SANTA BARBARA COUNTY
BOARD AGENDA LETTER

Clerk of the Board of Supervisors
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Agenda Number:	
Prepared on:	12/30/03
Department Name:	County Administrator
Department No.:	012
Agenda Date:	1/5/04
Placement:	Departmental
Estimated Time	3 hours
Continued Item:	NO
If Yes, date from:	

TO: Board of Supervisors

FROM: Michael F. Brown, County Administrator

STAFF CONTACT: Ken A. Masuda 568-3411; Shirley Moore 568-3107

SUBJECT: **Consider Reductions to the FY 03-04 Budget to Offset Loss of Additional Vehicle License Fee Revenues**

Recommendations:

That the Board of Supervisors That the Board of Supervisors:

A. Receive a status report on the most recent state actions with respect to the vehicle license fee (VLF) payments for FY 2003-04.

B. Receive a report on further mid-year budget reduction options including presentations on actual and potential VLF revenue losses of up to $16.5 million.

C. Adopt the Budget Management Action Plan (BMAP) of adjusting the budget based on actual performance of the VLF on a twice per month basis.

D. Select $1.6 million of program reductions and reserves and designations to cover realized (actual) VLF reductions to date.

E. Direct the County Administrator to return to the Board after the first January VLF payment is received to give a status report and further recommendations.

F. Authorize planning for future contingent actions (to be ready in case the VLF backfill initiated by the governor is reduced or stopped). These include:

    1. Direct the County Administrator and the Human Resources Department to explore feasibility of furloughs in lieu of layoffs and service cuts with all employee organizations and report back to the Board.

    2. Direct the County Administrator and Human Resources Department to explore the feasibility of deferral of cost of living increases in lieu of layoffs and service cuts with all employee organizations.

3. Direct all department heads to prepare recommendations, and place on the Board agenda for consideration, proposed fee increases which were developed as part of this mid-year review or in the course of normal business so that these may be in place if the current VLF backfill is reduced or suspended including but not limited to:
    a. Registration fee for adult Public defender clients and for parents of juvenile clients
    b. Increase Planning and Development fees charged for applicant and non-applicant appeals
    c. Implement land development fee schedule increases in April rather than July of 2004
    d. Implement beach parking fees for those beach parks which do not yet have a parking fee.

Alignment with Board Strategic Plan:

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

Discussion:

INTRODUCTION

The County is faced with a potential motor vehicle license fee (VLF) revenue loss of $16.7 million. This loss is in addition to the $6.1 million loss the Board of Supervisors dealt with just three months ago.

This new loss estimate is composed of two different, but related, parts. The first part, called "Gap-1" refers to local revenue losses due to the lack of a State "backfill" of fee payments for parts of June, and all of July, August, and September, 2003. Gap-1 has grown to $7.7 million or $1.6 million more than the original estimate presented in October. Most of these gap losses have already occurred and, as mentioned, $6.1 million of the $7.7 million has already been offset by Board action in October. The terms "gap," "backfill," and reasons for the gap are explained below. The second and larger part of the loss, called "Gap-2" refers to a combination of projected General Fund and Public Health Fund VLF revenue losses which would occur if there is no backfill for the period from January through June, 2004. This portion of the overall loss is estimated at $14.9 million. If the State fails to make payments between now and June 30, 2004, and the County fails to reduce expenditures proportionately, a deficit of $16.7 million could result.

HISTORY

The VLF is a fee paid by vehicle owners on the depreciated value of motor vehicles. It is paid in lieu of a personal property tax (like taxes assessed on boats and airplanes).

- Originally collected by local governments, in 1934 the collection was shifted to State DMV

- In 1948 the rate was set at 2% of the vehicle's current estimated value. That rate has not changed since 1948
- In 1986 voters passed Proposition 47 ensuring that VLF revenues were designated for local governments
- In 1991 the State enacted a major change in the funding and responsibility for certain health, mental health, and social services programs, known as "realignment." As part of this change, vehicle depreciation schedules were revised and the additional revenue generated was transferred to counties for the realigned programs.
- Beginning in 1998, with the State enjoying a revenue surplus, a succession of VLF reductions were implemented which included statutory language that the State would offset any revenue losses to cities and counties. This offset has subsequently become known as the State "backfill." In 1998 VLF fees were reduced by 25%, in 1999 by 35%, and in 2000 by 67.5%.

