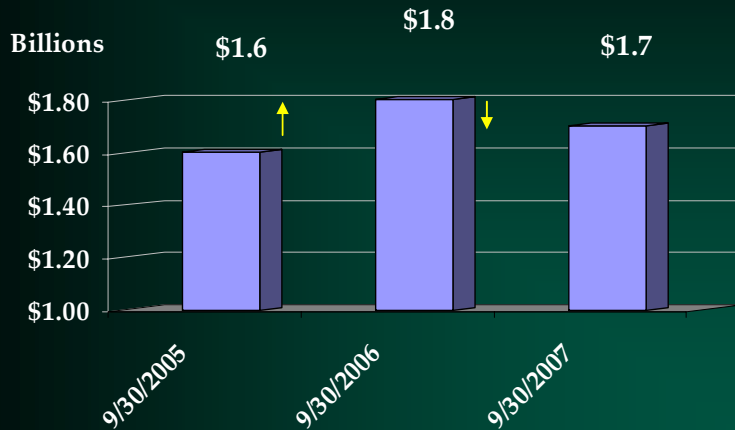
The reason for this is that the debt payments were structured in ways that require the bulk of the payments to be made fairly early in the loan....Approximately 70% or \$1.67 billion of the County's current outstanding debt principal and interest payments comes due in the next ten fiscal years.

For a more in-depth review of the County's' Debt Profile, Please refer to the Annual Debt Guide that you each received today.

I will now turn it over to Felicia Landerman for a review of county investments.

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INVESTMENT PORTFOLIO



So far, we have talked about the fiscal impact of County controlled functions. Now, we will talk about the Clerk & Comptroller's role as investor of county funds. During the year, all investment operations and portfolio holdings were in compliance with the County's comprehensive investment policy.

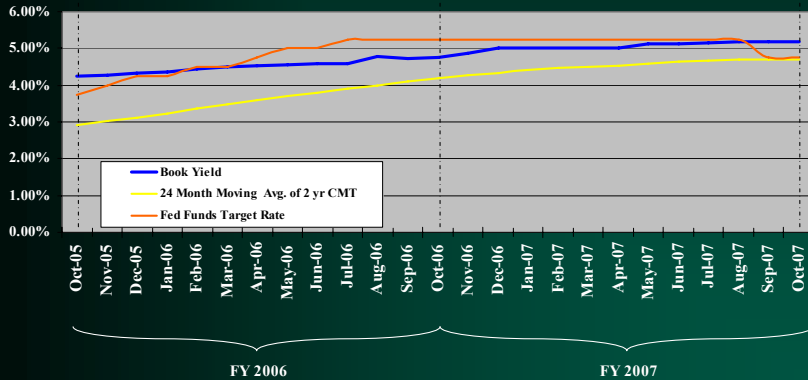
At fiscal year end, the portfolio balance totaled \$1.7 billion – a decrease from the prior year. This is the first time in over ten years that the year end portfolio balance decreased from the prior year. There were two significant factors contributing to this decrease. First, the portfolio funds were used for a large increase in capital assets. Second, with the downturn in the real estate market, there was a considerable decline in impact fee revenue. In past years, impact fee revenue has helped to increase portfolio size.

If the County continues to build its capital infrastructure at the pace indicated in the net asset review presented earlier, without a corresponding increase in revenues, the portfolio balance will likely continue to fall, with a resulting decline in investment income.

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INVESTMENT PERFORMANCE

24 Month Historical Yield Comparison
Fiscal Year End 9/30/2005 to 9/30/2007



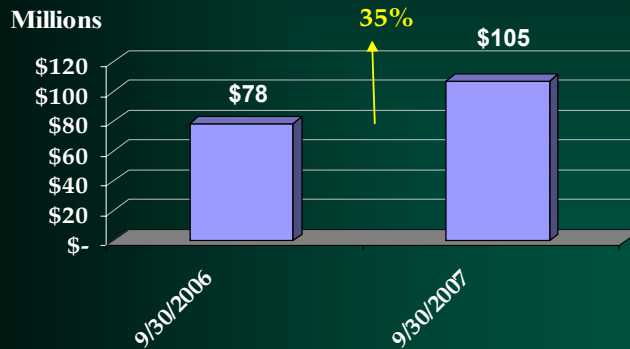
This next graph shows the county's yield on investments versus the county designated benchmark over the past two of fiscal years. The County's yield is indicated by the blue line and the benchmark is shown in yellow. The benchmark selected by the Board of County Commissioners is the 24-month moving average of the 2 year Constant Maturity Treasury note. At the end of the year, the portfolio yield was 5.17% which was higher than the benchmark which stood at 4.7%, a spread of 47 basis points.

