



**BOARD OF SUPERVISORS
AGENDA LETTER**

Agenda Number:

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

Department Name: CEO
Department No.: 012
For Agenda Of: November 29, 2022
Placement: Administrative
Estimated Time: N/A
Continued Item: No
If Yes, date from: N/A
Vote Required: Majority

TO: Board of Supervisors
FROM: Department: Mona Miyasato, County Executive Officer
Director(s)
Contact Info: Nancy Anderson, Assistant CEO – Budget and Research
Jeff Frapwell, Assistant CEO – Cannabis Administration Division
SUBJECT: Fiscal Year 2022-23 First Quarter Budget Status Report and Cannabis Taxation, Compliance and Enforcement Update

County Counsel Concurrence

As to form: N/A

Auditor-Controller Concurrence

As to form: N/A

Recommended Actions:

It is recommended that the Board of Supervisors:

- a) Receive and file the Fiscal Year (FY) 2022-23 First Quarter Budget and Status Report as of September 30, 2022, showing the status of appropriations and financing for departmental budgets adopted by the Board of Supervisors; and
- b) Determine that the above actions are not a project under the California Environmental Quality Act (CEQA), because pursuant to sections 15378(b)(4) and 15378(b)(5) the recommended actions consist of organizational, administrative, or fiscal activities of government that will not result in direct or indirect physical changes in the environment.

Summary:

The FY 2022-23 budget status report for the first quarter ending September 30, 2022 provides a fiscal-year-to-date look at the County’s financial position relative to the FY 2022-23 adjusted budget.

With only three months into the current fiscal year, there is much activity that has yet to determine the final fiscal position of the County’s General Fund. At this time, staff look at the final assessed valuations determined by the Assessor on July 1 and other changes that could have potential impacts on the assumptions used in the FY 2022-23 adopted budget and estimate what the variances may be.

For the first quarter, taking into consideration those identified changes, the General Fund is projected to have a net positive variance of \$25.8 million compared to the adopted budget. The majority of the variance (\$22.4M) is related to General Revenues. Property tax revenue comprises \$17.5 million of the variance that is primarily driven by assessed values coming in higher than initially estimated due to unusually high residential and commercial property transactions in the previous fiscal year. Other significant variances include the Probation Department at a positive variance of \$2.4 million related to salary savings due to vacancies and a \$1.04 million negative variance for the Sheriff's Office related to overtime usage. While still early in the year, cannabis revenue is once again trending at lower collections than budgeted with a \$6 million negative variance.

The fiscal position of the General Fund will continue to be monitored and presented to the Board on a quarterly basis. At the end of the fiscal year, any funds resulting from a positive variance are typically carried forward for the Board to consider as part of the next budget cycle development as priorities and fiscal issues are identified. The five-year forecast for the General Fund will be presented to the Board in December, which will set the stage for FY 2023-24 budget development.

FIRST QUARTER REPORT

The first quarter for the fiscal year includes activity through September 30, 2022. In this report, projected financial results for the fiscal year end are compared to the annual adjusted budget. The major differences (variances) between budgeted and actual amounts are discussed on the following pages.

This report highlights the variances that exceed the following thresholds:

- 1) General Fund departments (including Discretionary General Revenues) with projected variances greater than \$300 thousand per department; shown in the Financial Summary Report (Attachment A) and;
- 2) Special Revenue and Other Funds with projected variances greater than \$500 thousand per fund; shown in the Financial Summary Report (Attachment B).

Both Attachments A and B use actual revenues and expenditures for the first three months of FY 2022-23, and then add departmental projections for the next nine months to arrive at the "Projected Actual" columns. These annual Projections are then compared to Adjusted Budgets for both Sources and Uses to produce a "Net Financial Projected Variance" for the end of the fiscal year (shown in the far-right column of the Attachment A and Attachment B reports).

BUDGET POLICY

Departments are responsible for maintaining expenditure levels within the Board-approved budget appropriations in accordance with Board adopted policy and procedure '*Budgetary Control & Responsibility*' as the following abbreviated excerpt states:

- A. If expenditures are projected to exceed appropriations, the department head responsible for the budget shall perform one or more of the following steps in the following order:
 - 1) Lower the expenditure level to maintain overall expenditures within the total amount budgeted,
 - 2) Request a transfer from fund balance within the same department and fund under the department head's control (if available for appropriation),

- 3) Prepare a transfer request from General Fund Contingency and an agenda item for the Board of Supervisors with a memo to the County Executive Office, providing adequate justification.

