BOARD OF SUPERVISORS AGENDA LETTER

Clerk of the Board of Supervisors
105 E. Anapamu Street, Suite 407
Santa Barbara, CA 93101
(805) 568-2240

Agenda Number:

Submitted on: (COB Stamp)

Department Name:	County Executive Office
Department No.:	012
For Agenda Of:	December 12, 2023
Placement:	Departmental
Estimated Time:	1 hour
Continued Item:	No
If Yes, date from:	
Vote Required:	Majority

TO:	Board of Supervisors	
FROM:	Department Director(s)	Mona Miyasato, County Executive Officer
	Contact Info:	Nancy Anderson, Chief Assistant County Executive Officer
		Paul Clementi, Budget Director
SUBJECT:	Fiscal Year 2024-25 Budget Development Report and Proposed Policies	

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County Counsel Concurrence
As to form: N/A

Auditor-Controller Concurrence
As to form: N/A

Other Concurrence:
As to form: N/A

Recommended Actions:

That the Board of Supervisors:

a) Receive and file the Fiscal Year 2024-25 Budget Development Report that includes a five-year forecast of major budgetary components for the General Fund and other major funds;

b) Adopt the Fiscal Year 2024-25 Budget Development Policies;

c) Review funding priorities for Fiscal Year 2024-25 and provide staff additional direction as appropriate; and

d) Determine pursuant to California Environmental Quality Act Guidelines §15378 that the above activity is not a project under the California Environmental Quality Act.

Summary:

This item is before the Board to receive a report on the five-year forecast of major budgetary components for the General Fund and other major funds, adopt the recommended budget development policies, and provide staff with direction on Board priorities to guide budget development for the upcoming fiscal year. Most significantly, the County appears to be in a fiscally stable budget position next year but expenditures at existing levels are exceeding expected revenues, causing deficits over the next five years. Fortunately, due to fiscal planning that anticipated these shortfalls, the deficits can be fully mitigated but only in the first and second years. The forecast assumes no new ongoing programs, staffing or costs beyond modest growth levels.

In summary, the General Fund five-year forecast reflects the following:

- Moderate, consistent growth in revenue, but not to the same degree experienced in recent years. Local discretionary revenues from property, transient occupancy, and sales taxes are expected to slow slightly in FY 2024-25 before returning to relatively stable, modest growth.

- The economic outlook reflects no imminent recession, with softening of the economy occurring into 2024, followed by a return to more typical growth rates in 2025.

- Projections for the County's General Fund reflect deficits in all five years of the forecast, as high as $7.7 million in two of the years. The shortfalls can be fully offset in years one and two, and partially offset in year three, with the planned release of $10.6 million of ongoing funding that was set aside in prior years.

- The deficits are primarily the result of salary and benefit costs, growing at an average annual rate of 4.1%, outpacing estimated discretionary General Fund revenue growth of 3.1% per year. Additionally, departments continue to project significant operational impacts related to homelessness services costs, the implementation of the Voter's Choice Act, and increasing healthcare services costs in the County's detention facilities, among others. There are also other fiscal issues still under review that will likely have significant General Fund implications, including those related to impacts of legislative changes on departmental operations, deferred maintenance, and legal settlement compliance.

- The forecast indicates greater revenue will be needed to support current operations and programs in the near future, or budget reductions will be required.

- A preliminary estimate of one-time unallocated fund balances in the General Fund available to address priorities in the FY 2024-25 budget is $22.8 million, with an additional $4.7 million in Proposition 172 funds specific to public safety costs. However, these balances are not sufficient to fund all identified funding priorities based on existing obligations, Board commitments, and emerging issues.

Background:

The County Executive Office (CEO) commences the annual budget planning process each year by preparing budget development policies as a guideline for departments and five-year forecast projections for consideration as the Board deliberates on the County's long-term fiscal plans. The budget development report includes a five-year forecast for the General Fund of major budgetary components to provide a context for balancing short-term objectives with long-term goals during the upcoming budget development cycle (Attachment A). While the focus is on the County's General Fund, forecasts of five years of revenue and expenditure projections for other major County operating funds have also been reviewed. This report also identifies fiscal issues that have the potential to impact demands on County resources during the forecast period. Some are broad issues with countywide impact and others are smaller, specific issues within departments.

The report also includes the proposed budget development policies for FY 2024-25, as they serve as guiding principles for development of the upcoming year's recommended budget, which will be presented to the Board preliminarily during April budget workshops and for final adoption during June budget hearings. The FY 2024-25 proposed policies are similar to those adopted last year, with one recommended addition to further guide and focus budget development. This addition, regarding funded vacant positions, is explained in this letter, and the policies are presented in full in Attachment B (changes are presented in bold, italicized text).

The primary objective for budget development will be maintaining status quo budgets for departments to the extent possible, while funding cost increases related to negotiated labor contracts, increasing pension and general liability insurance costs, and additional mandated costs. The budget development policies continue to take into consideration that discretionary revenue growth is limited and uncertain, including cannabis tax revenue. Concurrently, investments in deferred maintenance, insurance and internal service fund rate mitigation, and the Northern Branch Jail remain prudent policy commitments.

ECONOMIC OUTLOOK:

State Forecast. UCLA Anderson Forecast avoids a recession in 2024 but indicates softening and slow- down of the economy, with return to more normal growth in 2025.

Over the last three quarters, the UCLA Anderson Forecast has issued a two-forecast scenario report detailing what they saw as a 50:50 probability of a "recession" and "no recession." In their October 2023 report they departed from the two-forecast scenario approach and returned to one forecast scenario in which they believe a recession has been avoided, but that a softening of the economy will occur into 2024, followed by a return to more typical growth rates in 2025.

According to the report, the absence of an immediate recession can be attributed to a combination of factors, including the simultaneous tightening of monetary policy, increased demand generated by legislative acts, and a lack of overbuilding in housing and auto sectors. Over the past 18 months, the Federal Reserve has been increasing interest rates to combat inflation. Various factors, including consumer spending and stimulative fiscal policies, have contributed to keeping the economy stable. Nationwide retail sales have remained strong, durable goods orders are rising, and factory construction is stable. Core inflation has also been gradually declining. While monetary policy has been restrictive, market expectations suggest lower rates in the future. Strong labor markets have helped drive the post-pandemic recovery, but slower growth in 2024 may lead to fewer new jobs and a slight increase in the unemployment rate. Housing markets generally remain robust, with latent demand and population growth supporting construction. Despite the absence of an imminent recession, uncertainties such as government shutdowns, geopolitical events, and changes in economic policies after an election could alter the economic trajectory.

