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:

Department Name:	County Executive Office
Department No.:	012
For Agenda Of:	December 13, 2022
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, Assistant County Executive Officer
SUBJECT:	**Fiscal Year 2023-24 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: N/A

Recommended Actions:

That the Board of Supervisors:

a) Receive and file the Fiscal Year (FY) 2023-24 Budget Development Report that includes a five-year forecast of major budgetary components for the General Fund and other major funds;

b) Adopt the FY 2023-24 Budget Development Policies (Attachment B);

c) Provide staff with any preliminary direction on Board priorities for FY 2023-24, as appropriate; and

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

Summary

The County Executive Office (CEO) is commencing the annual budget planning process for FY 2023-24 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 main focus is on the County's General Fund, forecasts of five years of revenue and expenditure projections for other major County operating funds have 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 budget development policies proposed for FY 2023-24, 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 2023-24 proposed policies are similar to those adopted last year, with specific changes to further guide and focus budget development. New additions are explained in this letter, and the policies are presented in full in Attachment B (new additions are presented in bold italicized text).

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

- Steady consistent growth in revenue, but at lower more typical pre-pandemic levels than have been seen over the past two fiscal years. Local discretionary revenues from property and sales taxes are expected to be relatively stable with modest growth.
- While state revenues related to personal income are being monitored for decline, as the State Legislative Analyst's Office recently forecasted a $25 Billion deficit for next year, the forecast does not show a direct impact of potential State reductions. The Board may choose to partially backfill losses of State revenue, if any occur; however, the forecast does not assume any backfill.
- Inflation is anticipated to continue at least through FY 2023-24 but the forecast does not include a major recession at this time. In most years, revenue growth is helping to offset the General Fund portion of negotiated salary increases and increases in costs for health benefits, retirement contribution and insurance premiums.
- The County's forecast projects at least a $1.38 million surplus in FY 2023-24, predominantly the result of extraordinary property tax growth in FY 2022-23.
- Subsequent years of the forecast reflect deficits. A primary driver of the deficit, which begins in FY 2025-26, is $5 million ongoing expenditures toward homeless services once existing grant funding ends. Salary and benefit cost increases, also use up most of the discretionary revenue growth in the last four years of the forecast, with those costs alone exceeding available revenue in FY 2027-28. Additionally, NBJ costs are expected to increase by approximately $2.4 million annually beyond the NBJ funding plan.
- A preliminary estimate of one-time unallocated fund balances in the General Fund available for consideration in the FY 2023-24 budget is $10 million with an additional $6.6 million in Proposition 172 funds specific to public safety costs. However, some portion of these funds likely will be needed to help mitigate the future-year projected deficits or possible reductions in State or Federal revenues.

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 proposed budget development policies continue to take into consideration discretionary revenue growth is limited, including cannabis tax revenue, and investments in deferred maintenance, the strategic reserve and the Northern Branch Jail remain prudent policy commitments.

EXPERT AND STATE OUTLOOK

The outlook of the U.S. economy is uncertain with continued high inflation trends and an increased possibility of a recession during the next 12 months. In its September 2022 Report, the UCLA Anderson Forecast predicts that the U.S. economy will continue to see below-trend growth. In addition, inflation has become persistent and broad-based even as crude oil prices have declined. Several other risk factors pointing in the direction of a possible recession include: possibility that the Federal Reserve will increase interest rates too aggressively, which would lead to constrained consumer spending and business investment; poor consumer sentiment about the economy (public sentiment is usually a leading indicator of economic conditions); housing market shifts as mortgage rates increase and home prices decline; impacts to the exports sector as prices for U.S. goods have increased; and labor unrest.

However, the UCLA Anderson consensus does not estimate more than a 50 percent chance of a recession in the next year, despite these risk factors. A few positive trends are continuing including likely upward revisions to GDP trends during the first half of 2022, continued consumer spending despite the pessimistic sentiment, continued employment growth, and easing supply chain pressures.

Table 1. Average Annual Gross Domestic Product Growth Forecast

Forecast	2022	2023	2024
September 2022	1.5%	0.3%	2.0%
June 2022	2.8%	2.0%	1.9%

Source: UCLA Anderson Forecast

Specific to California, GDP is growing (only slightly behind Germany for the 5th largest GDP). The state is seeing robust investments, including both venture capital investments and direct foreign investments that are higher than all other states. In addition, job growth for non-farm sectors has increased to approach February 2020 levels. However, many new jobs are in sectors different from those where job loss was most evident: New job creation has been in the areas of logistics, technology and healthcare, whereas about 80% of the missing jobs are in leisure and hospitality, education, and other services. Housing markets are also down in the state with interest rates on the rise, and median prices of single-family homes is 7% lower than the previous peak. Overall, the state is showing a weaker forecast as a product of the slowing growth nationwide.