The orange line represents the Fed funds rate, which greatly impacts the county's yield on investments. As you could see, the Fed Funds rate remained constant throughout the fiscal year. Then, the Federal Reserve began an aggressive easing cycle marking the beginning of a downward trend in short-term interest rates.

In anticipation of this occurring, during the fiscal year, we strategically extended the portfolio's duration as well as restructured the portfolio in order to preserve future income and maintain a positive spread to the benchmark.

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INVESTMENT INCOME



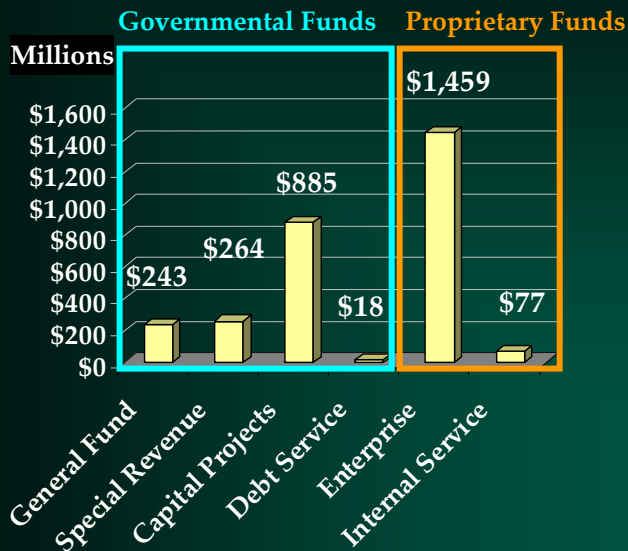
After meeting our primary objectives of safety of principal and liquidity of funds, we strive to earn a competitive market rate of return to benefit the citizens of Palm Beach County. Investment income on the portfolio increased from \$78 million in fiscal year 2006 to over \$105 million in fiscal year 2007 – a 35% increase.

For a more in depth review of County Investments, please refer to the Annual Investment Guide that you each received today.

I will now turn it over to Richard Iavarone for more on the county's financial picture.

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FUND BALANCE COMPARISON



Thank you Felicia...

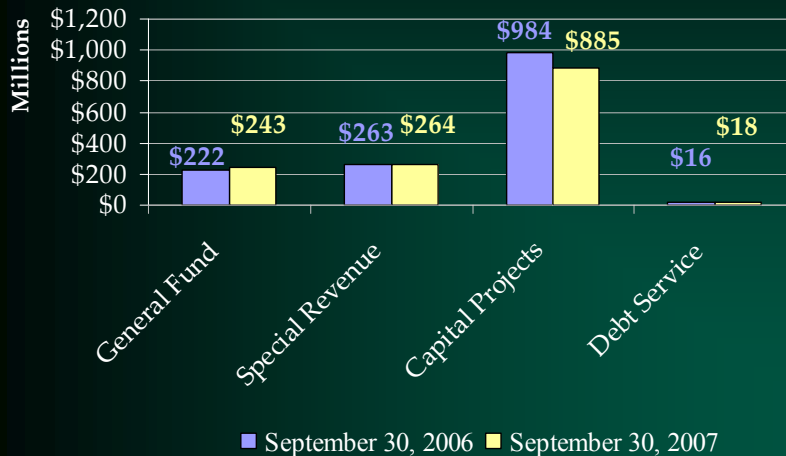
Governmental accounting rules require the County to use fund accounting for its revenues and expenditures. The two fund categories shown here are governmental and proprietary.

Governmental funds include the general fund, special revenue, capital projects and debt service funds. Proprietary funds include enterprise and internal service funds.

We are going to take a closer look at governmental funds which account for the bulk of property tax, sales tax, impact fees and other user fees, all of which are projected to decrease in the coming years.

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GOVERNMENTAL FUND BALANCES



First, let's define fund balance. For the most part, fund balance represents county funds that were not spent by the end of the fiscal year.