Table 1. Average Annual Gross Domestic Product Growth Forecast

Forecast	2023	2024	2025
October 2023	1.5%	2.3%	2.4%

Source: UCLA Anderson Forecast

Specific to California, the economy has both risks and opportunities ahead. As with the rest of the nation, there are risks due to politics, world events, and the potential for higher interest rates that could slow down economic growth. However, there is a chance for growth through increased international immigration and return of technical manufacturing jobs back to California. The unemployment rate is expected to hover around 4.3% this year, rising slightly in the coming years. Job growth is possible, with more non-farm payroll jobs, but income growth may slow in the remainder of 2023, improving in 2024 and 2025. The housing market has weakened over the last couple of years, correlating with increased mortgage rates over the historically low rates experienced during the pandemic. Despite higher borrowing rates, efforts to build more homes in California should lead to a housing market recovery, although it may not fully solve the housing affordability problem.

Year-to-date state revenues reported by the State of California Department of Finance indicate that General Fund revenues (personal income tax, corporation tax, sales and use tax) are generally meeting budget estimates. However, the Budget Act monthly cashflow assumes an extended payment and filing deadline for Californians in most counties to November 16, 2023. The delay affects personal and corporate income tax categories other than withholding, making it difficult to draw conclusions about taxpayers' behavior in the current fiscal year. This new extension will make it exceptionally difficult for the State to develop a 2024-25 proposed budget framework, as the Governor's proposed 2024-25 budget is required to be presented to the Legislature by January 10, 2024.

PRELIMINARY PROJECTIONS FOR FY 2024-25:

Countywide Salary and Benefits Costs. Forecasted salary and benefit costs are consistent with average annual increases in prior years.

Salary and benefit costs for County employees are forecasted to increase by an average of 4.1% or $34.9 million per year over the next five fiscal years. Forecasted growth is consistent with actual average growth over prior fiscal years and slightly lower than prior year budgeted growth due to assumed stability in staffing levels, moderate cost-of-living adjustments and slightly lower pension contribution rate projections across all five years. As the largest structural component of the County's budget, personnel costs represent approximately 53% of total operating costs, and 70% of the General Fund operating budget. The three primary drivers, comprising over 90% of all salary and benefit costs, are salary, pension, and healthcare contributions. Given the substantial obligation these costs place on the County budget, prudent monitoring and control of fluctuations in salary, pension, and health benefit costs are critical to ensuring the County's fiscal stability.

This year's five-year forecast makes specific assumptions related to cost-of-living and equity adjustments; pension investment returns and contributions; and health benefit premiums and allocations, summarized as follows:

- **Salary cost** assumptions in the coming five fiscal years include a combination of known cost-of-living and equity adjustments established in current labor agreements, and an assumed cost-of-living increase for the years that extend beyond current contract terms. All non-safety labor agreements, which represent most county employees, expire in June 2024 and are scheduled for re-negotiation before the first year of the forecast. Accordingly, and consistent with past practice, an assumed 3% cost-of-living adjustment was applied to these groups and unrepresented groups across all five fiscal years of the forecast. The balance of safety labor agreements end at the close of years three and four of the forecast. Agreed-upon cost-of-living and equity adjustments ranging from 2.5% to 7.5% were applied to these groups for contracted years, and a 3% cost-of-living assumption was applied in the years that extend beyond the contract term.

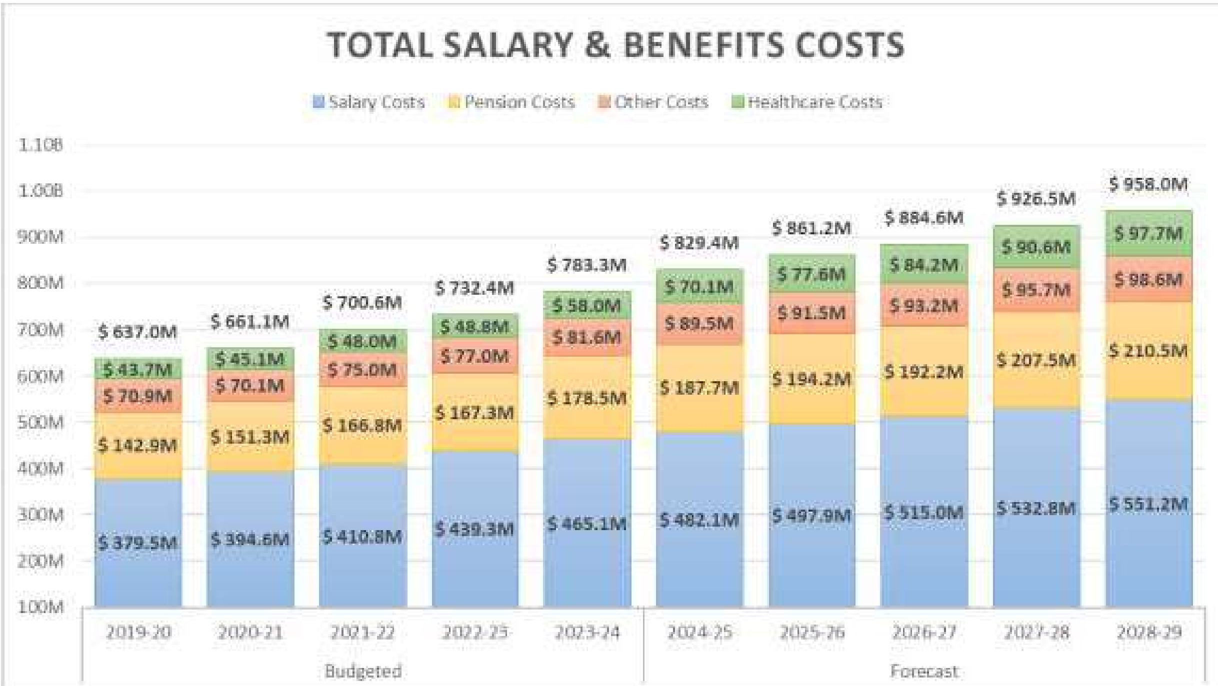
  As a result of these assumptions, salary costs for all operating funds are estimated to increase by an average of 3.5% per year and total $86.1 million over all five years of the forecast. This is consistent with actual average rate of growth over prior fiscal years. Approximately 46% of salary costs – $39.9 million over the five-year forecast period – are within the General Fund. Staff notes that negotiated adjustments greater than the assumed 3% in the years that extend beyond current contract terms would correspondingly increase salary and benefit costs for all five years of the forecast.

