



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: County Executive Office
Department No.: 012
For Agenda Of: 12/13/16
Placement: Departmental
Estimated Time: 1.5 hours
Continued Item: No
If Yes, date from:
Vote Required: Majority

TO: Board of Supervisors

FROM: Department Director(s) Contact Info: Mona Miyasato, County Executive Office *mm*
Tom Alvarez, Budget Director, 568-3432

SUBJECT: **FY 2017-19 Fiscal Outlook Report, Early Estimate of Funding Gaps, Budget Development Calendar and Budget Development Policies**

County Counsel Concurrence

As to form: N/A

Other Concurrence:

As to form: N/A

Auditor-Controller Concurrence

As to form: N/A

Recommended Actions:

That the Board of Supervisors:

- a) Receive and file the Fiscal Years 2017-19 Fiscal Outlook Report, including an early estimate of funding gaps and impending financial challenges faced by the County in the coming fiscal years; and
- b) Adopt the Fiscal Years 2017-19 Budget Development Calendar outlining the planned Board, CEO, and departmental budget activities and provide direction as appropriate; and
- c) Adopt the Fiscal Years 2017-19 Budget Development Policies, receive staff comments and provide direction as appropriate; and
- d) Authorize the County Executive Office and the Human Resources Department to implement a Hiring Review Process for future hires; and
- e) Determine pursuant to CEQA Guidelines §15378 that the above activities are not a project under the California Environmental Quality Act.

Summary Text: Over the last several years, the national and local economy has slowly strengthened, and Santa Barbara County has experienced modest revenue growth. This growth has enabled the County to fulfill major commitments, such as funding for the future operations of the Northern Branch Jail, maintenance needs, and enhanced fire services, as well as to provide modest salary increases and restore a few key staff positions.

In the coming years, however, the County will be facing significant salary and benefit cost increases. This is largely due to pension costs, which will grow each year over the next five years, starting with an increase of \$12.2 million, and growing to \$46.1 million by the fifth year. These cost increases are expected to significantly impact County departments and will likely necessitate service level reductions over the five year period absent new revenue.

In response to this financial challenge, staff is developing a phased, budget re-balancing process to create immediate actions to address the FY 2017-18 budget and longer term strategies to achieve structural balance in the coming years. These new conditions will require changes to our normal budget process to ensure collaborative development of appropriate solutions and to keep the Board apprised of progress during the budget development cycle.

Background:

Projection of General Fund Contribution and Budget Imbalances

Economy is growing at modest rate but pension and other costs will cause budget gap. The national and local economies continue to slowly strengthen, and we are nearing full employment levels. In Santa Barbara County, property values and businesses continue to grow at a modest rate, which has allowed the County finances to stabilize in recent years. We are now entering a fiscal environment of modest County revenue growth.

This growth is offset by existing Board priorities and increasing salary and benefit (S&B) costs. An October 2016 decision by the Santa Barbara County Employee Retirement System (SBCERS) to lower the assumed rate of return by 50 basis points will significantly increase County pension contributions. Pension costs had largely stabilized in the past two years, but this recent change, combined with the need to make up for shortfalls in the fund's investment earnings, results in \$12.2 million General Fund needed next year. These new pension costs exceed prior forecasts, and while funds had been set aside in the FY 2016-17 budget for anticipated pension increases, the magnitude of the increase exceeds the amount set aside.

In short, this year's Fiscal Issues are greater when compared to last year's primarily because last year's report did not predict significant increases in pension costs. The table below summarizes the estimated cost of the Fiscal Issues and detailed descriptions of each follows.

Fiscal Issue Summary:

Tier 1 Issues: Expected occurrence within the next two fiscal years						
Issue		FY 2017-18 Impact	FY 2018-19 Additional Impact	One-time or Ongoing	FY 2017-18 Discretionary Impact	FY 2018-19 Discretionary Impact
		(\$ in millions)			(\$ in millions)	
1	Pension Fund Stability	\$ 12.2	\$ 8.2	Ongoing	\$ 3.9	\$ 2.6
2	Behavioral Wellness Inpatient System of Care	4.7	-	Ongoing	4.7	-
3	Health Insurance	3.7	4.5	Ongoing	1.2	1.4
4	State Gas Tax (HUTA) Revenue Reduction	3.0	-	Ongoing	3.0	-
5	Northern Branch Jail Operations Funding	1.5	1.8	Ongoing	1.5	1.8
6	Deferred Maintenance	1.4	2.4	Ongoing	1.4	2.4
7a	Main Jail Medical/Mental Health Services	1.0	-	Ongoing	1.0	-
7b	Main Jail – Capital Needs	2.6	1.6	One-time	2.6	1.6
8	Social Services Local Share for CalFresh	0.6	0.3	Ongoing	0.6	0.3
9	Social Services IHSS MOE Increase	0.5	0.2	Ongoing	0.5	0.2
Total		\$ 31.2	\$ 19.0		\$ 20.3	\$ 10.3

These anticipated cost increases are expected to create structural imbalances in many departments as we do not expect revenue increases to enable a “status quo” budget. The CEO’s office has estimated the “Gap” in funding for the General Fund and believes that revenues must be increased and/or services reduced to enable a structurally balanced General Fund. Non-General Fund departments are also expected to have structural balancing problems as their other funding sources are not projected to keep pace with cost increases.