As of September 30, 2007 governmental funds reported ending with combined fund balances of \$1.4 billion, a decrease of approximately 5% or \$73.9 million from fiscal year 2006.

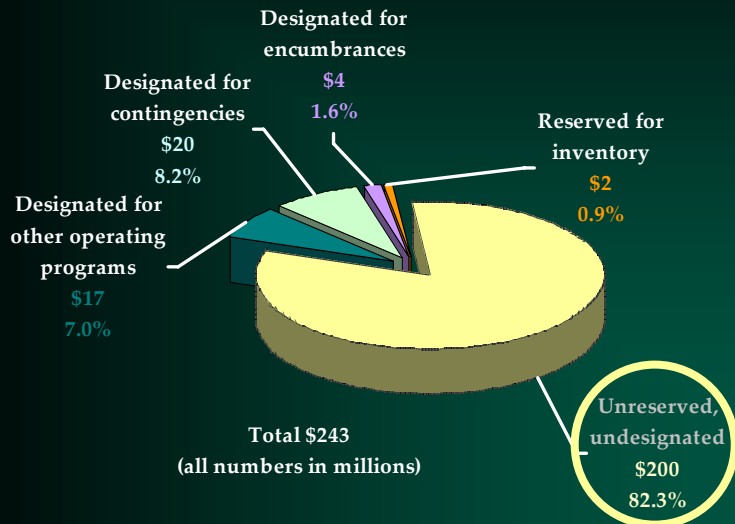
The decrease in fund balance resulted from a decrease in the Capital Project funds by \$99 million due to project activity in the General Government, Parks and Recreation, Environmental Lands and Road Program Capital Project Funds. Some of this activity will result in recurring costs that will impact future budgets.

As we have seen, legislative changes and economic conditions like the down turn in the housing market have already adversely affected revenues. This slowing in revenue will affect fund balance in the future.

Now, let's look at the general fund and a proposed accounting change.

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GENERAL FUND FUND BALANCE



This is a snapshot of fund balance of the General Fund at the end of Fiscal Year 2007 as reported in the CAFR.

There has been a lot of discussion about how fund balance is reported in the financial statements. This discussion is not limited to Palm Beach County.

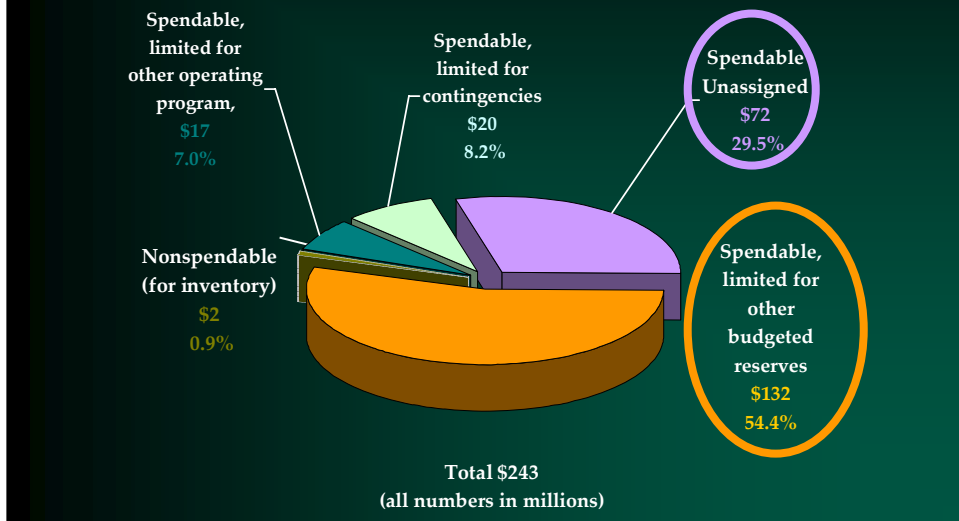
The Governmental Accounting Standards Board "GASB" recognizes that fund balance is one of the most universally used pieces of governmental financial information and that the existing accounting rules are unclear and nearly 30 years old.

As a result, GASB has issued proposed rule changes on fund balance reporting.

What does this mean to us?

