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

Submitted on:
(COB Stamp)

Department Name:	CEO
Department No.:	012
For Agenda Of:	September 12, 2023
Placement:	Departmental
Estimated Time:	30 minutes
Continued Item:	No
If Yes, date from:	N/A
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

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SUBJECT: **Fiscal Year 2022-23 Fourth 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 Fourth Quarter Budget and Status Report as of June 30, 2023, 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 and financial update for the fourth quarter ending June 30, 2023 provides a look at the County's year-end financial position relative to the FY 2022-23 adjusted budget.

The County ended FY 2022-23 consistent with projections reported to the Board in previous quarterly budget updates. The County ended with a net positive $27.2 million year-end balance carry-forward in the General Fund, $933 thousand less than projected at the end of the third quarter. Approximately $15.5 million of the positive balance was due to higher than anticipated property tax collections in Discretionary General Revenues, as was reported to the Board throughout the fiscal year. While the year-end balance is

one-time in nature, the growth in property taxes was built into the FY 2023-24 Adopted Budget as an ongoing source for General Fund costs. Several other General Fund departments also ended the year with expenditure savings and/or higher than anticipated revenues, most notably Treasurer-Tax Collector ($737,000), Clerk-Recorder-Assessor ($668,000), and Probation ($376,000). These variances are explained in greater detail later in the report.

While this is a significant positive year-end balance, staff recommends maintaining the Board's prudent fiscal practice of preserving the balance for one-time needs and reserves in the FY 2024-25 budget. This is recommended given continued inflationary pressures and known or potential needs, which exceed the year-end balance funding. Planning for known impacts include the following:

- <u>Disaster Recovery</u>
  Countywide there are estimated to be over $100 million of damages to County infrastructure caused by two storm events in January and February/March 2023. Repair and recovery costs continue to be monitored and will require some level of funding from General Fund reserves before State and federal reimbursements are received, although at this time those numbers are still unknown. In the current fiscal year, $14 million of General Fund has already been earmarked in the Disaster Recovery fund balance. However, the overall need in Public Works and other departments, such as Community Services, for General Fund cashflow assistance could be as high as $30 million, and utilization of some of this positive year-end balance, potentially up to $16 million, will be necessary. Potential impacts of the expected El Nino storms this winter have not been included in this estimate; possible impacts of such an event are still being assessed.

- <u>Advance construction fund reserves for debt-funded capital projects</u>
  Several large-scale capital projects will require temporary cashflow assistance through the General Fund, including six projects planned to receive Certificate of Participation (COP) debt issuance during the latter half of FY 2023-24. The CEO's Office is working with project managers to refine project schedules and determine how much cash assistance will be needed during FY 2023-24 ahead of the debt issuance. Currently, about $7.0 million is available in the advance construction reserve, but $3 to $6 million more is likely necessary in the coming months, prior to issuance, and would come from this year-end carryover.

- <u>Other potential or anticipated one-time uses on the horizon include:</u>
  - Incompetent to Stand Trial penalty assessment
  - preliminary design costs for expansion of beds at the Northern Branch Jail
  - cost inflation on previously approved capital projects;
  - new capital projects;
  - increased one-time implementation costs of the Workday Enterprise Resource Planning software;
  - implementation costs of new countywide plans (e.g. Climate Action Plan, Recreation Master Plan)

Staff will bring the five-year forecast to the Board in December, which will set the stage for FY 2024-25 budget development and may highlight additional needs for the one-time funds.

Special Revenue Funds are required to end the year balanced, so those funds are not included in this update, except for the Sheriff's Inmate Welfare Fund, which required a draw from fund balance to close the year, as discussed below. There were no other significant year-end issues for any of these funds.

Background:
FOURTH QUARTER REPORT

In this report, the year-end financial results for the fiscal year-end are compared to the annual adjusted budget. The major differences (variances) between budgeted and actual amounts through June 30, 2023, are discussed below.

This report highlights General Fund departments (including Discretionary General Revenues) with positive variances greater than $300,000, shown in the Financial Summary Report (Attachment A), or that would have ended negative without additional assistance. As mentioned above, this report does not discuss Special Revenue Funds, which are required to end the year with a balanced budget.

Attachment A uses actual revenues and expenditures for the fiscal year 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).

Additionally, while the Sheriff's Office ended with a balanced budget, it did so with the help of American Rescue Plan Act (ARPA) and Proposition 172 funding as discussed below.