- **Pension costs** are driven by salary increases, pension investment returns, and retirement plan membership. This year's forecast reflects an average growth in pension costs of 3.4% per year, which is lower than prior year budgeted growth of 5.5% but only slightly lower than the 3.9% actual average rate of growth over prior fiscal years. Drivers of change in employer contribution rates include the smoothing in and out of prior year investment gains and losses, which are demonstrated in the moderate pension cost growth in years one and two of the forecast followed by a slight decrease in year three (related to the smoothing in of an investment gain) and then a sharp increase in year four (related to the smoothing in of an investment loss). See chart below for details. Across the five fiscal years of the forecast, it is estimated that pension costs will grow a total of $32 million. Final retirement rates for FY 2024-25 will be approved by SBCERS in December and incorporated into the preliminary budget presented to the Board during April workshops.

- **Health benefit costs** are primarily driven by increases in medical insurance premiums, which were budgeted to increase by 9% in 2024, but will actually increase by 12.2%. While it is anticipated that the $800,000 difference between budgeted and actual premium increases in FY 2023-24 can be covered with budgeted salary savings, Human Resources' Benefits Division projects annual increases of 10% to account for continued growth in healthcare costs. This year's forecast also considers planned increases in County contributions toward dependent and family healthcare plan premiums and assumes increased participation in these plans as a result. In total, health benefit costs for all operating funds are estimated to increase by an average of 11.1% per year and $39.6 million over all five years of the forecast. Increases are greater than prior year budgeted growth of 3.8% and the actual average annual growth of 3.6% over the prior fiscal years, as those years included smaller premium increases in 2021 and 2023 (5.3% and 8.8% respectively) and a 2.4% decrease in 2022.

- **Other salary and benefit costs** comprise approximately 10% of all budgeted salary and benefit costs and include primarily Social Security contributions, workers compensation payments, and overtime pay, among others. While these costs are budgeted as a smaller and relatively stable share of the county's budget, fluctuations in workers compensation and overtime payments in particular have the potential to drive up personnel costs in a given year. These increases are typically covered with salary savings, especially in the case of overtime pay, which is largely driven by vacancies. Other salary and benefit costs are estimated to increase by 3.9% per year and $17 million over all five years. This rate is slightly higher than prior year budgeted growth of 2.8% due to anticipated increases in the workers compensation rate in the final four years of the forecast, but lower than prior year actual average growth of 6.6%, which was mostly driven by expenditures on overtime for the Sheriff's department. These overtime expenses were mostly covered by salary savings in the department, and are not included in budgeted or forecast numbers, where funding is tied to allocated positions.

The following table compares the past five fiscal years of budgeted salary and benefit costs to the five-year forecast period. On average, forecasted costs grow by 4.1% per year and result in a cumulative $174.7 million increased cost to the County by FY 2028-29 – $78.3 million (44.8%) in the General Fund. This represents slightly slower growth in salary and benefit costs compared to prior year budgeted increases, but is consistent with actual average growth per year over previous years. Further detail regarding salary and benefit assumptions is located in **Attachment A**. And further discussion of the anticipated impact of forecasted salary and benefit costs to the General Fund is presented in the Five-Year Financial Forecast table, in the following section of this letter.



<u>General Fund.</u> Discretionary revenues are stable but expected to grow less than in prior years due to a softening economy and slower economic growth; this means revenue growth next year will be below what we typically anticipate but rebounding in future years.

The General Fund represents the main operating fund for the County and is therefore a primary focus of budget discussions. Discretionary revenues generated within the County are of critical importance as they are distributed to departments as General Fund Contribution (GFC). GFC provides funding for departmental operations and services for which no special or dedicated revenues are available. About 90% of total GFC is allocated to General Fund departments, and the balance is allocated to certain special revenue departments that use GFC as a local match for State and federal funding. Forecasts for the County's major discretionary revenues have been prepared and areas of significant impact are detailed below.

Discretionary Revenue. The major discretionary General Fund revenue sources consist of property tax, Countywide Cost Allocation Plan, transient occupancy tax, and sales tax revenues. Growth of these revenue sources is critical as they fund increases in labor and operational costs for many County operations. As mentioned in the Economic Outlook section above, a softening of the economy is projected to slow growth early in the forecast before stabilizing and returning to more typical growth levels in the last few forecast years. The forecasted discretionary revenues are largely reflective of this outlook. The forecast for all discretionary revenues is referenced on pages 2-3 of Attachment A.