Funding Gap in the General Fund is illustrated through three Scenarios. To evaluate the projected impact on the County, Gap Charts were prepared under three scenarios:

Scenario #1 – Discretionary General Revenues and General Fund Contributions. This illustrates the normal General Fund Contribution level and uses the same methodology as used during the development of the 2016-17 General Fund Contributions. It shows there is adequate growth in discretionary revenues to fund the normal portion of costs (General Fund Contribution) even with increases in salary and benefit costs, assuming current levels of service and employees. *This scenario, however, ignores what departments would be required to fund for their portion of costs.*

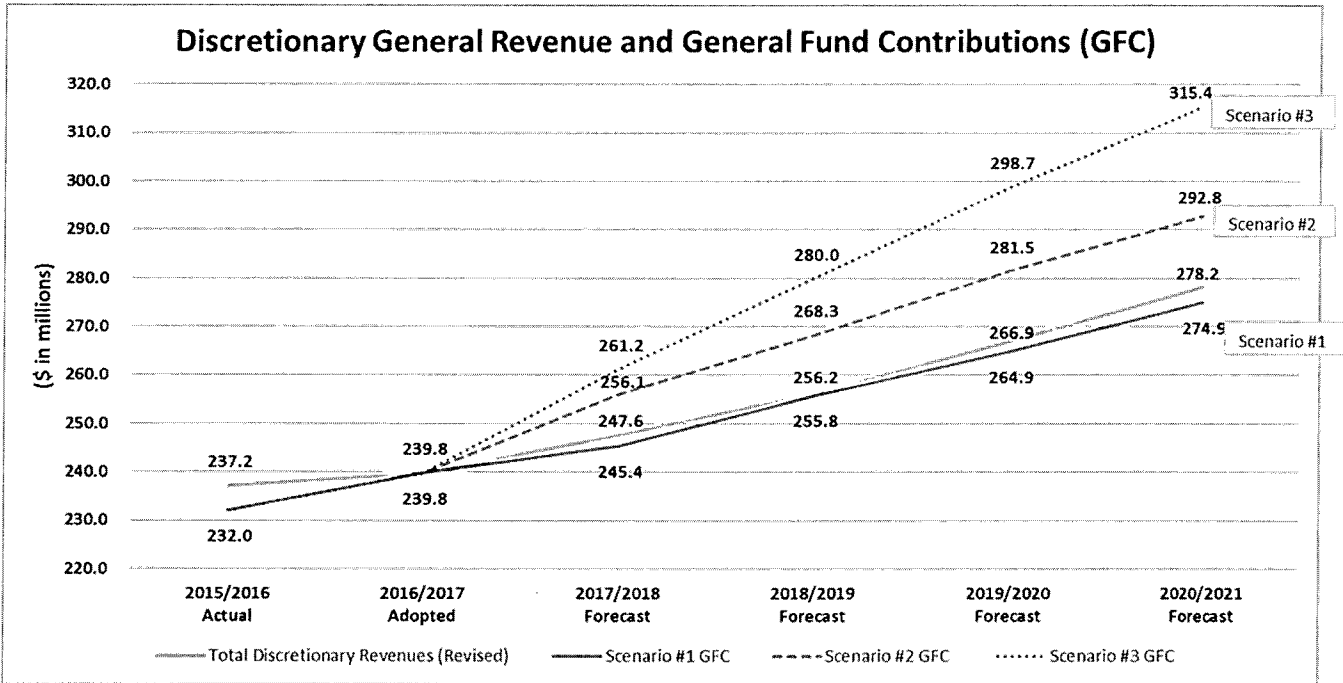
Scenario #2 – Scenario #1 above plus recurring or new fiscal issues. This illustrates the normal General Fund Contribution level to departments as in Scenario #1 plus the costs of funding the fiscal issues discussed in the Fiscal Outlook Report. Some of these issues are mandated and others are at the discretion of the Board.

Scenario #3 – Scenario #1 and #2 above plus funding gaps (deficits) in General Fund departments. This illustrates the total increased costs in the General Fund departments, acknowledging the normal General Fund Contribution plus the expenditures departments would normally fund with non-GFC sources. *This shows the full magnitude of the increased salary and benefit cost increases within the General Fund.* Departments will have some offsetting revenues, but those are not yet estimated and not illustrated below. This is effectively a worst case scenario in the General Fund.

Special Revenue Funds and Other Funds will also have increased costs and funding gaps. Not shown on the graph below, are the projections for some of the major special revenue funds. If state and federal

revenues are not adequate to fund these increases, service reductions will be required to balance these funds.

