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:	CEO
Department No.:	012
For Agenda Of:	August 30, 2022
Placement:	Departmental
Estimated Time:	30 Minutes
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 CEO

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SUBJECT: **Fiscal Year 2021-22 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:

That the Board of Supervisors:

a) Receive and file the Fiscal Year 2021-22 Fourth Quarter Budget and Financial Status Report as of June 30, 2022, 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 Fiscal Year 2021-22 Budget and Financial Update for the fourth quarter ending June 30, 2022, provides a look at the County's year-end financial position relative to the FY 2021-22 adjusted budget.

The County ended with $8.9 million greater than projected at the end of the third quarter, with a net positive $22.4 million in the General Fund. The majority of this was in Discretionary General Revenues due to unusually high collections for transient occupancy tax (TOT), and property transfer taxes and supplemental property taxes from residential and commercial property transactions. Several other General Fund departments also ended the year with expenditure savings and/or higher than anticipated revenues, most notably Probation ($4.2 million), Public Defender ($321,000), Auditor-Controller ($302,000), Clerk-

Recorder-Assessor ($534,000), and Treasurer-Tax Collector ($324,000). These variances are explained in greater detail later in the report.

While this is a more significant positive year-end balance than in prior years, staff recommends maintaining the Board's prudent fiscal practice of allocating the balance toward one-time needs and reserves in the FY 2023-24 budget. This is recommended given inflationary pressures, Board priorities that were only partially funded in this year's budget, and planning for known impacts such as the following:

- one-time projects and set asides (Planning Department consultant $1.1 million and EV infrastructure costs $1.1 million) only partially funded in FY 2022-23, for which additional funding must be identified;
- a budget policy requiring a minimum of $5 million be maintained for uninsured litigation costs;
- cost inflation on previously approved capital projects (estimated $2.5 million);
- cash advances for debt-funded capital projects that will be underway prior to debt issuance ($3 million; these costs will be reimbursed once the debt is issued);
- new capital projects; and,
- anticipated significant pension cost increases, given the FY 2021-22 returns of 0.16% on an assumed 7.0% return for the year (estimated $6-8 million).

Staff will bring the five-year forecast to the Board in December, which will set the stage for FY 2023-24 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. There were no significant issues to close the year 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, 2022, 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 ended with a balanced budget, it did so with the help of ARPA and Proposition 172 funding as discussed below.

Discussion:

GENERAL FUND SUMMARY (Attachment A)

The General Fund had a year-end net positive variance of $22.4 million. The departments with significant net financial impacts are discussed in detail below.

Significant Department Variances

Probation had a positive variance of $4.2 million, or 5.5% on a total adjusted budget of $77.0 million, primarily due to staffing vacancies generating significant savings in salary and benefit costs as well as savings in services and supplies related to medical and mental health services in the facilities.

Public Defender reflects a positive variance of $321,000, however, since year-end, staff have identified an administrative error where restricted grant funding should have been fund-balanced at year-end, which would have reduced the variance to $169,000. A correcting transaction will be posted in FY 2022-23 to ensure the grant funds are spent in accordance with the designated use.

Sheriff's Office was able to resolve a $2.7 million negative variance at year-end through various revenue transfers, including Proposition 172 funds. Overtime costs at year-end were $12.4 million, which was $8.6 million in excess of adopted budget. Most of this overage was absorbed by salary and benefit savings due to numerous funded vacancies within the department, and a portion was reimbursed from ARPA funding, for deputy overtime related to early opening of the Northern Branch Jail to mitigate the spread of COVID-19 during an outbreak in the Main Jail facility. Additionally, an overage of $572,000 related to inmate pharmaceutical costs also contributed to the negative variance.

Eligible pandemic direct response costs of $2.2 million were reimbursed from ARPA funding as planned, and to balance the remaining negative variance, $438,000 was released from the $2 million in Proposition 172 funding previously approved by the Board for this purpose. The CEO's Office will return to the Board in the fall to discuss staffing considerations and a policy recommendation regarding mitigation of overtime in the Sheriff's Office.

Community Services ended the fiscal year with a small positive variance of $109,000, due primarily to better than anticipated camping revenues in the Parks Division. The additional camping revenue resolved the negative variance of $293,000 reported in the third quarter, which had been due to a prior-year accounting error where camping revenues for the first quarter of FY 2021-22 were erroneously posted to FY 2020-21.

Auditor-Controller ended the fiscal year with a positive variance of $302,000, or 3.0% on a total budget of $10.2 million, due primarily to savings in salaries and benefits for vacant, funded positions.

