SANTA BARBARA COUNTY
BOARD AGENDA LETTER

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

Agenda Number:	
Prepared on:	1/12/02
Department Name:	County Administrator & Auditor
Department No.:	012
Agenda Date:	2/5/02
Placement:	Departmental
Estimated Time	2.0 Hours
Continued Item:	NO
If Yes, date from:	

TO:	Board of Supervisors
FROM:	Michael F. Brown , County Administrator Robert Geis, Auditor-Controller
STAFF CONTACT:	Jim McClure 568-3413
SUBJECT:	FY 01-02 Budget Update & FY 02-03 Operating Plan Workshop # 2

Recommendations:

That the Board of Supervisors:

A. Accept and file, per the provisions of Government Code Section 29126.2, the Fiscal Year 2001-02 Financial Status Report as of December 31, 2001 showing the status of appropriations and financing for all departmental budgets adopted by the Board of Supervisors.

B. Accept an update on the forecasted FY 01-02 financial condition on 6/30/02, significant exposures facing the County and some leading indicators of possible financial challenges facing the County starting in FY 02-03.

C. Approve setting the Roads Designation for FY 02-03 at $500,000

Alignment with Board Strategic Plan:

An efficient government able to anticipate and respond effectively to the needs of the community.

Executive Summary and Discussion:

Fiscal year 2001-02 continues to track relatively closely to what is budgeted. General Fund discretionary revenues will exceed the budgeted amount by between $2-3 million before compensating for the amounts transferred to the new city of Goleta……about that same amount will be transferred. Departments are managing their budgets well and most will end the year in a positive position….therefore, overall we would say FY 01-02 will be a good year.

Unfortunately, the same cannot be said for Fiscal Year 2002-03. We are currently looking at a General Fund shortfall of between $3-5 million. The Public Safety departments will be challenged to live within the budget principles due to the significant pay and benefit increases, coupled with a downturn in Prop 172 revenues and increases in various Internal Service Funds (ISFs for Workers Comp, Liability and Information Technology) charges. Most other departments will also have to absorb their portion of growth in COLAs, significant increases in their ISF charges and a leveling of their various revenue sources.

The most prominent issue on the horizon, however, is where and by how much the State budget will impact county operations and customers. By almost any account the Governor's Budget is overly optimistic by several billion dollars and reductions impacting local government, will most likely be announced sometime later this summer. This then is the framework that the FY 02-03 Budget process must work within……not a pretty picture.

A. **FINANCIAL STATUS REPORT FOR FY 01-02:**

We are filing a Financial Status Report as of December 31, 2001 to apprise the Board of the County's financial condition at the end of the second quarter of FY 01-02. We have held Monthly Projection (MOPROs) meetings with departments during which we have reviewed their actual performance as compared to their budget. As a result, the confidence level is much higher in our revenue and expenditure forecast. These meetings also provided an opportunity for departments to bring forward issues and concerns that may influence budget decisions to be made over the next few months. We appreciate the time and effort the departments devote to the MOPROs, which help to provide more accurate financial data to assist your Board in making more informed decisions.

Key Points of Fiscal Interest as of 12/31/01…. General Fund

General Revenues (County's Discretionary Revenues)

- Property Taxes (Secured, Unsecured and Unitary) are projected to end the year at over a million dollars greater than budgeted, subject to any material roll corrections. The anticipated growth of over 8% is higher than what was projected in the FY 01-02 Budget development. This growth is driven by a combination of the 2% allowed CPI under Prop 13, new construction, change of ownership, and reinstatement of previously lowered (Section 51s) property tax values. The Assessor's Office has been working for some time to develop reports out of the their new system that would identify the contribution of each of these factors. This capability would help us better understand the current growth as well as use this understanding to make better forecast of future growth. Unfortunately, they have been unable to create these reports given other more pressing system issues they must deal with. Hopefully these reports will be available before the next quarterly update in May 2002. **Taking into account the approximately $650K that will be transferred to the new city of Goleta, we expect to end the year with a net increase of about $500K.**