In addition, the County Budget Act, Section 29121, California Government Code, places liability for over-expenditure upon the department director authorizing the expenditure:

Except as otherwise provided by law, obligations incurred or paid in excess of the amounts authorized in the budget unit appropriations are not a liability of the county or dependent special district, but a personal liability of the official authorizing the obligation.

GENERAL FUND SUMMARY (Attachment A)

As of September 30, 2022, the General Fund had a projected year-end positive variance of \$25.8 million. This is the result of favorable results in most General Fund departments, partially offset by a reportable negative variance in one department.

General Revenues (Department 991) projects a positive year-end variance of \$22.4 million, 6.6% over total budgeted revenues, shown in detail in the table below. This variance is due primarily to higher than budgeted Property Taxes, Sales and Use Taxes, Transient Occupancy Taxes (TOT), and Interest Income. Cannabis Cultivation and Retail Storefront Taxes are projected to come in lower than budgeted but are not contributing to the projected year-end variance and are explained later in this section.

Property Taxes are the major driver of the General Revenue's positive variance through the first quarter as they project higher than budget by \$17.5 million. Secured and unsecured property taxes are mainly driving this variance as they project to exceed budget by \$13.7 million, primarily due to the real estate market that flourished over the last several years resulting from historically low mortgage rates and high demand for residential and commercial properties. As expected in a strong real estate market, a high volume of property ownership changes occurred over the past two years and were reassessed upon property transfer. In many instances, the reassessed property values had increased substantially, thereby contributing to robust assessed property value growth of 8.1% for the property tax year 2022-23. At the time that the current fiscal year's property tax budget was developed, staff had anticipated that assessed value growth would be strong at 4.5%; however, the Assessor finalized the tax roll at the end of June with substantially higher growth resulting in the positive variance. Property Taxes In-lieu of Vehicle License Fees (VLF) are also contributing to the positive variance in property taxes as they project higher than budget by \$2.4 million, given that they too are driven by assessed value growth.

Sales and Use Taxes are projecting a positive variance of \$1.8 million as consumer demand for taxable goods remains high despite an uncertain economy. Although the County outpaced regional and State Sales and Use Tax averages, consultant HdL expects recent actions taken by the Federal Reserve to exert downward pressure on many of the major industry sectors, resulting in slower growth in the second half of the current fiscal year. Transient Occupancy Taxes (TOT), which is highly dependent on tourism, is also projecting a positive variance and expected to exceed budget by \$1.7 million. Although TOT receipts remained elevated through the first quarter, staff anticipates growth to slow in the second half of the fiscal year, similar to Sales and Use Taxes, as actions taken by the Federal Reserve to curb inflation begin to impact consumers. Interest income is the final significant driver of the General Revenue's positive variance as it projects to exceed budget by \$1.1 million. In the first two years of the pandemic, treasury interest rates dropped to well below 1% but have modestly, yet consistently, increased over the course of the past calendar year as banks enter a higher rate environment. Year-end projections have been updated accordingly to reflect this new trend in rates.

Cannabis Cultivation Tax is currently projecting a negative variance of \$6 million on a \$15.2 million adopted budget. This projected decrease continues to be attributable to the oversupply of wholesale cannabis product and resulting price compression that continues to persist locally and state-wide. Cannabis Retail Storefront Tax is also projected to end the year under budget by \$471 thousand on a \$1.1 million adopted budget. This decrease is due to the timing of when each retail operator is expected to complete the land use entitlement and business licensing processes. When the budget was developed, staff had assumed that one retail storefront operator would commence operations at the end of fiscal year 2021-22, and two other operators would commence operations early in fiscal year 2022-23. The anticipated commencement of operations for all three operators has been delayed, with all three entities expected to open for business at various times throughout the current fiscal year. Staff will continue to closely monitor cannabis tax revenues as the fiscal year progresses and will keep the Board apprised of updated projections when new information becomes available.

Discretionary General Revenue Summary (in thousands):			
Source	Adjusted FY 2022-23	Projected FY 2022-23	Variance Proj vs. Adjusted
Property Taxes	\$ 261,719	\$ 279,237	\$ 17,518
Sales and Use Retail State Tax	14,240	16,010	1,770
Cannabis Cultivation Tax	15,193	9,140	(6,053)
Cannabis Retail Tax	1,100	629	(471)
Transient Occupancy Tax	15,165	16,891	1,726
Interest Income	727	1,834	1,107
All Other Revenues	32,415	32,713	298
Total Discretionary Revenues	\$ 340,559	\$ 356,454	\$ 15,895
Decrease to Cannabis Fund Balance	\$ 16,293	\$ 9,769	\$ (6,524)
All Other Transfers	324,266	324,266	0
Projected Fiscal Year End Variance	\$ -	\$ 22,419	\$ 22,419

Probation is projecting a positive year-end variance of \$2.4 million, 2.9% on a total budget of \$81.7 million, primarily due to staffing vacancies. The department continues to work on filling these vacancies and has reduced the number of vacancies compared to the beginning of the fiscal year.