GENERAL FUND SUMMARY (Attachment A)

The General Fund had a year-end net positive variance of $27.2 million. The departments with significant net financial impacts area discussed in detail below.

<u>Significant Department Variances</u>

General Revenues (Department 991) ended the year with a positive variance of $24.2 million, 7.0% over total budgeted revenues, shown in detail in the table below. This variance is due primarily to higher than budgeted Property Tax, Interest Income, Transient Occupancy Tax (TOT), Sales and Use Tax, Franchise Fees, and a reduction in the allocation of General Fund Contribution (GFC) to the Department of Social Services. Cannabis Cultivation and Retail Storefront Taxes also came in lower than budgeted but are not contributing to the year-end variance and are explained later in this section.

Property Taxes were the major driver of the General Revenue positive variance as they exceeded budget by $15.5 million. Secured and unsecured property taxes mainly drove this variance as they exceeded budget by $6.3 million, primarily due to the strength of the real estate market 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 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 fiscal year 2022-23 property tax budget was developed, Auditor-Controller 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 2022 with substantially higher growth resulting in the positive variance. In addition, Property Taxes In-lieu of Vehicle License Fees (VLF) are driven by assessed value growth and contributed to the positive variance by $2.4 million. Supplemental taxes also ended higher than budget, by about $3.8 million, largely due to the high volume of property transfers that occurred over the past few years and changes to the associated assessed value as properties get reappraised. Fines, forfeitures, and penalties also factored into the positive variance as they came in higher than budget by about $1.7 million, driven by higher payments made on current and prior year delinquent taxes. The growth in revenue from FY 2022-23 was built into the FY 2023-24 Adopted Budget for ongoing costs incurred in the General Fund.

Interest Income was another significant driver of the General Revenue positive variance as it exceeded budget by $4.0 million due to treasury interest rates that have continued to increase in each quarter since the beginning of calendar year 2022, when the fiscal year 2022-23 budget was developed. Given the trend of increasing interest rates, staff has correspondingly increased the budgeted amount for interest income in fiscal year 2023-24.

Transient Occupancy Tax (TOT), which is highly dependent on tourism, ended with a positive variance of $2.0 million. Although TOT monthly receipts grew solidly in the first half of the fiscal year and are driving the positive variance, receipts in the second half of the year declined on a year-over-year basis, largely due to economic uncertainty and actions taken by the Federal Reserve to curb inflation. This trend is expected to continue through the first half of fiscal year 2023-24, before reverting to modest growth beginning in calendar year 2024. In the FY 2022-23 Adopted Budget, the Board funded a TOT Compliance position in the Treasurer Tax Collector's office to perform proactive audits of hotels and short-term rentals. The department was able to purchase software to assist with this effort, but the position remains vacant as recruitment efforts continue in earnest.

Similarly, **Sales and Use Tax** revenue also finished the year with a positive variance of $932 thousand as consumer spending remained steady through the first half of the fiscal year. However, receipts for the second half of the year came in flat on a year-over-year basis. According to Sales and Use Tax consultant, HdL, the actions taken by the Federal Reserve to address inflation over the past year are exerting downward pressure on many of the major industry sectors, resulting in decreased consumer demand for goods and an anticipated deceleration in Sales and Use Tax growth through the end of calendar year 2023, before seeing modest growth beginning in calendar year 2024.

Franchise Fees also contributed to the positive variance as they exceeded budget by $829 thousand, primarily due to a timing issue as some prior year payments were received in fiscal year 2022-23.

A **Reduction in GFC Allocation to the Department of Social Services** (DSS) in the amount of $894 thousand also contributed to the Discretionary Revenue's overall positive variance. This allocation amount was withheld, as the department received several revenue allocations from the State which exceeded budgetary expectations, therefore eliminating the need for a portion of their overall annual GFC allocation. This is not an ongoing reduction to DSS' GFC going forward, but something that is looked at on an annual basis when State revenues are known.