2003-2004 BUDGET VLF REVENUES

VLF revenue anticipated by the County to be received in FY 2003-04 is shown below. General Fund VLF revenue shows both a "base" composed of VLF fee payments and a "backfill" composed of State payments.

VLF General Fund Base	$8.9 million
VLF General Fund Backfill	$18.5 million
Total General Fund	$27.4 million
Total VLF Realignment	$10.5 million
Total VLF budgeted	**$37.9 million**

Last June, the Department of Finance determined that it did not have sufficient funds to continue the VLF backfill and "triggered" reinstatement of the higher level of VLF fees paid prior to 1998.

However, there was a three-month and 11 day gap between the trigger date of June 19 and October 1 when DMV began collecting the higher fees. So, when the Legislature adopted its 2003-04 budget without backfilling local governments for lost revenues during the three month-eleven day period, a local government revenue shortfall, known as **"the VLF backfill gap"** was created.

The VLF revenue is an important part of the County's available discretionary revenue. A brief look at where this discretionary revenue is allocated is shown in Attachment A.

Original Gap Estimate (Gap-1)

The original State estimate of statewide VLF gap losses was $875 million. However, this was not shared between city and county general fund and county VLF realignment recipients because the Legislature altered, for FY 03-04, the revenue sharing formula so that funds for realignment programs were not affected. Thus, our original presentation to the Board of Supervisors on State budget impacts showed a General Fund revenue loss of $6.1 million.

This loss was composed of a $4.3 million reduction in General Fund VLF revenues due to the gap (the gap recognized time needed by State Department of Motor Vehicles to implement the increased VLF approved by Governor Davis) and a further $1.8 million reduction in General Fund VLF revenues due to a shift of funding from city and county discretionary VLF revenues to VLF Realignment programs, in order to hold these Realignment programs harmless from "gap" losses.

- General Fund Adopted VLF Revenues $27.4 million
- Less General Fund VLF Loss, and $4.3 million
- Less General Fund VLF Shift to Realignment $1.8 million
- Net Anticipated General Fund VLF $21.1 million

Action Previously Taken

During October, your Board acted to reduce the FY 03-04 County budget as a result of State actions.

Gap-1 is Larger than Originally Estimated

Recent information from the State indicates that the VLF "backfill gap" is significantly larger than anticipated. The State now estimates the gap at $1.3 billion, or $425 million more than the original estimate. It is assumed that the additional gap amount will fall on the city and county discretionary VLF revenue shares rather than the VLF realignment amounts.

Santa Barbara County's "share" of the total gap is estimated at $8.7 million over two fiscal years based on calculations distributing the gap statewide to cities and counties. Our current fiscal year gap is estimated at $7.7 million which is $1.6 million more than the original October estimate of $6.1 million.

So, the County's best case projection for FY 2003-04 now looks like this:

- General Fund Adopted VLF Revenues $27.4 million
- Less Direct and Realignment Shift VLF Loss $ 7.7 million
- Net Anticipated General Fund VLF $19.7 million

State Repayment of Gap-1 (backfill) – In 2006!

Current State law characterizes the gap amount as a "loan" from cities and counties which will be repaid by the State not later than August 2006. Amounts due to Santa Barbara County total $8.7 million ($7.7 million for FY 2003-04 and $1.0 million for FY 2002-03).

Recommended Action on the Additional $1.6 million County Revenue Gap

These recommendations are contained in Attachment B, which is an excerpt of the total list of potential cost reductions and revenue increase that could be used to offset the $16.5 million potential 2003-04 deficit. These recommendations will result in no layoffs and no significant current service reductions.

PLUGGING GAP-1 DOES NOT MEAN WE ARE "OUT OF THE WOODS"

As you know, the VLF increase triggered by Governor Davis on June 19, 2003 was rescinded by Governor Schwarzenegger on November 17, 2003. This VLF fee reduction created a second gap, called "Gap-2" between locally anticipated VLF revenues for the remainder of the fiscal year and VLF revenues which the lower fees would provide, without a backfill.

Then, on December 18, following days of intense discussion, lobbying, and negotiation, the Governor announced that he was directing that backfill payments to local governments totaling $2.65 billion be provided for the remainder of the fiscal year.