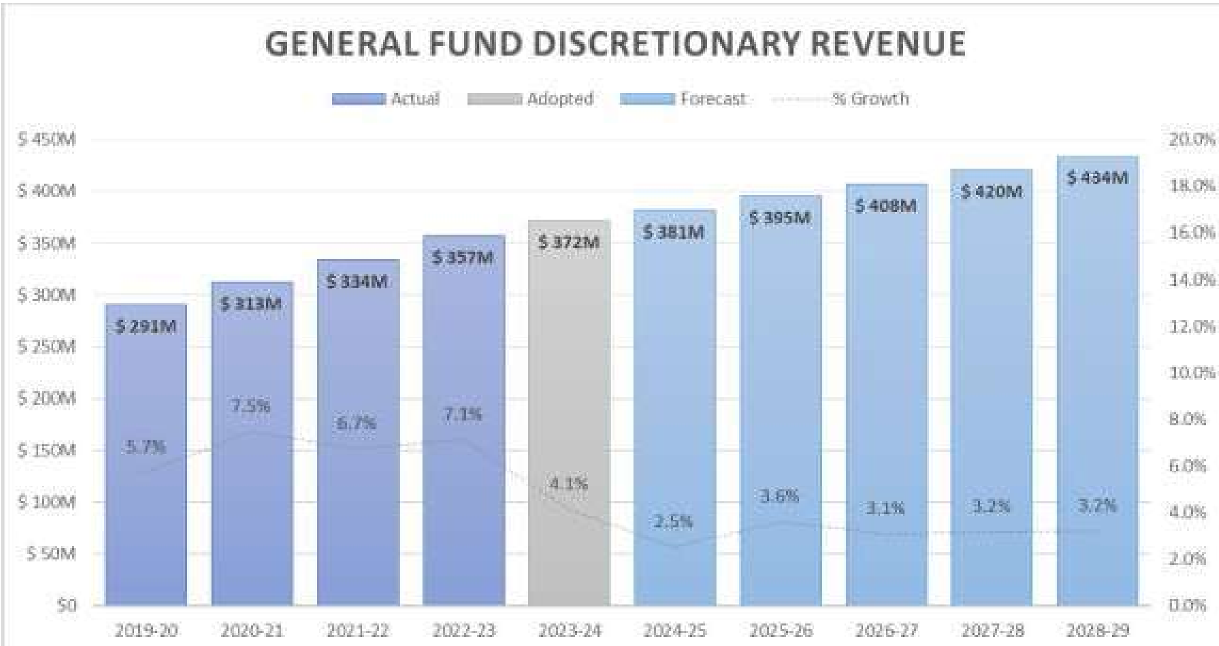
- **Property Taxes** make up approximately 80% of the County's discretionary revenue sources. The forecast assumes moderate property tax revenue growth, but not to the same degree experienced in recent years. This is primarily due to the slowing real estate market that began in FY 2022-23, which was driven by a sharp increase in mortgage rates after experiencing historically low mortgage rates in the wake of the pandemic. While assessed value growth was strong and drove property tax revenues over the past two fiscal years, coming in at 8.0% in FY 2022-23 and 6.4% for FY 2023-24, assessed value growth over the forecast period is expected to decelerate as the economy slows and the volume of real estate transactions decrease. Assessed value growth of residential and commercial properties is a significant component of property tax revenue growth as it drives major revenues such as Secured Property Taxes and Property Taxes in lieu of Vehicle License Fees (VLF). Auditor-Controller staff have estimated assessed value growth of 4.0% in FY 2024-25, then growth of 3.5% for the remainder of the forecast years. This anticipated growth in assessed value, along with other contributors to property tax revenue, translates into expected property tax revenue of $301.8 million in FY 2024-25, an increase of $10.6 million (or 3.6%) over FY 2023-24 estimated actual revenue. For the remainder of the forecast, property tax revenue growth of about 3.3% has been estimated, totaling about $42.4 million over those final four years.

- **Countywide Cost Allocation Plan (CAP)** revenue reimburses the General Fund for costs of internal support services incurred by proprietary (Enterprise and Internal Service Funds (ISFs) and subvented funds (Behavioral Wellness, Social Services, etc.). In year one of the forecast, a total of $23.1 million in CAP revenue has been estimated representing a 5% increase over the FY 23-24 adopted budget, mainly due to increased costs incurred by General Fund, internal support service departments such as General Services, Human Resources, and County Counsel. Year two reflects total CAP revenue of $25.1 million, an increase of 9.1% and is driven primarily by ERP-related costs being recouped for the first time. Year three assumes growth of 0.4% as General Fund internal support services costs are expected to decrease, then assumes modest growth of about 1.7% in the final two forecast years for total revenue of $25.7 million and $26.1 million, respectively.

- **Transient Occupancy Tax (TOT)** is generated based on lodging in the unincorporated area of the County and now represents the County's second highest discretionary revenue, as the Santa Barbara County region remains a popular travel destination. In the first year of the forecast, this revenue ($17.5 million) is expected to show only modest growth of 2.5% over the current year's revised projections of $17.1 million, as economic headwinds continue and consumers pull back on discretionary spending. For the balance of the forecast years more typical growth of 4% has been estimated, totaling approximately $3 million in growth over that four-year period. While there has been speculation that the Biltmore Hotel could potentially reopen in the fall of 2024, a definitive reopening date has not yet been established. Given the uncertainty regarding when the reopening will actually occur, the forecast does not assume any TOT revenue generated by the Biltmore over the next five years.

- **Local Sales Tax** represents the local portion of the retail sales tax collected by the State from sales generated within the unincorporated areas of the County. Although consumers have faced a significant amount of economic uncertainty, they have remained resilient in spending on taxable goods, despite higher prices resulting from increased inflation and other adverse economic conditions. Sales and use tax revenue in the unincorporated area is expected to generally maintain at current levels in the current year and next year before rebounding in FY 2025-26 to more typical growth levels as the economy stabilizes and consumer sentiment improves. In the current year, we expect only a 0.6% ($90 thousand) reduction in sales tax revenue, compared to FY 2022-23 actuals and in fiscal year 2024-25 the forecast assumes a slight decrease in growth of 0.3% ($45 thousand) to $15.0 million. Over the final four forecast years more typical growth levels of about 3% are expected, an average revenue increase of about $470 thousand per year.

The following table demonstrates anticipated growth in General Fund discretionary revenue compared to the FY 2023-24 Adopted Budget and actual revenue collections in the prior four fiscal years.



<u>Five-Year Financial Forecast</u>. The forecast indicates expenditures, primarily driven by salary and benefit costs, outpacing revenue growth even when revenue rebounds to typical growth rates. Through careful planning that anticipated these deficits, the shortfall can be offset in years one and two, but significant policy and operational issues remain unfunded beyond that.

A five-year forecast of ongoing expenditures funded with ongoing General Fund discretionary revenue was prepared using the forecast projections for discretionary revenue and salaries and benefits, in addition to consideration of prior Board policy commitments and certain anticipated major operational cost increases. The forecast assumes status quo operations and does not include any potential department expansion requests or fiscal issues that are still being determined, monitored, and quantified. It also does not anticipate discretionary revenue being used to offset department deficits caused by decreases to existing State or federal funding. Cannabis tax revenue was excluded as an available ongoing source due to the uncertainty around that revenue source.