The Legislative Analyst's Office (LAO) November California's Fiscal Outlook for FY 2023-24 indicates a possible $25 billion budget deficit, mainly driven by lower revenue estimates as inflation persists, and partially offset by lower spending in certain areas. The LAO's estimate does not assume a recession will occur, but rather accounts for the heightened risk of a recession. While the state has $23 billion in General Purpose Reserves available to allocate to General Fund Programs, the LAO recommends that the Legislature plan for FY 2023-24 without using reserves, instead saving those funds for use in the event that a recession does occur. The Governor's preliminary budget will be issued in January and revised in May 2023. The state will have more information about its budget condition in May 2023, and will be able to determine at that time whether use of reserves will be necessary.

PRELIMINARY PROJECTIONS FOR FY 2023-24

The forecast for the coming budget year and development of a financial plan for that year are determined based on certain key elements. The primary elements include: 1) State and federal actions that will increase or decrease County costs or revenues; 2) the amount of increase/decrease in the County's assessed valuation impacting property taxes and other major discretionary revenues; 3) the status of the current year's budget and year-end fund balances carried forward to the next fiscal period; and 4) known, quantifiable changes in local program costs and revenues. These elements must be evaluated and carefully monitored before the County can establish a plan for next year's budget. Information relative to these elements is discussed on the following pages, including significant fiscal issues identified by staff that are being monitored and may have potential budgetary impacts.

The CEO has developed forecasts for major budgetary components, provided in Attachment A, that are based on assumptions and key economic factors. Projections will be reassessed and updated for the recommended budget as more current information is obtained. The major budgetary components provided in Attachment A include:

- General Fund discretionary revenue, including property taxes, sales taxes and cannabis revenue
- Changes in salaries and benefit costs
- General Fund reserves (990 Accounts)

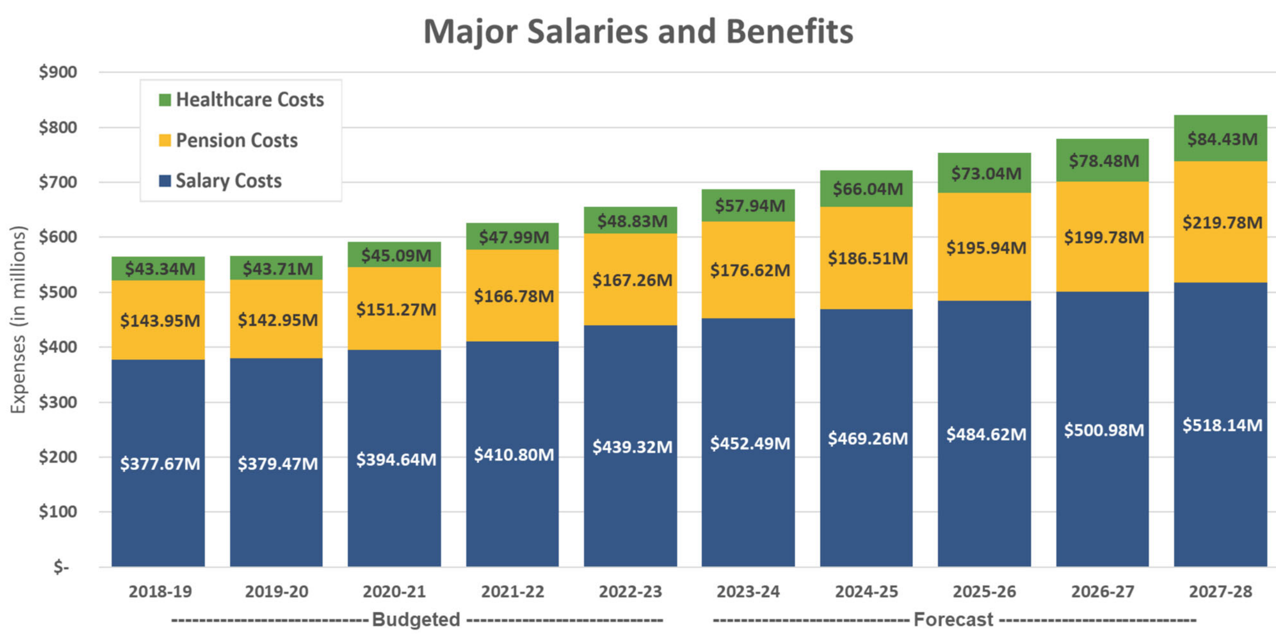
Countywide Salary and Benefit Costs

Salary and benefit costs are major budgetary drivers that affect all County operating funds. Most labor contracts are currently in place, with increases between 2.0% and 2.5%, as well as additional equity adjustments where negotiated, for FYs 2023-24 and 2024-25. Assumptions for the years after expiration of the MOUs were generally 3.0%. Salary costs for all operating funds are estimated to increase $13.2 million in FY 2023-24 growing to a cumulative increase of $78.8 million over 5 years. The General Fund portion of the projection is $6.5 million for FY 2023-24 with a cumulative total of $38.2 million by FY 2027-28.