- Supplemental Property Taxes are running $500K above budget. However, we believe this is the result of the Assessor's Office working down an approximate 7-month backlog, (about 6000) of change of ownership transactions for property transfers that occurred in the first half of calendar year 2001. The Assessor's office is analyzing this issue and hopefully we'll have better information prior to finalizing the FY 02-03 budget.
- Retail Sales Taxes are right on budget. **The Auditor's Office estimates Sales Tax Revenues over the remainder of the year will be reduced by about $1.2 million. This is the estimated amount that will accrue to the new city of Goleta.**
- Transient Occupancy Taxes (TOT) at the end of the 2nd quarter were above plan by $300K. The main driver for the increase has been the Bacara Resort, which was not in our base for much of the first 2 quarters in FY 00-01. While currently above target, the gap is shrinking each month as the impacts of Sept 11, appears to be continuing to affect several of our hotels.. **The Auditor's Office estimates TOT Revenues over the remainder of the year will be reduced by about $985K, which will accrue to the new city of Goleta.**
- Interest Earnings are significantly lower … almost $400K less than budgeted. The multiple occasions of lowering of interest rates by the Federal Reserve over the past year is obviously impacting us. Given this, we are projecting annual interest earning to be down by about $800K for FY 01-02 and are projecting this trend to continue into FY 02-03. .
- Motor Vehicle In-Lieu continued to perform above expectations. As of December 31, 2001 it was about $760K ahead of what we budgeted for FY 00-01.
- Federal-in-Lieu taxes have come in at a little over $200K above budget as a result of an increased federal allocation to this program. This is a welcome increase and, as we understand, establishes a new base level.
- **<u>NET IMPACT.</u> Overall, the General Fund Discretionary Revenues are about $2.1 million above our budgeted amount through 12/31/01. For the fiscal year we expect discretionary revenues to increase somewhere between $2-3 M……approximately the same amount that will be transferred to the new city of Goleta as a result of incorporation.**

Departmental

- Given information provided during our January MOPROs most General Fund departments will end the year in a slightly positive position. The only material exception is the Clerk Recorder Assessor. That department should end the year with between $300-500K in unanticipated revenues, which will fall to Fund Balance. These revenues are driven by increased Supplemental taxes and their associated cost, and a significant increase in recording fee revenues driven by home refinancing.
- **The General Services Department** has two programs that require monitoring and are a continuing concern…electricity & natural gas rates/cost and workers compensation (see discussion under Special Revenue Funds).

    <u>Electricity & Natural Gas cost.</u> As all of us are keenly aware, electricity rates have increased dramatically and costs have correspondingly risen. In the FY 01-02 budget we set aside $600K in a designation to partially mitigate these anticipated rate increases….but that was only part of our strategy. We also appropriated about $400K last year for energy saving projects and departments were encouraged to conserve. General Services is tackling this problem on several fronts……. After a competitive bidding process, GS has selected a contractor to install low-energy lights (the Social

Services & Admin Buildings have been upgraded with more energy efficient lighting and we would expect a reduction of several percentage points as a result of these actions)…...they have implemented a program to increase awareness of county staff on energy cost saving measures…. and, they are compiling usage by building and will be working with departments to reenergize and accelerate conservation in county facilities. Without these actions we would have exceeded our energy budget by hundreds of thousands of dollars. Due to conservation efforts and reductions in natural gas prices we currently forecast we'll come in right on budget including using the $600K from the designation.

- **General Fund Salary Savings,** at the end of the second quarter, are approximately $1.5 million or about 2 %. We fully expect this to drop as the year progresses when higher than budgeted COLAs and equity adjustments kick in.
- **General Fund Departmental summary. No significant issues other than those noted. Expect a slightly positive fund balance on 6/30/02.**

Key Points of Fiscal Interest…. Special Revenue & Enterprise Funds

- With the exception of Mental Health & the Workers Compensation Funds, all significant variances in our Special Revenue and Enterprise Funds were the result of timing of either receipt of revenues, releasing designations or when expenditures will actually occur.

- **Mental Health Fund background.** In the FY 01-02 Budget we increased the County contribution to ADMHS by approximately $800K in order to help reduce the apparent funding gap based upon the department's estimated 6/30/01 position, which should have had the fund ending the year with a zero fund balance.. Unfortunately, the department ended the year with a negative fund balance approaching $1 million. Two major contributors to this condition are the Multi-Integrated System of Care (MISC) & Mentally Ill Offender Crime Reduction (MIOCR) programs where reimbursements & available revenues were significantly less than the cost of providing these services. We recommended and your Board approved, at the November budget update, an additional $950,000 be appropriated from contingency to bring their fund balance back to zero.