Discretionary General Revenue Summary (in thousands):			
Source	Adjusted FY 2022-23	Actual FY 2022-23	Variance Actual vs. Adjusted
Property Taxes	$ 262,545	$ 278,004	$ 15,459
Interest Income	727	4,686	3,959
Transient Occupancy Tax	15,165	17,202	2,037
Sales and Use Retail State Tax	14,240	15,172	932
Franchise Fees	3,193	4,022	829
Cannabis Tax	16,293	6,117	(10,176)
All Other Revenues	32,072	32,156	84
Total Discretionary Revenues	**$ 344,235**	**$ 357,359**	**$ 13,124**
Decrease to Cannabis Fund Balance	$ 16,293	$ 6,117	$ (10,176)
All Other Transfers	327,942	327,045	(897)
Fiscal Year End Variance	**$ -**	**$ 24,197**	**$ 24,197**

Cannabis Cultivation and Retail Storefront Tax ended the fiscal year with a negative variance of $10.2 million on an adopted budget of $16.3 million. This decrease continues to be primarily driven by a decline in cultivation tax due to the oversupply of wholesale cannabis product and resulting price compression that continues to persist locally and state-wide as well as the continued prevalence of product on the illegal market. Other major factors contributing to the decrease in revenue include cultivators withdrawing from the program for a variety of reasons and some electing not to grow, mostly due to market conditions. Another contributing factor to the lower receipts is the timing of when each retail operator is expected to complete the land use entitlement and business licensing processes, relative to the timing assumptions made when the budget was developed. Additionally, receipts for the retail storefront businesses that have commenced operations have come in lower than staff had projected and is likely due to those entities establishing themselves as new operations in their respective locations. Staff will continue to monitor retail storefront tax receipts as this is a new activity being conducted in the unincorporated area without any historical data available for reference.

Despite declining cannabis revenues, the revenues that did materialize, in addition to fund balance carryover from last year, were sufficient to fund the FY 2022-23 cannabis program costs and other allocations made from cannabis revenues in prior years, including funding for libraries, planners in long range planning, deferred maintenance funding, and more. At the FY 2023-24 budget workshops held in April, the Board approved replacement of about $1.2 million in GFC for ongoing libraries funding and three long range planner positions that were previously funded by cannabis tax revenue. At the FY 2023-24 budget hearings in June, the Board approved an additional swap of about $1.7 million in GFC for ongoing equity funding, translation services, elections staff, and replacement to further reduce reliance on cannabis tax revenue. This replacement of cannabis tax revenue funding with GFC will help fund Board priorities in the event that cannabis tax revenues continue to decline or remain at lower levels. Staff will continue to closely monitor cannabis tax revenues into the next fiscal year and will update the Board quarterly.

General County Programs ended the fiscal year with a positive variance of $789 thousand, 0.3% on a total budget of $298.4 million, mainly due to the recognition of $742 thousand in ARPA reimbursement to the General Fund, stemming from a required fiscal year 2021-22 accounting correction.

Treasurer-Tax Collector and Clerk-Recorder-Assessor-Elections both ended the fiscal year with positive year-end variances primarily driven by salary savings associated with vacant, funded positions. The Treasurer-Tax Collector ended with a variance of $737 thousand (7.3% on a total budget of $10.1 million) while the Clerk-Recorder-Assessor-Elections ended with a variance of $668 thousand (3.8% on a total budget of $17.4 million).

Probation ended the fiscal year with a positive variance of $376 thousand, 0.4% on a total budget of $88.6 million; down from the $4.0 million surplus projected at third quarter. This significant change is due primarily to expenditures not anticipated at third quarter: a legal settlement, a modular classroom for the Juvenile Justice Center (JJC), and increased salary and benefit costs in the fourth quarter.

Sheriff-Coroner's Office ended the fiscal year with a budget deficit of $1.5 million, which was balanced after the CEO released $1.5 million from Proposition 172 set-aside funds, per the Board's prior policy approval of October 18, 2022. Additionally, $487 thousand of ARPA funding was used to reimburse eligible pandemic-related costs, prior to the release of the Proposition 172 set-aside. As anticipated throughout the fiscal year, this need was primarily due to overtime and extra help costs in excess of budget, as well as some unanticipated contractual and other cost increases. Overtime costs for the year were $17.3 million on an annual budget of $5.1 million, exceeding budget by $12.2 million. For comparison, overtime costs for all of FY 2021-22 totaled $12.4 million. However, each year, most of this overage is absorbed by salary and benefit savings as a result of numerous funded vacancies within the department, except for overtime related to filling behind deputies on leave or in training. It is important to note that there are other impacts to the department and staff resulting from the extensive overtime being incurred, such as an increase in disability retirements, staff fatigue, increased leave taking, and higher staff turnover.