Clerk-Recorder-Assessor ended the fiscal year with a positive variance of $534,000, or 2.5% on a total budget of $21.0 million, mainly due to salary savings for vacant, funded positions, in addition to savings in services and supplies expenditure line items such as office expense and professional & special service.

Treasurer-Tax Collector ended the fiscal year with a positive variance of $323,300, or 3.7% on a total budget of $8.7 million, primarily due to salary savings on vacant, funded positions.

Discretionary Revenue Variances

General Revenues (Department 991) ended the year with a net positive year-end variance of $16.2 million, or 4.9% on a $327.8 million adjusted budget, shown in detail in the table below. This variance was attributable to higher than budgeted Transient Occupancy Taxes, Property Taxes, Property Transfer Taxes, and Sales and Use Retail State Taxes. Cannabis Cultivation and Retail Taxes collected for the fiscal year came in significantly lower than budgeted, but are not impacting the year-end variance, as explained later in the section.

Discretionary General Revenue Summary (in thousands):			
Source	**Adjusted FY 2021-22**	**Actuals FY 2021-22**	**Variance Actuals vs. Adjusted**
Property Taxes	$ 170,980	$ 175,331	$ 4,351
Sales and Use Retail State Tax	12,537	15,341	2,804
Cannabis Cultivation Tax	18,431	8,719	(9,712)
Cannabis Retail Tax	625	0	(625)
Transient Occupancy Tax	12,116	16,984	4,868
Property Transfer Tax	4,458	7,747	3,289
All Other Revenues	108,668	109,510	842
Total Discretionary Revenues	**$ 327,815**	**$ 333,632**	**$ 5,817**
Decrease to Cannabis Fund Balance	$ 19,056	$ 8,719	$ (10,337)
All Other Transfers	308,759	308,759	0
Net Fiscal Year End Variance	**$ -**	**$ 16,154**	**$ 16,154**

Transient Occupancy Taxes are showing the largest positive variance as FY 2021-22 actual receipts exceeded the $12.1 million adopted budget by $4.9 million, or 40%. Robust receipts for the year were attributable to an economy that surged in the wake of the pandemic, coupled with the public's pent-up demand for travel as tourists flocked to the Santa Barbara region for vacation and weekend getaways. For FY 2022-23, a budget of $15.2 million has been adopted that takes into consideration growth incurred in FY 2021-22.

Property Taxes were also a major contributor to the positive variance as they exceeded budget by $4.4 million, or 2.5%, due to a real estate market that continued to thrive through FY 2021-22, driven by strong demand for residential home purchases and historically low mortgage rates that persisted for much of the fiscal year. Supplemental property taxes contributed to most of the variance at $2.4 million more than anticipated. A high volume of property ownership changes occurred over the past two fiscal years and the assessed values on those properties were adjusted accordingly. Further contributing to the positive variance were delinquent and redemption penalty amounts collected that exceeded the adopted budget by $1.4 million. In FY 2022-23, the budget reflects an increase in total property tax revenue of 4.2% over the prior year's adopted budget, and a 2.1% increase over the actual receipts.

Property Transfer Taxes were another significant contributor to the fund's positive variance as they exceeded the FY 2021-22 adopted budget of $4.5 million by $3.3 million, or 74%. The market conditions mentioned above, which include strong demand from buyers coupled with high home prices and low mortgage rates drove a high volume of property transfers and the corresponding taxes collected. A budget of $5.5 million has been adopted for FY 2022-23 which represents a 29% decrease from the prior year's actuals collected. This decrease is mainly attributable to the real estate market that has begun to cool somewhat as a result of actions taken by the Federal Reserve to address rising inflation, which has led to an uptick in mortgage rates from historic lows, and a slight decrease in property sales prices. Taxes collected for July are in alignment with this developing market cool down as the number of property transfers and total taxes received dropped substantially when compared to prior years.

Sales and Use Retail State Taxes were another significant contributor to the General Revenue's positive variance as actuals exceeded the $12.5 million adopted budget by $2.8 million, or 22.4%, spurred by substantial economic growth and sales activity that occurred nationally and locally. The major industry sectors of restaurants and hotels, and fuel and service stations, saw the most substantial year-over-year growth in the County's unincorporated areas. Based on guidance from consultant, HdL, the FY 2022-23 adopted budget of $14.2 million reflects a flattening of sales tax growth when compared to the prior year, mainly due to factors that include continued high levels of inflation that are expected to persist into 2023, impacts of the Federal Reserve's anticipated interest rate increases through the balance of calendar year 2022, fuel price instability, and a volatile stock market, all of which are likely to impact consumer confidence and their decisions relating to discretionary purchases.