  Mental Health Status: The department, along with the assistance of the Auditor-Controller, has made significant progress gaining a better understanding and greater control of the department's finances. Moreover, in December 2001, the department received unanticipated Realignment revenues of approximately $600K, which will help them maintain service levels during this fiscally constrained restructuring period. The Auditor and the department will be returning to your Board in the February/March 2002 timeframe to provide you with an update on the progress and remaining issues.

- **Workers Compensation Fund:** We continue to be very concerned about significant increases in workers compensation cost and incurred liability. Claims costs continue to exceed budget and as reported in our November 2001 update, our incurred liability has risen from about $30 million at 6/30/00 to over $50 million as of 6/30/01. General Services has established a project team with representatives from the Auditor-Controller's Office, the Treasurer's, the County Administrator and General Services. The team has been meeting about every two weeks; they have had two actuarial studies performed, which has helped us better understand where we are and how we got there. Additionally, General Services is now providing web based Workers Compensation information to departments to assist them in monitoring and identifying underlying causes so that we can minimize future claims. At this week's Board meeting the department is providing an update and recommended a mid-year rate increase to, at least, slow the growing gap between reserves and liabilities**.** We will track this closely and monitor progress at our monthly projection meeting. General Services has also requested an additional actuarial report as of 12/31/01 to provide more up to date status…this should be completed by February 2002.

FIN REPORTS

Our Financial Information Network (FIN) is designed to accurately track revenues and expenditures on a monthly basis and projects results by adding actual receipts and expenditures in past months to remaining estimates. This system is designed to produce accurate management information and to facilitate more informed management decision-making. *The attached reports (enclosures 1, 2 &, 3) are available to you on FIN at the end of each month.*

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Significant Concerns

- **Salary & Benefit Increases:** There have been several significant changes in the salary and benefits arena that will challenge our ability to maintain current service levels.

    a. The costs of the new MOU with the Fire Bargaining Unit combined with continued impoundment of property taxes for oil company assessment appeals means the **Fire District** can no longer fully fund the operations of the Fire Department. Commencing in FY 02-03 it is almost certain that in order to continue the same level of service, the General Fund or new outside sources (such as a Benefit Assessment…see note 1 below) will need to start subsidizing the Fire District by approximately $2.8 million per year. This is a major policy shift in funding responsibility for this function since in theory the property taxes allocated to the Fire District were designed for this purpose. The county contribution of $900K/year previously provided the Fire Department by the County General Fund was to offset the loss of a watershed tax designed to cover the difference between what the state reimburses and the cost of providing this coverage in State Responsible Areas, not for normal fire operations.

    b. The cost of other **MOUs**, including various equity adjustments and retirement benefit increases, recently negotiated has further increased fiscal pressures in the coming years.

    c. Continued increases in **Workers Compensation** will add cost but no increased products or services to our clients and customers. (See Workers Compensation discussion above).

    d. With the continued poor performance of the stock market coupled with significantly lower interest rates, the **retirement fund's** lower return on investment could result in higher **employer contributions** in the coming years.

    (Note 1) …as a result of the ERAF shift and other financial difficulties, some Count y fire districts have gone to the voters and had approved Benefit Assessments to supplement property tax revenues in order to maintain service levels desired by the residents.

- **The Goleta Incorporation** will impact the FY 01-02 Budget as well as future years. In FY 01-02 the County's General revenues will be reduced by approximately $3.0M. With incorporation on February 1, 2002, the County will be responsible for providing services to that area for the remainder of the fiscal year (Feb 1, 2002 to June 30, 2002). However, at the same time, the County will lose certain revenues (Property Taxes, Retail Sales and Transient Occupancy Tax are the major ones) generated from that area. Additionally, as part of the Revenue Neutrality agreement we will be loaning the City $1.5 million from the Strategic Reserve until 2011. We have reconstituted the Goleta Project Team made up of impacted departments and will be working with the city representatives during the transition. Over the next 8 months we will be devoting significant resources to ensure a smooth transition with no reductions in service levels and negotiating contracts with the new city for continued services from the Sheriff, PW, Parks and Animal Control.