General Fund budgetary deficits of $7.7 million and $1.7 million are anticipated in years one and two of the forecast and are projected to continue growing in out years. Deficits are primarily driven by salary and benefit costs outpacing revenue growth; and are made larger by new and growing obligations to the General Fund related to homelessness services, election expansions, and jail medical costs. Due to prudent fiscal planning by the Board, projected deficits may be fully offset in years one and two, and partially offset in year three, with the release of a $10.6 million set-aside of prior year ongoing set-asides. However, projected deficits in years three through five remain unfunded at this time.

FIVE-YEAR FINANCIAL FORECAST
INCREMENTAL CHANGE IN GENERAL FUND ONGOING REVENUE AND COSTS
FISCAL YEARS 2024-25 THROUGH 2028-29

Row	Category	Ongoing Revenue Sources:	FY 2024-25	FY 2025-26	FY 2026-27	FY 2027-28	FY 2028-29
1	Forecast	Discretionary Revenue (excludes Cannabis)	$10,744,000	$13,610,000	$12,056,000	$12,828,400	$13,385,000
		Total Revenue Change	$10,744,000	$13,610,000	$12,056,000	$12,828,400	$13,385,000
		Ongoing Cost Changes:					
2	Forecast	Negotiated and Assumed Salary Increases	$6,596,560	$5,352,860	$5,789,847	$6,098,646	$6,303,848
3	Forecast	Pension Costs	2,507,160	1,941,583	(509,612)	4,639,997	1,001,471
4	Forecast	Health Benefits	3,444,981	2,278,457	1,992,865	2,002,658	2,172,581
5	Policy	Northern Branch Jail Operations	2,400,000	2,300,000	2,200,000	1,400,000	1,200,000
6	Policy	Rate Increases	1,120,000	1,625,000	1,828,000	1,932,000	2,136,000
7	Policy	18% Deferred Maintenance		42,700	158,900		127,300
8	Operational	Homelessness Services Costs	473,300	473,300	1,135,000	2,662,400	
9	Operational	IHSS MOE & Labor Increases		575,000	1,242,900	538,600	551,900
10	Operational	Voter's Choice Act Implementation	1,222,000				
11	Operational	AB 1869 Backfill Sunset			850,000		
12	Operational	Detention Facil. Healthcare Services Annual Increases	700,000	735,000	771,800	810,300	850,900
13	Operational	ARPA-funded Criminal Justice Programs			435,000	435,000	
14	Fiscal Plan	Release Board Approved Prior Year Set Aside Offset: General liability, labor/pension	(7,720,001)	(1,713,900)	(1,264,099)		
		Total Change in Costs	$10,744,000	$13,610,000	$14,630,601	$20,519,601	$14,344,000
		Annual (Deficit)/Surplus	**$0**	**$0**	**($2,574,601)**	**($7,691,201)**	**($959,000)**

Further detail regarding each projected category of the five-year forecast is included as follows.

- **Policy**

a) Northern Branch Jail Operations: The operating costs of the Northern Branch Jail (NBJ) continue to exceed the ongoing funding set aside for that purpose. Based on cost projections and status quo staffing levels, General Fund increases exceeding $2 million a year will be necessary, until ongoing revenue equals ongoing costs in FY 2026-27. The projected amount to then maintain parity between revenue and expenditures for NBJ operations is $1.4 million in FY 2027-28 and $1.2 million in FY 2028-29. If population at the jail is reduced over time, the increases may decline in the out years.

b) Rate Increases: Internal service charges and insurance premiums continue to present a financial issue for some General Fund departments. General liability insurance and Information Technology charges specifically are expected to grow by almost 33% over the forecast period. In accordance with Budget Development Policy 3.h, adopted in FY 2022-23, the forecast reflects General Fund Contributions growing from $1 million in year one to $2 million in year five to help departments manage these increases and avoid service level reductions.

c) 18% Deferred Maintenance Allocation: The Board has a current policy that 18% of unallocated Discretionary General Fund revenues will be committed for maintenance needs to be allocated to Public Works (50%), General Services (35%) and Parks (15%). While there is no anticipated growth in deferred maintenance funding allocations to departments in FY 2024-25 after accounting for planned policy-driven General Fund Contributions, modest growth in the County's deferred maintenance allocation is projected in future fiscal years, as shown in the above table.

- **Operational**

a) Homelessness Service Costs: The County will begin to see a reduction in funding for homelessness services as pandemic-related funding sources expire. Limited-term grant sources expiring within the next two fiscal years include the Homeless Housing, Assistance and Prevention (HHAP) Program, Housing and Homelessness Incentive Program (HHIP), Community Economic Resilience Fund (CERF) Program, Emergency Solutions Grants (ESG-CV), Housing and Disability Advocacy Program (HDAP), and American Rescue Plan Act (ARPA) funds. Services provided through these funding sources are in the areas of homelessness prevention, shelter and interim housing, capital development, supportive services, outreach, and more. Some services are expected to be discontinued due to the limited-term nature of their funding. Other services and projects, which the County is either obligated by grant and regulatory agreements to continue, or has deemed critical, will realize growing funding shortages in each forecasted year, totaling $4.7 million through FY 2027-28. For example, the County's continued operation of its Homeless Management Information System (HMIS) and Coordinated Entry Systems (CES) is a requirement for nearly all homelessness funding sources. Homelessness funding continues to be very dynamic with State and federal funders opting for specific, limited-time program funding. While the Housing and Community Development (HCD) Division aims to secure competitive funding to offset this impact, these decreases in funding require the identification of alternative sources to sustain services and shelter operations.