In October 2022, the Board authorized a $2 million annual set-aside of Proposition 172 funds for use toward eligible overtime costs and recruitment efforts, including hiring incentives, to assist the department. To-date, the department has provided new hire incentives to four Sheriff Deputies and two Custody Deputies, including relocation costs and lodging as well as advanced vacation and sick accruals. As mentioned above, $1.5 million of the $2 million set-aside was released toward eligible costs to balance the department's budget in FY 2022-23, and the set-aside funding has been replenished to $2 million in FY 2023-24.

CEO Budget staff has worked with the department since the October meeting to identify potential solutions to account more accurately for overtime drivers that includes tracking and monitoring overtime data and information. This work was intended to develop an overtime validation process to establish a base overtime budget moving forward. The department recently provided an analysis and breakdown of overtime drivers—including overtime due to position vacancies, academy and field training, lost time (vacation and sick time and other leaves of absence), emergency and seasonal events, and "minimum staffing levels" to meet operational needs that could not be achieved with the budgeted FTE—for FY 2022-23. However, the department noted current system limitations in tracking certain leaves, and certain assumptions were applied in lieu of specific time-tracking mechanisms; therefore, it will take some time for CEO staff to fully vet the analysis and determine whether the proposed methodology can be applied to future years. Ultimately, CEO Budget staff anticipate that the department will need to develop and implement new time tracking processes throughout their organization to accomplish the necessary level of detail required. Until that time, CEO Budget staff cannot recommend any ongoing funding to address the Sheriff's staffing requests related to shift relief, since a baseline of overtime cannot yet be determined.

Additionally, the Inmate Welfare Fund is a Special Revenue Fund which required a draw on existing fund balance of $224 thousand to balance the fund at the end of the fiscal year. This is due to significant losses in revenues for pay phone charges as a result of changes in State law that limit how much inmates can be charged per minute for use of phones while in custody. The Inmate Welfare Fund has adequate fund balance to cover operating costs for the next few fiscal years, but in case this proves to be a permanent reduction in operating revenue, the department is currently evaluating the ability to reduce expenditures without substantially compromising services provided. In addition to expenditure reductions, the department may eventually need to seek an alternative funding source, such as the General Fund or Realignment funding through the Community Corrections Partnership (CCP), to maintain existing services, particularly if additional legislative changes further reduce the fund's ability to generate revenues through charges for services. 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.

ADVANCE CONSTRUCTION RESERVE ACTIVITY

Beginning in FY 2021-22, the budget included 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. There have also been temporary transfers to General Services for design and construction of the new Probation headquarters, which is currently underway, as well as the EOC portion of the Fire Dispatch Center project. Both transfers will be reimbursed once debt is issued for this, and other projects. Finally, a transfer was made at the end of the fiscal year to cover costs on the Betteravia Solar Array, which will be reimbursed by a loan from the California Energy Commission upon project completion. The status of these transfers and reimbursements will be reported in each quarterly update to the Board.

Project	Transferred To-Date	Reimbursed to General Fund To-Date
Floradale Bridge	($5,270,600)	$3,000,000
Foothill Bridge	($3,000,000)	$0
Probation HQ	($1,281,194)	$0
EOC/Fire Dispatch Center	($309,418)	$0
Betteravia Solar Array	($1,416,379)	$0

The Board approved a Budget Development policy in December 2021 to establish an Advance Construction Reserve in General County Programs to provide cashflow for reimbursable 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 B)

During the fourth quarter, the County collected $2.0 million in cannabis taxes. Four enforcement actions were conducted against illegal cannabis operations, resulting in the confiscation of 554 plants and twenty pounds of cannabis product with an estimated street value totaling $309,000. The County issued 9 new cannabis business licenses in the quarter; however, similar to the third quarter, several more business license applicants have withdrawn from the application process resulting in a change to the acreage cap eligibility lists.

As previously reported, the County has approved enough cultivation acreage in land use entitlements to exceed the acreage cap in the unincorporated inland area. However, currently the acreage cap in this area is no longer exceeded by pending business license applicants. The operators that were on the waiting list for this area were offered acreage and if responsive, secured their spot in the acreage cap. There are now approximately 160 acres still available in the unincorporated, inland area. Further details can be found in Attachment B.

Attachments:

A – Financial Summary Report – General Fund
B – Cannabis Taxation, Compliance and Enforcement, Fourth Quarter FY 2022-23

Authored by:

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