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FUND BALANCE NEW EXPOSURE DRAFT



This is our projection of how the general fund might look after implementation of the new GASB rule. It is based on certain assumptions including formal reserve and fund balance policies and procedures which determine what classifications can be used. Upon implementation of the new rules, these policies and procedures will need to be disclosed in the notes to the CAFR.

GASB's intent is to enhance the usefulness of fund balance information by providing clearer fund balance classifications. To improve clarity and consistency, the new rules standardize the categories and the criteria used for classifications within each category. You'll notice the terminology has changed significantly and in a way which should provide a better understanding of the intended use.

In order to comply with GASB's new rules, a formal reserve policy that includes fund balance policies and procedures needs to be finalized and approved. We are ready to work with County staff to accomplish this goal.

Now I would like to turn this back to Clerk & Comptroller Sharon Bock for a recap

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RECOMMENDATIONS

- Capital infrastructure spending should slow at a rate consistent with revenue so as not to negatively impact Net Assets.
- A review of the current Debt Policy and development of a more comprehensive Debt Policy, which includes debt issuance provisions, should be established to ensure accountability and transparency and to take maximum advantage of the County's 'AAA' rating.
- Formal Reserve & Fund Balance Policy should be created and adopted to ensure accountability and transparency and to account for new Governmental Accounting Standards Board rules.

To summarize, we have three recommendations which, if followed, would form the basis of policy decision prioritization.

First, it's clear that expenses are growing at a faster rate than revenues can cover.

Even if we cut operating expenses without significant review and reduction of capital project expenditures, we will continue our need to infuse our current budget with liquid assets from our reserves and investment portfolio. In essence, the cost of our infrastructure increases as our long-term ability to support that infrastructure decreases.

We recommend:

Capital infrastructure spending should slow at a rate consistent with revenue so as not to negatively impact Net Assets.

A review of the current Debt Policy and development of a more comprehensive Debt Policy, which includes debt issuance provisions, should be established to ensure accountability and transparency and to take maximum advantage of the County's 'AAA' rating.

Formal Reserve & Fund Balance Policy should be created and adopted to ensure accountability and transparency and to account for new Governmental Accounting Standards Board rules.

Secondly, a review of our debt structure clearly shows that 27% of the county's total debt outstanding is due over the next 3 years, and 70% to our total debt outstanding is due over the next 10 years.

This front-end loading of our debt payments comes at a time when our revenue sources, especially for G.O. and Non-Ad Valorem Bonds, are decreasing.

Lastly, because of the reduction in our revenue sources, whether market driven or politically driven, we will need to look to our reserves and fund balances to fund the counties needs as we transition over the next few years.

Even though we currently have high fund balances and reserves, this depleting resource will need to be carefully managed to ensure its use for policy priorities and the sustainability of vital county services.

Also, as you have heard from Richard, this area of government accounting has always been difficult to explain. The "Government Accounting Standards Board" is proposing changes to the fund description. But more importantly, the new rules include standardizing the criteria used within each classification.

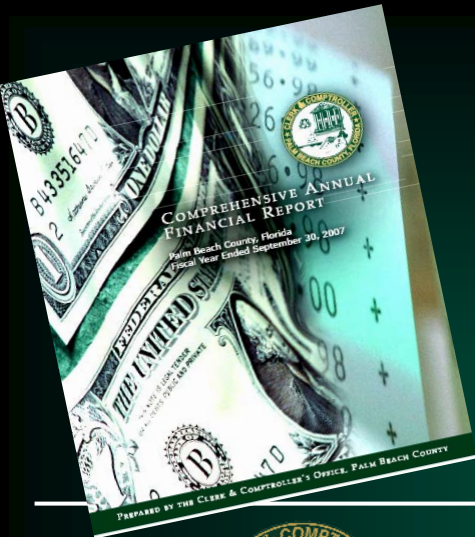
We recommend the immediate creation and adoption of a reserve and fund balance policy to ensure not only complete and accurate reporting, but policy standards for its use.

Unlike many endeavors that have a win/lose outcome, government is not judged on its performance. It's judged by its objective processes, explainable to the public.


As your Chief Financial Officer, our professional staff is ready to work with you to help develop the processes needed at this time.

Thank you.

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Questions?



Sharon R. Bock
Clerk & Comptroller
Palm Beach County

At this time, my Finance Team and I are available to answer any questions you may have.