   Additionally, the County has committed to funding two temporary interim supportive housing communities for a period of five years (Hope Village and La Posada). However, funding has only been identified for services and operations for the first two years of both projects. To continue operation of these two projects beyond the first two years would require up to $8.5 million of additional one-time funding based on current projections and estimates prior to the projects being occupied.

b) In-Home Supportive Services (IHSS) Maintenance of Effort (MOE) & Labor Increases: The IHSS program, administered by the Department of Social Services (DSS), provides assistance to income-eligible aged, blind and disabled individuals, which enables recipients to remain safely in their own homes and communities. Program costs are shared by the federal, State and county governments. The IHSS MOE is the county share of costs, comprised of locally negotiated wage and benefit costs for individual providers and an annual 4% inflation factor. These costs are generally paid through State 1991 Realignment revenue and an ongoing General Fund Contribution that is only utilized by the department in the event that alternative funding sources are insufficient. In FY 2024-25, IHSS MOE costs are projected to exceed 1991 Realignment revenue and the department's ongoing General Fund Contribution by $798,800. A portion of this deficit can be offset using a one-time $600,000 general fund set-aside, which the County earmarked in a prior year specifically for this purpose. DSS fund balance can be drawn to cover the remaining $198,000 balance of the FY 2024-25 shortfall plus another $739,000 of the $1.3 million shortfall projected for FY 2025-26. After utilizing available one-time set-asides and fund balances to augment revenue in the first two years of the forecast, a remaining shortfall of $575,000 is projected in FY 2025-26, which grows to $1,242,900 in FY 2026-27, and then increases by approximately $540,000 per year in the remaining years.

c) Voter's Choice Act (VCA) Implementation: VCA modernizes elections in California by allowing counties to provide greater flexibility and convenience for voters. This election model allows voters to choose how, when, and where to cast their ballot by mailing every voter a ballot, expanding in-person early voting, and allowing voters to cast a ballot at any vote center within their county. There are one-time costs associated with implementing VCA that will be funded by existing grants secured by the Elections Division of the Clerk-Recorder-Assessor-Elections Department. Ongoing costs, which include the addition of 3.0 FTE, will be offset somewhat by election billing revenue, resulting in a net ongoing cost of $1.22 million starting in FY 2024-25.

d) AB 1869 Backfill Sunset: AB 1869 repealed the authority of counties to charge defendants for various criminal justice fees, effective July 1, 2021. To offset the loss in revenue to counties, the bill included a backfill provision from the State, that is scheduled to expire after FY 2025-26. In FY 2026-27, after the sunset of the backfill, the County's annual allocation of $846,778, split between the Probation Department and the Sheriff's Office to support existing staffing and other costs of adult supervision programs, will become a new General Fund obligation.

e) Detention Facilities Healthcare Services Annual Increase: Wellpath (formerly California Forensic Medical Group) currently provides medical and mental health care services to the County's adult correctional facilities, and medical services in juvenile facilities. The FY 2023-24 Wellpath contract totals $14.7 million and is set to expire on March 31, 2024. Future contract amounts are included in the forecast table above and represent the projected cost of maintaining existing service levels with moderate annual increases. In addition to maintaining existing service levels, there may be additional staffing requirements, yet to be determined, necessary to comply with the Disability Rights California Remedial Plan, discussed further in a later section of this report.

f) ARPA-funded Criminal Justice Programs: The American Rescue Plan Act (ARPA) State and Local Fiscal Recovery Fund (SLFRF) currently funds several criminal justice positions that will need to be maintained with General Fund following the ARPA expenditure deadline of December 31, 2026. Some funding was previously set aside for this purpose, but additional funding is needed to fully cover the positions, in particular given actual and anticipated cost escalation over several years from when the funding was initially set aside. These positions include Sheriff co-response deputies for three teams; arraignment attorneys in Public Defender; data analysts in District Attorney, Public Defender, and CEO; and legal office professionals for discovery in District Attorney and Public Defender. As the ARPA deadline approaches, staff will continue to evaluate these programs and seek alternate funding sources to supplement discretionary funds.

General Fund Unallocated Fund Balances

As part of budget development, the Board also considers applying one-time carry forward fund balances from the previous fiscal year towards one-time expenditures. Unallocated fund balances include positive year-end balances carried forward from General Fund departments as of June 30, 2023, excess Proposition 172 revenue received in prior years, and unspent Emerging Issues account funds in General County Programs. At this time, it is anticipated there will be about $22.8 million of unallocated discretionary fund balance, comprised of $10.7 million in the GF Fund Balance Unallocated (9940 Account), $10.6 million in the Advance Construction Reserve (9819 Account), and $1.5 million in Emerging Issues Fund Balance (9890 Account) for the FY 2024-25 budget. Additionally, $4.7 million in Proposition 172 (9768 Account) may be available for qualifying uses. These balances would be allocated during budget development towards priority projects, or set asides, as identified in the Board Priorities section of this board letter. In light of the budgetary deficits identified in the five-year forecast and the growing number of undetermined General Fund obligations, as well as uncertainty around the State budget, cautious use of unallocated fund balance in FY 2024-25 would be advisable at this time. Other General Fund committed reserves are shown in Attachment A on page 4.

<u>Fiscal Issues in the General Fund Under Review</u>

As previously noted, department expansion requests and fiscal issues that are still being determined or monitored are not included in the General Fund forecast. Departments were asked to submit fiscal issues that were reviewed for significance and will be further considered as part of the budget development review process. If any items are determined critical to address in the FY 2024-25 budget, they will be detailed as part of budget workshops and ultimately the recommended budget. Some of the issues departments raised relate to facility conditions and workspace configuration, use of fund balance being used for ongoing operations, and revenue losses related to legislative changes. Additionally, some departments have identified projected increases in the costs to maintain existing operations with contracted services and supplies due to various factors including the recent inflationary pressures on a variety of goods and labor indices.

Significant fiscal issues are typically $500,000 or greater in ongoing impact related to legislative changes, new statutory mandates, or issues outside of the department's control that would result in severe service level impacts or risk to the County. Depending on the certainty of the impact, significant fiscal issues will either be added to the forecast table under the Operational category or noted in this section for monitoring. For FY 2024-25, the following items are being monitored:

- **Legislative Changes:** A variety of State bills continue to eliminate fee revenues or change funding formulas, or create unfunded mandates for the criminal justice departments in particular, among others. This includes but is not limited to various post-conviction mandates and the SB 678 funding formula change for Probation. These issues will be monitored and considered during budget development.