Cannabis Cultivation Tax receipts for FY 2021-22 reflect revenue of $8.7 million on an adopted budget of $18.4 million, representing a shortfall of $9.7 million. Declining cannabis cultivation revenues continue to be attributable to the oversupply of wholesale cannabis product and the resulting price compression that has persisted state-wide as significant numbers of new cannabis operations continue to get licensed and enter the market, thereby contributing to the supply of an already saturated wholesale market, while consumer demand largely remains static. Cannabis Retail Storefront Tax also ended the year with a negative variance of $625 thousand as retail storefront taxes failed to materialize altogether which is directly related to the timing of when each of the six retail operators are expected to complete the land use entitlement and business licensing processes.

Cannabis-funded projects and positions were not impacted by the total revenue shortfall of $10.3 million, because it was covered by a combination of prior year carryover, unspent funds from FY 2021-22, and a portion of the cannabis prudent reserve. The intent of a cannabis prudent reserve policy was to plan for unforeseen scenarios and help lessen the impact of tax revenue volatility, given that the legalized cannabis industry is still somewhat new and maturing. However, if significant revenue shortfalls occur again in FY 2022-23, some one-time expenditures may need to be delayed, or funding from a non-cannabis source identified, to keep this fund balance from going negative. The prudent reserve currently totals $3.9 million.

In FY 2022-23, a Cannabis Cultivation Tax budget of $15.2 million has been adopted which assumes that a number of newly permitted and licensed operators will commence operations and begin generating sales within the fiscal year. This budget also assumes that the pace in which new cannabis operators will navigate the permitting and licensing processes will continue to increase, given that additional staffing resources have been devoted to address the high volume of applications, coupled with staff's efforts to streamline both processes. A Cannabis Retail Storefront Tax budget of $1.1 million has also been adopted for FY 2022-23, which assumes that several of the six retail operations will commence operations at varying times throughout the fiscal year, based on their current progress in obtaining the necessary permits and business license. Staff will continue to closely monitor cannabis tax revenues and will have an update for the Board after first quarter receipts have been collected.

ADVANCE CONSTRUCTION RESERVE ACTIVITY

Beginning in FY 2021-22, the budget includes 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. The Board has approved an estimated cashflow need for two bridge projects currently in progress. The status of those transfers will be reported in each quarterly update to the Board.

Project	Board Date	Approved Maximum	Transferred To-Date	Net Remaining	Period of Cashflow Need
Floradale Bridge	6/8/2021	$6,800,000	($5,270,600)	$1,529,400	2021-2024
Foothill Bridge	1/11/2022	$6,000,000	-0-	$6,000,000	2022-2025
Totals		**$12,800,000**	**($5,270,600)**	**$7,529,400**	

To the extent that federal reimbursements are received throughout the projects, that cash will be used first prior to any General Fund transfer. The Board approved a new Budget Development policy in December 2021 to establish an Advance Construction Reserve in General County Programs to set aside the maximum amount estimated for the projects and track the activity. Staff will process a budget revision request as cashflow is needed for the project.

CANNABIS TAXATION, COMPLIANCE AND ENFORCEMENT ACTIVITY (Attachment B)

During the fourth quarter, the County collected $2.4 million in cannabis taxes. Six enforcement actions were conducted against illegal cannabis operations, resulting in the confiscation of 1,701 plants and nine pounds of cannabis product with an estimated street value totaling $856,000. The County issued 19 new cannabis business licenses in the quarter; however, several business license applicants have also withdrawn from the application process altogether.

As previously reported, the County has approved enough cultivation acreage in land use entitlements to exceed the acreage cap in the unincorporated inland area. There are currently five operators with approved land use entitlements that have secured their spot on the waiting list for this area, requesting over 203 acres. In November 2021, the Board approved an ordinance amendment establishing June 30th, 2022, as the sunset date to cease operations for those operators that claimed legal non-conforming status and that failed to make it on to the eligibility list. Staff have since confirmed that all six operators subject to this deadline have complied with the ordinance. Two of those six operators remain in the permit process and continue to pursue a land use entitlement. Further details can be found in Attachment B.

<u>Fiscal and Facilities Impacts:</u>

Impacts are stated above in this Board letter.

<u>Attachments:</u>

A – Financial Summary Report – General Fund

B – Cannabis Taxation, Compliance and Enforcement, Fourth Quarter FY 2021-22

Authored by:

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