Sheriff-Coroner Office is projecting a negative year-end variance of \$1.04 million, 0.6% on a total budget of \$183.6 million, primarily due to overtime costs in excess of budget. Actual overtime costs through the first quarter were \$4.3 million on a quarterly budget of \$1.0 million, exceeding the quarter's budget by \$3.3 million. However, all but \$300 thousand, or 10%, of the first quarter overage is being absorbed by salary and benefit savings as a result of numerous funded vacancies within the department. If these trends continue, the department could ultimately exceed their overtime budget by \$12 million, of which all but \$1.2 million would be absorbed with salary savings. The department has also incurred approximately \$100 thousand in pandemic direct response costs to be reimbursed through ARPA funds, which will offset a portion of the projected deficit.

Consequently, if the department has more success in filling vacancies and retaining staff in the coming quarters, they will no longer be experiencing salary savings that cover 90% of their unbudgeted overtime, but will still have periods of high overtime while newly hired staff is being trained to work in the facilities. This would cause their projected negative variance to grow even larger, and is an unavoidable short-term cost as new staff come on board. As stipulated in the October 18, 2022 presentation on Sheriff Overtime

Usage and Costs, the department may receive reimbursement for eligible overtime costs and recruitment incentives from the \$2 million set-aside of Proposition 172 funds at year-end, and the CEO’s Office continues to work closely with the department to develop more robust tracking of overtime drivers.

Public Health is projecting a positive year-end variance of \$484 thousand, 8.3% on a total budget of \$5.8 million, primarily due to salary and benefit savings as a significant number of positions are vacant in the Animal Services Division.

SPECIAL REVENUE AND OTHER FUNDS SUMMARY (Attachment B)

There were no reportable variances in the Special Revenue and Other Funds for the first quarter.

ADVANCE CONSTRUCTION RESERVE ACTIVITY

Beginning in FY 2021-22, the budget includes the temporary transfer of General Fund cash to Public Works (Fund 0017) for costs associated with high cost bridge construction that requires cashflow in advance of federal reimbursement. The Board has approved an estimated cashflow need for two bridge projects currently in progress. The status of those transfers will be reported in each quarterly update to the Board.

Project	Board Date	Approved Maximum	Transferred To-Date	Net Remaining	Period of Cashflow Need
Floradale Bridge	6/8/2021	\$6,800,000	(\$5,270,600)	\$1,529,400	2021-2024
Foothill Bridge	1/11/2022	\$6,000,000	-0-	\$6,000,000	2022-2025
Totals		\$12,800,000	(\$5,270,600)	\$7,529,400	

To the extent that federal reimbursements are received throughout the projects, that cash will be used first prior to any General Fund transfer. The Board approved a Budget Development policy in December 2021 to establish an Advance Construction Reserve in General County Programs to set aside the maximum amount estimated for the projects and track the activity. Staff will process budget revision requests as cashflow is needed for the projects.

CANNABIS TAXATION, COMPLIANCE AND ENFORCEMENT ACTIVITY (Attachment C)

During the first quarter, the County collected \$1.03 million in cannabis gross tax receipts. The County completed four enforcement actions against illegal cannabis activities: 300 plants and 62 pounds of cannabis product were confiscated totaling an estimated street value of \$226 thousand. The County also issued seven new cannabis business licenses.

As reported in the past, the County has approved enough cultivation acreage in land use entitlements to exceed the acreage cap in the unincorporated inland area. There are currently six operators with approved land use entitlements on the waiting list for this area requesting a total of over 220 acres. The acreage cap in Carpinteria has yet to be committed. To date, operators submitted a total of 210 business license applications through the first quarter, of which 62 have been issued. The majority of these pending business license applications remain in process, largely due to: 1) applicants that have been approved for a land use entitlement, but have not yet been issued a final, un-appealable entitlement, as many applications are being appealed after approval, and 2) applicants that have not yet obtained required building permits to construct new buildings or change the use of existing buildings. Further details can be found in Attachment C.

Attachments:

A – Financial Summary Report – General Fund

B – Financial Summary Report – Special Revenue and Other Funds

C – Cannabis Taxation, Compliance and Enforcement, First Quarter FY 2022-23

Authored by:

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