Retirement costs are driven by salary increases, pension investment returns, and expectations regarding existing and future retirees. Costs are projected to increase about 5.6% ($9.4 million) in the first year of the forecast, a significant increase due to the factors mentioned above. The impact of investment gains and losses, as well as other actuarial changes, are smoothed in over a five-year period and continue to affect future years. The assumed rate of return used for the forecast is 7%. The contribution growth flattens to only 2% in the fourth year of the forecast before seeing a larger increase to contributions in FY 2027-28. This is due to the negative returns of FY 2019-20 being fully smoothed in by FY 2025-26, while the gains of FY 2020-21 are smoothed in for a final year in FY 2026-27. After those gains are fully smoothed in, they no longer offset the final year of smoothing for the FY 2021-22 losses that are driving the large increase in FY 2027-28. Final retirement rates for FY 2023-24 will be approved by SBCERS in December and incorporated into the preliminary budget presented to the Board at April workshops.

Healthcare costs are driven primarily by increases to medical insurance premiums, which saw about 9% increase in 2023, and are assumed to increase by that amount annually throughout the forecast period. Additionally, recent negotiations with all bargaining groups have included premium subsidies for employees on dependent and family insurance plans, phased in over three years, starting in calendar year 2023. This leads to higher increases in the first three years of the forecast, as compared to the final two years. Healthcare costs are anticipated to increase $9.1 million in FY 2023-24, growing to a cumulative increase of $35.6 million over the forecast period.

The following table shows a ten-year period of Major Salaries and Benefits Costs for the County with five years of budget and five years of forecast. The forecast for FY 2023-24 assumes growth of $31.6 million, or 4.8% overall. Over the five-year forecast period, growth averages about 4.6% each year for a cumulative increase of $167 million by FY 2027-28. The detail for major salary and benefit account assumptions can be found in Attachment A page 3. The anticipated impact on the General Fund of these changes in major salary and benefits costs over the five-year forecast period is presented on the financial forecast table for the General Fund on page 8 of this letter.



General Fund

The General Fund is the main operating fund for the County and a primary focus of budget discussions that relate to discretionary revenue, such as property, sales, transient occupancy and cannabis tax revenues. These major discretionary revenues are distributed to departments as General Fund Contribution (GFC), with nearly 90% allocated to General Fund departments. GFC finances departmental operations and services for which no special or dedicated revenues are available and, in special revenue departments, often serves as local match for State and federal funding. Forecasts for the major budgetary components for the General Fund have been prepared and areas of major impact are discussed below.

Discretionary Revenue. The primary discretionary General Fund revenue sources are property, sales, transient occupancy and cannabis tax revenues. Growth from these revenue sources are vital to paying for increases in labor and operational costs for many County operations, including most of the public safety function. The forecast for all discretionary revenue is shown on pages 1-2 of Attachment A.

- **Property Taxes**: Assessed value for property in the County has significantly grown over the past year. The Auditor-Controller estimated revenue assuming property tax assessed value growth at 4.5% for FY 2022-23; however, the final assessed tax roll from the Assessor at the end of June was greater at 8.1%. This additional revenue is now reflected in the revenue forecast for FY 2023-