- **Orange County Assessment Issue:** There has been a recent court ruling in Orange County that could have a huge impact on the assessed values of properties throughout the state. The court case centered around the reinstating of property tax factored base values after they had been lowered based upon market surveys or assessment appeals. For example, during the last recession in the early 90's, the County Assessor lowered assessed values on many properties as the market values dropped. Later in the 90's as the market boomed, the Assessor reinstated these factored base values to where they would have been under Prop 13 guidelines of no more than 2% increase per year using Section 51 of the state Revenue & Taxation code as authorization. The Orange County case argued that once the property values had been lowered, they could only be increased by no more than the 2% allowed under Prop 13. The court upheld this position and the case is currently being appealed. Should this ruling be applied to all such actions through out the state, there would be a significant reduction in our assessed value base impacting all of the agencies receiving property taxes.

- **Prop 36 backfill:** Proposition 36 was approved by the voters and became law on July 1, 2001and is funded for only 5 years. The underlying assumption is that by providing treatment to drug offenders, there would be a net savings (save on incarcerations, welfare dollars, reduced crime & recidivism, reduced courts cost, etc) and therefore, there would be no need to continue the funding. Initial feedback from the partners indicates this may be wishful thinking and there may be an ongoing cost of over $2 million per year starting in FY 06-07.

- **Various Grants ending:** Social Services, Probation, Public Health and AD&MHS all have grants or significant funding sources that are terminating in FY 01-02 which could result in several million dollars of reductions. These departments are meeting to develop alternatives where possible and phase out plans that will focus on minimizing impacts on our customers and clients.

The State Budget Crisis. ***This is by far our biggest area of concern for FY 02-03. The State is projecting a shortfall of somewhere between $12-15 Billion, without considering the potential impacts of the electricity bonds issue. The Governor has directed departments to freeze hiring in FY 01-02 and submit 15% reduction proposals for FY 02-03. While the Governor's Jan 2002 Budget appears to be balanced …. the LAO and other supposedly objective third parties have indicated it is most likely out of balance by at least $4 Billion. The State is also facing a severe cash flow problem due to the delayed bonding measure that is supposed to reimburse the state general fund for electricity purchases during the crisis of 2001. A couple of examples include:***

1. **Electric Cost (state bonds):** The PUC and the Governor are at odds over what takes priority …paying for the long term contracts negotiated by the governor or making the bond repayments on the roughly $6 Billion in bonds awaiting issuance. The contracts have a clause in them that says they will be paid first, but Wall Street needs to know there will be a sufficient flow of funds to repay the bonds. If the contracts are not renegotiated downward, and the ratepayer is responsible for the repayment, there will be another significant rate increase.

2. **Child Support Penalties:** As a result of California's delay in implementing a single, statewide automated system (California Child Support Automation System (CCSAS), the federal government has levied significant penalties against the state. The Governor's budget anticipates that federal legislation will be enacted to provide relief from the penalty in FY 02-03 for an estimated $181 million in State General Fund savings. If this does not occur we would anticipate the state to pass on these penalties to the counties in some form or anther….for Santa Barbara County our rough estimate is between $1.5-2 million

Setting the Roads Designation for FY 02-03: Over the past 2 years the General Fund has allocated $1M to a Roads Designation to help bring down the backlog of roads maintenance and repair. For FY 02-03 we are recommending that this designation be set at $500K.

As a result of the incorporation of the City of Goleta the County will be giving up certain revenues and funding responsibilities. As pointed out in the Comprehensive Fiscal Analysis the net impact on the Roads fund will be a positive position of roughly $400K per year. This is due to the fact that gas tax revenues are split by the state into city and county allocations and when a new city is created the majority of the gas taxes for that new city come only from the city allocation.

This fact was taken into consideration during the Revenue Neutrality negotiation and was viewed as a partial offset to the County's General Fund losing more in revenues than it lost in expenses transferred to the new city. Additionally, the County General Fund will be allocating approximately $390K more than the required Measure D MOE of $851K to Roads in order to remain qualified to receive additional state gas tax funding of between $1-2 million per year under AB 2928. At the proposed level of $500K, the remaining unincorporated area of the county will proportionally be receiving a greater contribution than before Goleta incorporated.

Summary of recommendations:

A Accept and file, per the provisions of Government Code Section 29126.2, the Fiscal Year 2001-02 Financial Status Report as of September 30, 2001 showing the status of appropriations and financing for all departmental budgets adopted by the Board of Supervisors.

B. Accept the update on the forecasted FY 01-02 financial condition on 6/30/02, significant exposures facing the county and some leading indicators of possible financial challenges facing the county starting in FY 02-03.

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