Questions regarding the Governor's "Backfill" actions. While the Governor's declared action was welcome questions were almost immediately raised regarding whether the Governor had the legal authority, without legislative action, to provide the backfill funding. As of yet there is no "iron-clad guarantee" that cities and counties will receive their shares of the $2.625 billion estimated backfill. Our revised estimate of the potential County VLF deficit (Gap-2) for the period from January through June 2004, assuming that General and Public Health funds receive only 32.5% of budgeted amounts for January-June, is $15.1 million. The total projected deficit, shown in the following table, is a combination of the $1.6 million additional gap and the $15.1 million potential January-June revenue loss; a total of $16.7 million. The $16.7 million represents almost 12% of the County's discretionary General Fund revenues.

Public Health Impacts. Why is the Public Health VLF Realignment revenue loss included in the total projected $16.7 million deficit? The short answer is, because, to the best of our knowledge, a financial maintenance of effort (MOE) imposed in 1978 as part of new State funding provided when counties lost property tax revenue due to passage of Proposition 13, remains in effect. Thus, any loss of Public Health VLF Realignment revenue would require substitution of other local matching funds. Presentation materials from the Public Health Department are included as Attachment C to this Letter.

Total Potential Deficit Calculated. The total deficit amount of $16.7 million is down from the $18.7 million forecast earlier because:

- The table assumes the General Fund will get to keep all of its November payment which included VLF fees at the full 2% rate
- The General Fund actual December payment was received, but amounted to only $434,000 or 22% of the projected total for that month
- Shift of VLF revenue from General Fund to VLF Realignment is accounted for
- The Public Health Fund December payment was received, and the $1.09 million was significantly above the anticipated $700,000 payment
- The ADMHS (Alcohol, Drug and Mental Health) Fund deficit is not included as that deficit can be made up from other revenues received.

General Fund Motor Vehicle License Fee Revenue Status and Projection

	Actual Totals July-Dec.	Jan.-June Projection @32.5% of Budget	Totals
Actual	4,008,539	5,411,292	9,419,831
Budget	10,776,869	16,650,131	27,427,000
Deficit	-6,613,874	**-11,250,455**	**-18,007,169**
Realignment	600,000	1,200,000	-1,800,000
			-19,807,169
Realignment Loss Accounted For			600,000
Prior Action			6,100,000
General Fund Deficit			**-13,107,169**

Public Health VLF Realignment Revenue Status and Projection

	Actual Totals July-Dec.	Jan.-June Projection @32.5% of Budget	Totals
Actual	3,293,310	1,606,855	4,900,165
Budget	3,531,546	4,944,170	8,475,716
Deficit	-238,236	-3,337,315	**-3,575,551**
Total Deficit			**-16,682,720**

State Lowers Estimate of Statewide VLF Revenues. The Governor's proposed backfill amount plus gap is less than the State's original full year backfill estimates. The proposed backfill amount of $2.625 billion plus the $1.3 billion backfill gap totals $3.925 billion, or $275 million less than the original full year backfill total of $4.2 billion. The State indicates that this estimate is due to lower statewide VLF revenue estimates. If the State's estimate holds, then our own revenue estimate is roughly 6.5% too high, and this translates into $1.78 million for the fiscal year. However, we believe that November revenues were lower than expected because buyers were holding off purchases while anticipating the VLF fee reduction. It will be a few months before we will have a better picture of statewide VLF revenues.

Other Significant Financial Issues. In addition to the real and potential VLF revenue losses, the County General Fund has these current and next year significant financial issues:

- The potential revenue shortfall from bailiff services to the Superior Court remains unresolved and could cost $600,000 this fiscal year
- Opening the new Santa Maria Juvenile Hall could result in an additional $1.2 million in staffing costs in FY 2004-05
- All local jurisdictions are under a Federal mandate to have touch screen voting systems with a "voter verifiable paper trail" (State requirement) in place for the March 2006 election. The system will need to be purchased in FY 2004-05 and could cost $5 million of which approximately $2.5 million would be a General Fund cost.

ADDRESSING THE $15.1 MILLION POTENTIAL JANUARY-JUNE REVENUE LOSS (GAP II)

The Budget Management Action Plan (BMAP)

The recommended strategy to financially navigate the County through the second half of 2003-04 is to make careful monthly adjustments based on the actual VLF payments illustrated in Chart 1 VLF Revenue Map. This assumes that there are:

1. No sudden financial policy changes by the state (like other major reductions to counties).
2. There are no extraordinary costs to the County other than those already known – for example the Gardner Ranch Wild Horse Management Issue; Michael Jackson Trial Logistics; natural disasters, etc.
3. That other local financial risks such as the refusal of the courts to pay $600,000 in Sheriff's bailiff costs are resolved.
4. That the major local revenues including the property tax, sales tax, transient occupancy tax and the public safety sales tax (Prop 172) perform as budgeted.