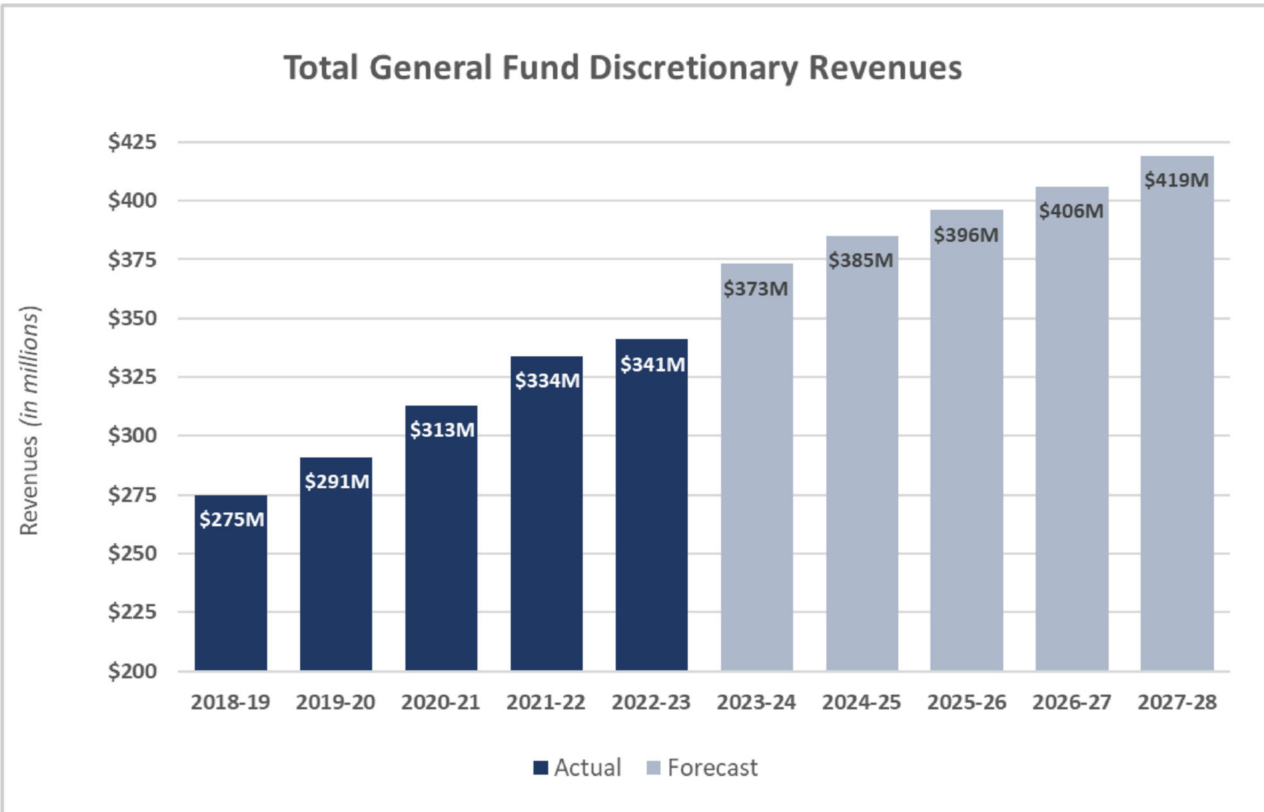
24, along with assumed assessed value growth of 4% in FY 2023-24. The primary driver of this increase is secured property taxes, which is comprised of residential and commercial properties. Overall, there is an estimated 11.2% increase in property tax revenues, including property taxes in lieu of vehicle license fees and redevelopment agency funds, between FY 2022-23 budget and the FY 2023-24 forecast. The balance of the forecast assumes that property tax revenue will experience mild growth of 2.7% in year two, with growth increasing slightly to 2.9% for each of the remaining forecast years. The net impact to the General Fund for property tax revenue for FY 2023-24 is an increase of $32.4 million.

- **Local Sales Tax**: 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. In the wake of the pandemic, sales tax receipts reached record highs as the economy surged and consumers sought to return to some semblance of normalcy after having spent the past couple of years isolating and social distancing. However, consumers are now facing economic uncertainty due to factors that include the increased price of goods due to high inflation, the impact of actions taken by the Federal Reserve to address inflation, and the adverse effects of the ongoing war in Ukraine. With the assistance of Sales and Use Tax consultant, HdL, local sales tax is expected to decline 1.6% in FY 2023-24 compared to FY 2022-23 estimated actuals due to the economic headwinds mentioned above and an assumed slowdown of the economy. This equates to a 10.7% increase compared to the FY 2022-23 adopted budget. Growth of 2.9% is forecasted in FY 2024-25 as the economy is predicted to recover, before increasing to 3.4% growth in each of the final two years of the forecast.

- **Transient Occupancy Tax (TOT):** TOT revenue is highly dependent on tourism and the availability of lodging in the unincorporated areas of the County. Although these revenues were negatively impacted early in the pandemic as a result of stay-at-home mandates, they rebounded to hit record highs in each of the past two fiscal years due to the surging economy, the waning pandemic, and the public's pent-up demand for travel. However, with the economy predicted to slow, disposable income is expected to contract which is likely to have an adverse impact on the demand for travel. Revenue is expected to grow a modest 1.3% over the current year's estimated actuals primarily due to the slowing economy. Compared to the FY 2022-23 adopted budget, the expected increase is 12.8% due to the lower estimate of TOT at that time. TOT revenue is projected to decline by 2% in FY 2024-25 and return to minimal, yet positive growth of 0.5% in FY 2025-26 as the economy recovers. Revenue growth is projected to continue to increase over the remaining forecast years, returning to more typical growth levels of 3% in the final forecast year.

- **Cannabis Tax**: Cultivation taxes make up the majority of cannabis tax revenue collected and have been declining since the start of FY 2021-22 due to the oversupply of wholesale cannabis product that continues to persist statewide, and the associated compression of prices. A cultivation tax revenue budget of $15.2 million was adopted for FY 2022-23, however, based on actual taxes collected through the first quarter, a fiscal year-end adjusted total of $9.1 million has been projected. Additionally, several new retail storefront operators are expected to commence operations this fiscal year and will begin contributing to the total cannabis taxes collected. A retail storefront budget of $1.1 million was adopted, however, that projection has been adjusted to $629 thousand due to slight delays in the timing of when these operators will open for business. FY 2023-24 projects a decline in total revenue of 9.4%, or $1.5 million over the FY 2022-23 adopted budget, but when compared to the FY 2022-23 year-end projections, represents an increase of