Revised Early Estimate Gap Charts; Scenarios #1 - #3: December 2016



Gap Summary

	2017/2018 Forecast	2018/2019 Forecast	2019/2020 Forecast	2020/2021 Forecast
Disc. General Revenue	247.6	256.2	266.9	278.2
Scenario #1 Gap	2.2	0.4	2.1	3.3
Scenario #2 Gap	(8.5)	(12.1)	(14.5)	(14.6)
Scenario #3 Gap	(13.6)	(23.8)	(31.8)	(37.2)

Budget Calendar (Attachment B)

New conditions call for changes to our normal budget process. To ensure transparency in the process, collaborative development of appropriate solutions, and to keep the Board apprised of progress during the budget development, staff is recommending additional steps in our normal process of budget development.

FY 2017-18 Budget Development Cycle

- December 2016: CEO office will issue to departments their General Fund Contributions (GFCs) (i.e. the amount of Discretionary General Revenue allocated to departments) based on current conditions.

- January 2017: Departments will create budgets for CEO staff review that balance through substantiated revenue growth or service level reductions.
 - HR and CEO will implement a “Hiring Review Process” to prioritize filling of vacant positions (New).
 - CEO staff to convene interdepartmental working group to research and review countywide short-, mid- and longer- term strategies for re-balancing; discussion of options at the Board’s April Workshops
 - CEO will provide an update, overview of the budget process, and begin discussion of priorities with the Board at the end of January (New)
- February 2017: Based on information provided by departments, budget “Gaps” will be revised; an update will be provided to the Board and further Budget Policy changes may be considered (New)
- March 2017: a preliminary review of possible departmental service level reductions will be presented to the Board (New)
- April 2017: Budget Workshops
- June 2017: Budget Hearings

FY 2018-19 Budget Development Cycle

- July 2017: Continued refinement of mid- and longer-term rebalancing and resiliency policy options for FY 2018-2020 budget, with recommendations to the Board by December 2017
- January 2018: New Budget Cycle; integration of rebalancing options reviewed above for FY 2018-19 and beyond

Budget Development Policies (Attachment C):

Continuance of existing Budget Policies is recommended; adjustments will be revisited in February when we have more information from departments. Last year’s Budget Development Policies are included without substantive changes, and we request that the Board approve these policies now so that the budget process can be initiated. After departments have developed their budgets and revised their budget gaps (surplus or deficits), staff will present these gaps to the Board in February 2017, and any necessary or suggested modifications to the existing Budget Policies can be considered at that time.

Potential changes to existing Budget Policies that the Board may wish to consider in February include the following:

- #4c – Workers’ Compensation funding – extend the recovery period of tail claims
- #5 - Strategic Reserve Funding at 8% of General Fund Operating Revenues - establish a fixed dollar amount versus a percentage.
- # 7c - 18% Maintenance Funding Policy - establish a fixed dollar amount, review or re-evaluate each year based on available funds

- In addition to the above, the Fire Tax Shift to 17% of the property tax base could be evaluated to determine if the amount of the shift could be adjusted (example 16% rather than 17%), or slowed (the rate of increase, which is 25% of the County's Secured Property Tax growth, could be lowered to keep the 17% target but slow the attainment of 17% during this deficit period).

A Hiring Review Process is recommended to evaluate all new hires. During the Great Recession, a hiring review process was implemented, whereby the CEO and HR reviewed each request to fill vacant positions prior to proceeding with the recruitment. This created departmental and executive review of each position being filled and was important to meet department balancing goals so that positions weren't filled and subsequently laid off. A similar process is being considered for implementation within the current FY 2016-17. Staff is seeking Board approval to implement a hiring review process to begin in the new calendar year. This does not mean positions will not be filled; it does mean, however, that departments will need to justify filling positions, in the context of their operational necessity and ability to balance their budgets next year.

Closing Comments

Over the next five years, pension-related cost increases will be a significant challenge. Discretionary General Revenues are normally adequate to fund annual increases in policy-based funding (GFCs). Next year, however, identified Fiscal Issues will require funding which exceeds available Discretionary General funds. In addition, because General Fund departments' salary and benefit increases are only partially funded by GFCs, General Fund departments will require additional funding, and absent that, propose service level reductions. These may be severe in some departments.

For Special Revenue Funds, such as Behavioral Wellness (DBW), Social Services (DSS), Child Support Services (CSS) and others are projecting flat revenues from key funding sources (such as State Realignment funds); as a result, they will require additional funding or service level reductions to balance the resulting structural imbalances.

As a result, strategic planning and budgeting will be more important than usual. Longer term solutions will be necessary to address the anticipated structural imbalance, and therefore, multi-year approaches are being developed to respond to this issue.

Performance Measure:

Contract Renewals and Performance Outcomes:

Fiscal and Facilities Impacts:

Budgeted: No

Fiscal Analysis:

Impacts are stated above in this Board letter.

Special Instructions:

None

Attachments:

Attachment A - Fiscal Outlook Report

Attachment B – FY 2017-19 Budget Calendar

Attachment C - FY 2017-19 Budget Development Policies & General Fund Allocation Policy

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