The actual operation of the plan is based on the premise that the General Fund VLF payment is scheduled to be received around the 10th of each month and the Public Health VLF payment is scheduled to be received around the 26th of each month. By monitoring the actual results it can be determined whether we are under or over the amounts necessary to balance at the end of the fiscal year.

The key to the plan is that at the end of any month in which underpayment occurs, the Board will reduce the expenditures by a like amount. In general the County needs to receive about $3 million per month. Thus, if at the end of January the County had received $1.6 million, the Board in February would reduce $1.4 million from the expenditure budget. Reduction options, which include the prudent use of designations, are included in Attachment D, in two schedules.

- Schedule 1 contains preferred reductions totaling $14.8 million.
- Schedule 2 lists additional reductions, including salary and benefit reductions and the further use of designations, totaling $8.9 million.

If, on the other hand, the target revenues for the month are met or exceeded, the Board would take no action.

Advantages

1. The plan makes reductions incrementally and does not cause radical reductions in services, employee jobs, etc., before actual results are known.
2. Action is based on the reality of actual VLF payments and provides time to see what the governor and the legislature are going to do generally with respect to the 2004-05 budget.
3. Does not create pay cuts or service disruptions from furloughs or other extraordinary measures which in the end may not be necessary if the payments keep coming.

Disadvantages

1. There is no guarantee that the payments will keep coming because the payments increase the state's 2003-04 impending deficit.
2. If the payments suddenly cease, whatever remaining amount is not covered will have to be solved (made up) in a more compressed timeframe. This would probably have the effect of putting more pressure on reserves. To counteract this tendency, our recommended initial $1.6 million offset to the additional VLF revenue losses does not depend on draws from reserves.
3. The plan does not lower overall County spending as fast as making major reductions now and thereby makes the 2004-05 budget more difficult. This is a particular disadvantage if current year VLF backfill is suspended and if reductions are continued in the State's 2004-05 budget.

In order to have contingency plans in place, in case the VLF backfill initiated by the Governor is reduced or stopped, it is recommended that the Board approve the following additional actions:

1. Direct the County Administrator and the Human Resources Department to explore feasibility of furloughs in lieu of layoffs and service cuts with all employee organizations and report back to the Board.
2. Direct the County Administrator and Human Resources Department to explore the feasibility of deferral of cost of living increases in lieu of layoffs and service cuts with all employee organizations.
3. Direct all department heads to prepare recommendations, and place on the Board agenda for consideration, proposed fee increases which were developed as part of this mid-year review or in the course of normal business so that these may be in place if the current VLF backfill is reduced or suspended including but not limited to:

    a. Registration fee for adult Public defender clients and for parents of juvenile clients

    b. Increase Planning and Development fees charged for applicant and non-applicant appeals

    c. Implement land development fee schedule increases in April rather than July of 2004

    d. Implement beach parking fees for those beach parks that do not yet have a parking fee.

Important Near-term Dates

The following are key dates relating to the State budget and the County's financial situation:

January 5	State Legislature Reconvenes
January 10 or 12	Governor's Proposed Budget is due to be released; January VLF Revenues to County General Fund amount known

January 20	County Administrator provides Board with VLF Status Report and State budget update
February 24	County Administrator and Auditor present mid-year financial report to Board of Supervisors
March 2	State bond measure, financing the State's FY 02-03 deficit on ballot

Other Information Provided

To assist with your deliberations our office has provided the following information requested by your Board either individually or at prior Board meetings:

1. A list of vacant General Fund positions (attachment E).
2. A list of vacation conversion amounts for January-June, 2003, by department (attachment F).
3. A list of General Fund discretionary reserves and designations and their current balances (attachment G).
4. Gardner Ranch and Michael Jackson costs to date, by department (attachment H).
5. Layoff cost estimates (attachment I).
6. Contractors on Payroll for FY 03-04 (attachment J).
7. Contracts for Professional Services for FY 03-04 (attachment K).
8. Potential and Proposed Fees and Fee Increases (attachment L).

Mandates and Service Levels: As detailed in the specific recommendations contained in attachments to this letter.

Fiscal and Facilities Impacts: As detailed in the specific recommendations contained in attachments to this letter.

Concurrence: Robert Geis, Auditor-Controller

Attachments

cc: Each Department Head
Deputy County Administrators
Administrative Analysts
Recognized Employee Organizations