51.2%, or $5 million. This increase consists of a net of $3.9 million in cultivation tax due to the assumption that a number of new cannabis cultivators coming online will outpace the lost revenue from those cultivators that have historically paid taxes, but that have been eliminated from the process. The remaining $1.1 million of the increase is attributable to several new retail storefront operators that are expected to obtain the required permits and licenses necessary to commence operations. FY 2024-25 projects growth of 13.3% mainly due to the assumptions that wholesale pricing improves slightly and the balance of operators that applied for permits and licenses will obtain those required documents and begin generating revenue. Year three of the forecast projects growth of 4.7% that steadily increases to 8.1%, or $20.3 million in the final forecast year primarily due to wholesale prices improving and entering positive growth territory.



The table above shows a ten-year period of General Fund Discretionary Revenues with 5 years of actual collections and 5 years of forecast. The forecast for FY 2023-24 assumes substantial growth of $32 million, or 9.4% overall, primarily driven by growth in property tax revenue as explained above. Discretionary revenues grow in each of the remaining year of the forecast with solid growth of 3.4% assumed in FY 2024-25, then grows by 2.7% in years three and four, before increasing in the final forecast year by 3.1%. The detail for all discretionary revenue account assumptions can be found in Attachment A pages 1-2. The change in discretionary revenue over the five-year forecast period is presented on the financial forecast table for the General Fund below.

Five-Year Financial Forecast. A five-year forecast as it relates to ongoing expenditures funded with ongoing discretionary revenue in the County's General Fund 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 and monitored. It also does not anticipate discretionary revenue being used to offset department deficits caused by decreases to their existing state or federal funding. Cannabis tax revenue was excluded as an available ongoing source due to the uncertainty of the future growth.

FIVE-YEAR FINANCIAL FORECAST
INCREMENTAL CHANGE IN GENERAL FUND ONGOING REVENUE AND COSTS
FISCAL YEARS 2023-24 THROUGH 2027-28

Row	Category	Ongoing Revenue Sources:	FY 2023-24	FY 2024-25	FY 2025-26	FY 2026-27	FY 2027-28
1	Forecast	Discretionary Revenue (excludes Cannabis)	$33,512,300	$10,885,100	$ 9,702,200	$ 9,322,500	$11,077,700
		Total Revenue Change	$33,512,300	$10,885,100	$ 9,702,200	$ 9,322,500	$11,077,700
		Ongoing Cost Changes:					
2	Forecast	Negotiated and Assumed Salary Increases	$ 4,713,100	$ 5,149,400	$ 4,682,000	$ 5,100,100	$ 5,312,400
3	Forecast	Pension Costs	2,541,400	3,049,200	2,884,800	1,198,800	6,208,000
4	Forecast	Health Benefits	2,722,700	2,481,300	2,129,500	1,695,000	1,835,000
5	Policy	Strategic Reserve Growth	265,600	-	38,000	98,300	-
6	Policy	Northern Branch Jail Operations Plan	1,300,000	1,250,000	1,200,000	1,150,000	900,000
7	Policy	18% Deferred Maintenance	360,000				
8	Policy - New	General Liability/Workers Comp/IT-GS Increases	4,750,000	2,000,000	2,000,000	2,000,000	2,000,000
9	Operational	Benefits & Initiatives	6,000,000				
10	Operational	IT Department Operations	500,000	500,000			
11	Operational	Homelessness Services Costs			5,000,000		
12	Operational	IHSS MOE & Labor Increases	630,500	1,126,600	189,300	187,600	197,700
13	Operational	Voter's Choice Act Implementation	850,000				
14	Operational	AB1869 Backfill Sunset				850,000	
15	Operational	CARE Court		400,000	700,000		
16	Fiscal Plan	Set Aside GFC for Future Deficits (990)	7,500,000				
17	Fiscal Plan	Release Board Approved Prior Year Set Aside Offset: General liability, labor/pension		(5,071,400)	(7,500,000)		
		Total Change in Costs	$32,133,300	$10,885,100	$11,323,600	$12,279,800	$16,453,100
		Annual (Deficit)/Surplus	**$ 1,379,000**	**$ -**	**$(1,621,400)**	**$(2,957,300)**	**$(5,375,400)**

The table above is ordered by category type. The forecast line items in the table have been previously discussed in the report. Policy, operational and fiscal plan line items are based on the following assumptions:

- **Policy**
  a) Strategic Reserve Growth: The Board has a current policy of maintaining a prudent reserve at 8% of total General Fund operating revenue (30 days working capital). The forecast assumes growth will be set aside each year to maintain the 8% balance for the forecast period.
  b) Northern Branch Jail Operations Plan: The operating costs of the Northern Branch Jail continue to exceed the ongoing funding set aside for that purpose. Based on cost projections and status quo staffing levels, t an increase to the operating fund each fiscal year from available revenue sources including General Fund and Proposition 172 will be necessary. The table above shows

the projected use of General Fund dollars each year, if the General Fund covered half of the increase. The other half would be recommended from Proposition 172, if available. If population at the jail is reduced over time the increases may decline in the out years.