- **Deferred Maintenance:** Costs to continue to address a backlog of deferred maintenance projects are estimated at $538 million (Public Works – $305 million, Community Services – $70 million, and General Services – $163 million). Board policy allocates ongoing funding as per the 18% maintenance policy and available one-time funds to these projects based on prioritized needs.

- **DRC Compliance:** In February 2021, the Court approved the negotiated Stipulated Judgment and Remedial Plan pursuant to a class action lawsuit, *Murray v. Santa Barbara County*, filed by Disability Rights California (DRC) to address subject matter expert recommendations pertaining to the County's adult detention facilities in the areas of medical care, mental health care, suicide prevention, ADA accommodations, environmental health and safety, and custody operations. In August 2023, the parties agreed to, and the Court approved, a Stipulation to the Remedial Plan that provided extended deadlines to the County in exchange for implementation of specific interim measures (collectively referred to as "Remedial Plan"). The County continues to implement essential elements of the Remedial Plan, but there is still much work to be done to achieve substantial compliance with the Remedial Plan requirements. As of the most recent Expert Monitor Reports from the on-site reviews in spring 2023, the majority of the compliance items have not yet reached substantial compliance. The remaining non-compliance items predominantly include facility, medical, and mental health needs, and may require substantial resource allocations yet to be determined and quantified.

Fiscal Issues in Other Major Operating Funds. Legislative changes are driving fiscal issues in other major operating funds that may impact service delivery in the future.

The following fiscal issues have been identified in other major operating funds and do not necessarily present a future financial obligation to the General Fund. Several of the issues included in this section are the result of legislative changes to funding that directly impact the delivery of County services.

The **Inmate Welfare Fund** (Fund 0075) is funded primarily by telephone commission payments from jail inmate telephone calls, as well as by sales commissions from inmate commissary purchases and placement of bail bondsman signs. Revenues are expended by the Sheriff's Office primarily for the benefit, education, and welfare of the inmates in the County's jails. The Inmate Welfare Fund pays for all inmate programming services, including education, recreation, alcohol and drug treatment, Drug Court support, vocational training, law library access, and indigent programs. In recent years, revenues have declined due to a 2021 legislative change that implemented a price cap on inmate telephone communication rates—the fund's primary revenue source—combined with lower sales due to the declining daily inmate population.

In FY 2022-23, a $224 thousand draw from fund balance was required to balance the fund at year-end. In the forecast years, expenditures at the current levels are projected to outpace revenues, resulting in continued and increasing use of the department's approximately $3 million fund balance. The Sheriff's Office has identified an existing consultant contract totaling $107 thousand that is no longer required and can be eliminated in FY 2024-25 without any service level reductions; however, to ensure the fund remains solvent in the long-term, it is likely that additional expenditure reductions, including programming reductions, would need to occur, unless a new revenue source is identified.

The **Health Care Centers Fund** (Fund 0042) receives State and federal revenues associated with operation of the County's health care centers, including Medi-Cal revenues. In recent years, the Public Health Department has relied on reserves to balance the Health Care Centers budget, an issue that became exacerbated by the State's 2022 transition of the pharmacy benefit for Medi-Cal beneficiaries from managed care plans to a State-operated fee-for-service program, reducing ongoing revenues within this fund.

However, the department has anticipated this change for years and is implementing a five-year Strategic Plan for the County's Health Care Centers focused on, among other things, increasing financial strength and resilience. Revenue-raising and operational efficiency solutions are being implemented at the clinics, including continuing to fill provider vacancies, optimizing clinic scheduling, and reducing patient cancellation of appointments.

The department is forecasting the use of approximately $3.2 million of its current $22.3 million fund balance in FY 2024-25, with a worst-case scenario projection of depleting its fund balance by FY 2028-29. However, operational solutions, such as increased provider appointments with patients each day, would have a significant positive financial impact and greatly reduce the reliance on reserves. Additionally, the Public Health Department is working on implementation of the CalAIM Enhanced Care Management (ECM) program, which may yield financial benefits within the fund. However, due to certain unknowns, revenues associated with CalAIM have not been incorporated into the department's five-year forecast.

The **Mental Health Services Fund** (Fund 0044) is primarily funded through a combination of Mental Health Realignment, Medi-Cal reimbursement for services, and General Fund dollars, which are used, among other things, to fund Lanterman-Petris-Short Act conservatorship services to individuals who are gravely disabled and have a mental health disorder. Some of the costs associated with providing mental health treatment for conserved individuals are reimbursed through Medi-Cal, with the exception of services delivered in Institutions for Mental Disease, which are ineligible for Medi-Cal reimbursement and instead funded through a combination of Mental Health Realignment and General Fund dollars. In the FY 2023-24 adopted budget, $667 thousand of General Fund dollars have been appropriated for conservatorship efforts.

Senate Bill 43 (SB 43), signed by the Governor in October 2023, significantly expands eligibility for conservatorship to include individuals with mental health and substance use disorders and will translate into a greater conservatorship responsibility for the County. The bill, which does not come with dedicated state funding to support its implementation, places a new unfunded obligation on county resources related to staffing, programming (including the development of substance use disorder assessment criteria and tools), and treatment services, the full cost of which is currently unknown. While implementation of SB 43 is slated for January 1, 2024, the County may delay until January 1, 2026 through the adoption of a Board resolution, which would allow the County additional time to prepare for and quantify the financial impact of this expansion.

The Mental Health Services Act Fund (Fund 0048) was established as a result of the State's 2004 behavioral health system expansion, and is funded through a 1% state tax on personal incomes in excess of $1 million per year. Mental Health Service Act funding is primarily allocated toward direct mental health services under the categories of community services and supports, prevention and early intervention, and innovation. In March 2024, Californians will vote on Proposition 1, a package of two bills (Senate Bill 326 and Assembly Bill 531) that would amend the 2004 Mental Health Services Act to, among other things, redirect 30% of its funding towards housing for the chronically homeless; and issue $6.380 billion in bonds to fund housing for homeless individuals and veterans with mental health or substance use disorders. If passed, the proposed categorical funding requirements of Proposition 1, primarily the reallocation of funding for housing, would potentially reduce the County's available funding for mental health services by $9 million, based on initial estimates. Major Behavioral Wellness programs currently funded through the Mental Health Service Act include Crisis Services, Adult and Children Outpatient Clinics, Crisis Stabilization Units, Wellness Centers and Crisis Residential Services. Proposition 1 includes an 18-month period during which counties would continue to receive current MHSA distributions as they develop transition plans.