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%). The increase for FY 2023-24 is estimated at $360,000 for a total of $12 million being allocated to those departments.

d) New –Insurance and ISF Charges Increase Mitigation: Rates charged to departments for internal services received, or to cover insurance premiums and worker's compensation costs, continue to rapidly escalate for a variety of reasons, including market conditions for insurance in California. General liability insurance and worker's compensation costs are expected to increase over 30% each in FY 2023-24. It is likely that the General Fund will need to help departments with these rate increases in the coming years to avoid service level reductions. Proposed budget policy 3.h), discussed below, explicitly addresses this issue.

- **Operational**

a) Benefits and Initiatives: The County, like many other employers, has been struggling to recruit and retain employees throughout the organization. Referral programs, hiring incentive bonuses among other strategies have been approved by the Board. Additionally, labor negotiations have included health benefit subsidies for all participants and equity considerations for critically impacted positions. A $6 million set aside of ongoing GFC is recommended for further long-term recruitment and retention efforts to be determined.

b) IT Department Operations: General Services in coordination with the County Executive Office is proceeding with the establishment of a separate IT Department in FY 2023-24 with full implementation continuing over the next two years as structure and staffing is developed. The IT Director position has been filled, with other critical positions being identified for consideration later this year. $1.3 million is set aside in the current year budget with anticipation of some growth over the following two years for full implementation.

c) Homelessness Services Costs: State grants and ARPA funding have been identified to fund many homeless project operations for the next three years; however, this limited funding ends by FY 2025-26. An estimated $5 million may be needed to continue these programs should alternative funding not be available.

d) IHSS MOE & Labor Increases: The IHSS program provides personal care and domestic services to low-income individuals to help them remain safely in their own homes and communities. IHSS costs are shared by the federal government, state, and county. Historically, counties paid 35 percent of the nonfederal share of IHSS service costs and 30 percent of the nonfederal share of IHSS administrative costs. Beginning in FY 2012-13, however, the historical county share of cost model was replaced with an IHSS county maintenance of effort (MOE), meaning county costs would reflect a set amount of nonfederal IHSS costs as opposed to a certain percent of nonfederal IHSS costs. The set amount for the County is anticipated to grow. Additionally, increased labor contracts affect the cost of the program. While DSS had been absorbing these increases through 1991 realignment funds, an ongoing general contribution of $300,000 was included in the FY 2021-22 budget. The department has provided the anticipated County obligation for the increased costs over time as shown on line 12 of the forecast table.

e) Voter's Choice Act (VCA) Implementation: This act modernizes elections in California by allowing counties to conduct elections under a model that provides 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 transitioning to VCA that will be funded by existing grants. Ongoing costs, which include the addition of 3.0 FTE, will be offset somewhat by election billing revenue and funds previously set aside in the General Fund, resulting in a net ongoing cost of $850 thousand.

f) AB 1869 Backfill Sunset: AB 1869 repealed the authority of counties to charge defendants for various criminal justice fees. Effective July 1, 2021, the bill includes a backfill provision that provides some relief to counties to mitigate revenues lost as a result of the repeal. The backfill provision sunsets after fiscal year 2025-2026. The County's backfill allocation for fiscal year 2021-22 totaled $846,778 and the funding was allocated between the Probation Department and the Sheriff's Office to support existing staffing and other costs of adult supervision programs.

g) CARE Court: In Fall 2022, Governor Newsom signed SB 1338, Community Assistance, Recovery and Empowerment (CARE) Court, a new court system framework to support those with mental health and substance use disorders. The County is required to implement the CARE Act by December 1, 2024. Preliminary estimates are that CARE Court will require the following additional General Fund staff FTE positions: in County Counsel, 1.0 Senior Deputy County Counsel position and 0.5 Senior Legal Office Professional position; in Public Guardian/Administrator/Conservator, 1.0 Public ADM/Conservator position; and in Public Defender, 1.0 Senior Deputy Public Defender, 1.0 Senior Legal Office Professional, 1.0 Investigator, and 1.0 Caseworker for one Countywide team. Behavioral Wellness does not anticipate a fiscal impact that would impact General Fund at this time due to anticipated State funding to offset implementation of CARE Court costs.

- **Fiscal Plan**

a) Set aside for Future Deficits (990): The five-year forecast shows deficits beginning in FY 2025-26 primarily resulting from the homelessness services costs currently being funded through temporary one-time funds, in addition to labor cost increases. Holding available ongoing resources for use towards these known future costs would be part of a prudent fiscal plan should alternative ongoing resources not be identified.

b) Release Board Approved Prior Year Set Aside Offset: As part of previous years' budget development fiscal plans, the Board approved the set aside of ongoing funding for GL Insurance increases ($500k) and labor negotiation increases ($4.5M) to plan for these anticipated fiscal impacts. Releasing these funds will be necessary to balance the General Fund beginning in FY 2024-25.