The **Workforce Innovation and Opportunity Act Fund** (Fund 0058) currently houses the County farmworker resource center program (Proyecto Campesino), which was established in July 2023 and funded with an $833,000 State AB 941 Farmworker Resource Center Grant and a $208,250 County match from the General Fund. Program funds were used to conduct a farmworker needs assessment and design an outreach project that ultimately included providing mobile services to the farmworker community. As of October 31, 2023, Proyecto Campesino conducted 64 outreach events and engaged with 3,212 farmworkers on matters primarily related to emergency support services, education access and support, and labor rights. Grant funding for this program is anticipated to end in May 2024, before which time the County will need to identify an alternative funding source for the ongoing operational costs in order to continue the program. Staff will return to the Board in the third quarter of FY 2023-24 to discuss the impact of the program in greater detail and discuss future service delivery and funding options.

FY 2024-25 PROPOSED BUDGET DEVELOPMENT POLICIES:

Policy amendment. Only one change to the Budget Development Policies is proposed for next year: deletion of extended funded vacancies in departments' budgets to free up resources for other needs.

Budget development policies serve as guiding principles for development of the upcoming year's recommended budget. The FY 2024-25 policies proposed herein are similar to those adopted last year, with one revision to further guide and focus budget development. The proposed policy revision is explained below. The complete policy document may be found in Attachment B, with revisions presented in bold italicized text.

Amend existing Policy 3.f): In order to allocate limited resources in a fiscally responsible manner, departments shall assume salary savings of no less than 3% or their 5-year average actual salary savings, whichever is lower, when developing their budget. ***Positions that have remained vacant and funded for more than two budget cycles may be recommended for deletion by the CEO, unless departments can justify the extended vacancy.***

A significant share of the County's budget is allocated toward the salaries and benefits of both filled and unfilled funded positions. Recognizing that not all positions will remain filled 52 weeks per year, County Budget Development Policy section 3.f. requires departments to build salary savings into their annual budgets. The proposed revision to this section expands on the policy of unencumbering historically underspent salary dollars by considering the deletion of funded positions that have remained vacant for more than two budget cycles so that the funding associated with those vacancies can be reallocated to other expenditure categories. The CEO's Office will work closely with departments that submit service level reductions, or expansion requests, during budget development to determine whether or not long-term funded vacancies can be unfunded in order to meet greater needs in the department, or elsewhere in the County.

REVIEW FUNDING PRIORITIES FOR FY 2024-25:

One-time priorities. Because General Fund expenditures are projected to exceed expected revenues next year, there is no anticipated available ongoing revenue to allocate. One-time funding will be available in FY 2024-25 to augment projects or programs, but the list of needs - based on existing obligations, Board priorities and emerging issues - exceed available funding.

As noted in the five-year forecast discussed above, costs related to salaries and benefits, prior policy direction, identification and mitigation of fiscal risks, statutory requirements, and known operational impacts are anticipated to outpace General Fund revenue growth by an estimated $7.7 million in FY 2024-25. To balance the budget for these issues, all projected GFC growth, plus $7.7 million in ongoing GFC that was set aside in prior years, will need to be used. While revenue and expenditure impacts will not be fully known until department budget submittals are assessed and estimates are refined, the overall budget picture is not likely to change.

Accordingly, it is anticipated that there will only be one-time General Fund dollars available. Outlined in the table below are known items that will require funding, including existing obligations, board priorities and emerging issues. Because funding everything on this list would exceed available fund balances, staff will continue to work in the coming months to refine the list and develop recommended appropriations for the highest priority needs.

Identified Priority Areas in FY 2024-25

Below are identified areas of funding need. The asterisked items denote existing obligations, Board priorities and emerging requirements which staff will consider first when developing recommendations over the coming months.

Coordinated Community Service Delivery and Strengthen Safety Net	Improve Criminal Justice System	Financial and Organizational Excellence	Sustainability and Climate Resiliency	Facilities and Infrastructure
Continue to make Santa Barbara County a place where our community can lead healthy, prosperous lives	Continue to improve our Criminal Justice system so that justice is served fairly, expeditiously and with humanity	Continue to improve the transparency, efficiency and effectiveness of how we do our work, and to make County of Santa Barbara a great place to work	Continue to reduce Santa Barbara County's contribution to climate change, and improve our resilience to the impacts of a changing climate	Continue to invest in the physical future of Santa Barbara County by building and maintaining infrastructure
Including: • *Dignity Moves projects, years 3 through 5 • *Housing Element implementation actions • *Improved access to inpatient mental health care treatment • Workforce housing options • Recreation Master Plan implementation • Set aside for allocation to District area special projects • Other homeless services, projects underway and interim funding for anticipated homeless services deficits • Consultant services for building permit backlog	Including: • *Jail improvements in accordance with Disability Rights California (DRC) settlement, including: Northern Branch Jail Design and Main Jail ADA, accessibility wellbeing improvements; potential augmentation of jail Medical Services	Including: • *Labor agreements • *Enterprise Resource Planning (ERP) software implementation and adoption • Backfill state revenue losses and set aside for future deficits	Including: • *Disaster Recovery Set-Aside and Projects • *Project Clean Water projects • *Electric Vehicle Charging Infrastructure • Climate Action Plan Implementation	Including: • New capital projects and deferred maintenance • Calle Real Master Plan

The next stage in budget development will be budget workshops in April, where staff will present the preliminary budget and bring forward information about how certain issues will be addressed through the Recommended Budget.

Fiscal Impacts:

The five-year fiscal outlook on the County's General Fund and other major operating funds are presented in this report and in Attachment A, along with discussion of significant fiscal issues that may further impact demands on funding in future years.

Attachments:

Attachment A: Five-year forecast of major budgetary components

Attachment B: FY 2024-25 Budget Development Policies and General Fund Allocation Policy

Authored by:

CEO Budget & Research Division