The forecast reflects a steady consistent growth in revenue, but at more typical pre-pandemic levels than have been seen over the past two fiscal years. While State revenues related to personal income are being monitored for decline and inflation is anticipated to continue at least through FY 2023-24, local discretionary revenues from property and sales taxes are expected to be relatively stable with modest growth. The forecast does not include a major recession at this time. Revenue growth is helping to offset the corresponding negotiated salary and health benefit increases recently approved and pension cost increases. The County's forecast projects at least a $1.38 million surplus in FY 2023-24 predominantly the result of extraordinary property tax growth in FY 2022-23. It is important to note that the forecast assumes status quo operations and no expansion requests or other department fiscal issues are included. By law, the Board must adopt a balanced budget. As part of the County's fiscal plan, it will be crucial to mitigate the years of deficit through careful planning of the use of future discretionary revenue growth or consider ongoing expenditure reductions or identification of additional revenue opportunities. While the forecast shows deficits in three of the five years forecasted, with prudent fiscal planning it is anticipated these can be resolved without significant service level impacts.

General Fund expenditures are projected to grow throughout the forecast period primarily due to increases in salaries, retirement contributions, and health insurance costs as well as escalating general liability and workers compensation insurance premiums. This growth in expenditures meets or exceeds the projected growth in General Fund revenues over the five-year period with minimal to no remaining ongoing sources for expansion of operations, new projects, or critical needs. Estimates will continue to be refined until budget adoption to ensure available funds are appropriated prudently and according to Board priorities. It will be imperative that thoughtful consideration is made related to the extremely limited ongoing discretionary resources that are available.

General Fund Unallocated Fund Balances. As part of budget development, the Board also considers one-time carry forward fund balances from the previous fiscal year towards one-time expenditures. The unallocated fund balances include those funds carried forward from General Fund departments at June 30, 2022, excess revenue received in Proposition 172 funds in prior years and unspent funds in the Cannabis Tax Revenue account. At this time, it is anticipated there will be at least $10 million available in the GF Fund Balance Unallocated (9940 Account), $6.6 million in Proposition 172 (9768 Account) and $0 remaining available in the Cannabis Fund Balance (9815 Account) for the FY 2023-24 budget. However, some portion of these funds likely will be needed to help mitigate the future-year projected deficits or possible reductions in State or Federal revenues.

Other General Fund committed reserves are shown in Attachment A on page 4.

General Fund Department Fiscal Issues Under Review. As previously noted, department expansion requests and fiscal issues 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 over the next few months along with budget submittals. Staff will assess the status of the issues identified, timing, and potential service level impacts as part of the budget development review process. If any items are determined critical to address in the FY 2023-24 budget, they will be detailed as part of budget workshops and ultimately the recommended budget. Some of the issues departments have indicated 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 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 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 2023-24, the following items are being monitored:

- **Legislative Changes**: A variety of State bills continue to eliminate fees or change funding formulas, or create unfunded mandates for the Probation Department, the Sheriff's Office, Public

Defender, and others. This includes, but is not limited to, post-conviction and CARE court mandates, SB 678 funding formula change for Probation and the backfill sunset related to AB 1869 for Probation and Sheriff. The ultimate impacts they will have are difficult to determine at this stage, but could be upwards of $6 million in the out years of the forecast. These issues will be monitored and considered during budget development.

- **Deferred Maintenance** – Estimated $506M: Public Works ($295M), Community Services ($77M) and General Services ($134M) continue to address a backlog of deferred maintenance projects. Board policy allocates ongoing funding per the 18% maintenance policy and available one-time funds to these projects based on prioritized needs.

Significant Fiscal Issues in Other Major Operating Funds

Public Works Roads Division and Public Health are anticipating significant fiscal issues in the coming years spurred by legislative impacts, cost inflation, and limited revenues. These special revenue funds will need to limit ongoing expansions, secure new sources of revenue, or reduce costs in the coming years to ensure that these funds remain self-sufficient. Their issues are described below.

Public Works – Roads Division: Inflation has resulted in significant increases in the Transportation Cost Index which provides Public Works with estimates to use on costs for future projects. Project cost increases may result in fewer projects completed if additional funding is not secured. As reported in previous forecasts, Public Works has been using fund balance to maintain Roads Division operations at current level of service, which has been a fiscal issue concern for the past few years. The department continues to anticipate depletion of the available fund balance by the end of FY 2023-24 resulting in service level impacts if not mitigated. The CEO's Office is exploring sources of funding with the department and understanding current needs of Measure A and will bring an update back to the Board prior to budget workshops in April.

Public Health – 340B Pharmacy Discount Elimination: In 2022, the State transitioned the pharmacy benefit for Medi-Cal beneficiaries from managed-care plans to a State-operated fee-for-service program. The State budget included backfill funds to cover loss of 340B revenue for covered entities, however the backfill funding Santa Barbara County will receive is expected to be less than 15% of the anticipated loss. The maximum loss could be $4.4 million. The Department has been monitoring this issue for many years and has already taken steps, such as transitioning away from an in-house Clinical Laboratory, to reduce costs. The Health Center programs are also developing plans to streamline organizational structures and look at service delivery to reduce future costs, as well as ways to increase patients and visits to increase revenue. The department anticipates using fund balance for the funding gap, if necessary, until planned cost reductions are implemented and/or other resources are identified.

FY 2023-24 PROPOSED BUDGET DEVELOPMENT POLICIES

Budget development policies serve as guiding principles for development of the upcoming year's recommended budget. The FY 2023-24 policies proposed herein are like those adopted last year, with two additions to further guide and focus budget development. New proposed policies are explained below with the complete policy document presented in Attachment B, with new additions presented in bold italicized text.

Policy 3.h) To the extent funds are available, the CEO's office will recommend General Fund Contribution, on a case-by-case basis, to help offset department rate increases that would otherwise result in service level reductions in the department.

Unlike with salary and benefit increases, departments do not receive guaranteed GFC increases based on a formula calculation each year to help cover the cost of rate increases, such as liability insurance and worker's compensation. The rationale behind this is that these rates are driven, at least in part, by department choices and behaviors and are within their control to mitigate and balance against, and a guarantee that increases will be covered by the General Fund would disincentivize mitigating actions on the part of departments to limit their increases.

However, in recent years, market conditions outside of department control have caused significant increases to rates, particularly in general liability and worker's compensation. While the CEO always strives to build a recommended budget that balances departments and limits service level reductions, this authority would more explicitly allow the CEO to build GFC increases into the recommended budget specifically to fund rate increases that would otherwise cause service level reductions. These recommendations will be made on a case-by-case basis, and only to the extent funding is available.

Policy 4.f) A minimum of $2 million will be held in General County Programs Proposition 172 fund balance, only to be released to the Sheriff-Coroner's Office upon review and recommendation of the CEO and approval by the Board, to: mitigate baseline overtime usage related to shift relief backfill including academy training time, vacation, sick, and other lost time, and special events/emergencies not reimbursed from other sources, and; reimburse for costs incurred for the County New Hire Incentive Program or other recruitment efforts pre-authorized by the CEO.

After receiving a report by the CEO on overtime usage in the Sheriff's Office at the October 18, 2022 Board hearing, the Board directed the CEO to incorporate this policy into the budget development policies. A key factor in the recommendation is that the department must provide greater analysis, at a granular level, of its budget and operations to better track expenditures, expected retirements and vacancies, and shift relief needs. Accurate time coding by staff to specific overtime activities will be essential to the data collection necessary to justify release of the funds. The CEO's Office will work with the department to establish a data tracking and reporting methodology to collect the information necessary to more fully analyze overtime drivers beginning next fiscal year.

PRELIMINARY DIRECTION ON BOARD PRIORITIES FOR FY 2023-24

The five-year forecasts of major budgetary components projected a slight surplus in the General Fund in the coming year and challenges for many of the special revenue funds. As usual, revenue and expenditure impacts will not be fully known until department budget submittals are assessed and estimates are refined. As we embark upon budget formation for FY 2023-24, preliminary Board direction at this time would be helpful for staff to keep in mind as work begins with departments on developing the budget.

It is anticipated there will be minimal General Fund ongoing and some General Fund one-time funds available; therefore, Board priorities that are one-time in nature, and not ongoing, should be considered over ongoing requests. Given the past Board and staff discussions, the following are funding items discussed by the Board in the past that that could be considered in the coming months as part of budget development:

- Increasing Long Range Planning resources to expedite projects
- Enhanced rural crime efforts
- Recruitment and retention initiatives for difficult to fill positions
- Countywide Library System support
- Enhancement of crisis intervention programs (Multidisciplinary Team or EMT Co-Response pilot, expansion of existing three Sheriff Co-Response Teams)
- Capital Improvement Program (CIP) list of priority projects
- Workforce Housing set aside
- Greater criminal justice diversion projects
- Augmentation of set aside for specific capital projects or future liabilities
- Open space and recreation projects
- Deferred maintenance
- Set aside for allocation to District area special projects

The next stage in budget development will be budget workshops in April, where staff will bring forward information about how certain issues have been or will be addressed through the recommended budget, and will provide a framework for Board consideration of options to prepare for and address anticipated fiscal demands in the coming years.

Impacts:

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

Attachments:

A – Five-year forecast of major budgetary components
B – FY 2023-24 Budget Development Policies & General Fund Allocation Policy

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