



**BOARD OF SUPERVISORS
AGENDA LETTER**

Agenda Number:

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

Department Name: CEO
Department No.: 012
For Agenda Of: March 8, 2022
Placement: Administrative
Estimated Time: NA
Continued Item: No
If Yes, date from:
Vote Required: Majority

TO: Board of Supervisors
FROM: Department Director(s) Contact Info: Nancy Anderson, Assistant CEO – Budget and Research
Mona Miyasato, County Executive Officer
Brittany Heaton, Principal Analyst - Cannabis

DocuSigned by:

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SUBJECT: Fiscal Year 2021-22 Second Quarter Budget Status Report and Cannabis Taxation, Compliance and Enforcement Update

County Counsel Concurrence

As to form: NA

Auditor-Controller Concurrence

As to form: NA

Recommended Actions:

It is recommended that the Board of Supervisors:

- a) Receive and file the Fiscal Year (FY) 2021-22 Second Quarter Budget Status Report and Cannabis Taxation, Compliance and Enforcement Update as of December 31, 2021;
- b) Provide other direction as appropriate; and
- c) Determine that the above actions are not a project under the California Environmental Quality Act (CEQA), because pursuant to sections 15378(b)(4) and 15378(b)(5) the recommended actions consist of organizational, administrative, or fiscal activities of government that will not result in direct or indirect physical changes in the environment.

Summary:

The FY 2021-22 budget status report for the second quarter ending December 31, 2021, provides a year to date fiscal year look at the County’s financial position relative to the FY 2021-22 adjusted budget. The County’s General Fund is currently projected to have a positive \$6.8 million surplus and is tracking closely to budget for most departments. Special Revenue and Other Funds are generally tracking to budget, with no reportable variances for the second quarter.

Similar to the first quarter, the positive variance in the General Fund is primarily the result of net positive variances of \$4.7 million in General Revenues, \$2.6 million in Probation, and \$393 thousand in Treasurer-

Tax Collector-Public Administrator. These positive variances are partially offset by a negative \$1.9 million in the Sheriff's Office and small negative variances in a few other departments. The reportable variances are explained in the report.

The second quarter continues to indicate a decline in current year cannabis tax revenue that is projected at a \$6 million shortfall based on second quarter receipts that is attributed to the oversupply of wholesale cannabis product and resulting price compression. There is also a summary later in this report on cannabis taxation, compliance and enforcement for the second quarter, as well as additional detail provided in Attachment C.

SECOND QUARTER REPORT

The second quarter for the fiscal year includes activity through December 31, 2021. In this report, projected financial results for the fiscal year end are compared to the annual adjusted budget. The major differences (variances) between budgeted and actual amounts are discussed on the following pages.

This report highlights the variances that exceed the following thresholds:

- 1) General Fund departments (including Discretionary General Revenues) with projected variances greater than \$300 thousand per department; shown in the Financial Summary Report (Attachment A) and;
- 2) Special Revenue and Other Funds with projected variances greater than \$500 thousand per fund; shown in the Financial Summary Report (Attachment B).

Both Attachments A and B use actual revenues and expenditures for the first six months of FY 2021-22, and then add departmental projections for the next six months to arrive at the "Projected Actual" columns. These annual Projections are then 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 and Attachment B reports).

BUDGET POLICY

Departments are responsible for maintaining expenditure levels within the Board-approved budget appropriations in accordance with Board adopted policy and procedure '*Budgetary Control & Responsibility*' as the following abbreviated excerpt states:

- A. If expenditures are projected to exceed appropriations, the department head responsible for the budget shall perform one or more of the following steps in the following order:
 - 1) Lower the expenditure level to maintain overall expenditures within the total amount budgeted,
 - 2) Request a transfer from fund balance within the same department and fund under the department head's control (if available for appropriation),
 - 3) Prepare a transfer request from General Fund Contingency and an agenda item for the Board of Supervisors with a memo to the County Executive Office, providing adequate justification.

In addition, the County Budget Act, Section 29121, California Government Code, places liability for over-expenditure upon the department director authorizing the expenditure:

Except as otherwise provided by law, obligations incurred or paid in excess of the amounts authorized in the budget unit appropriations are not a liability of the county or dependent special district, but a personal liability of the official authorizing the obligation.

GENERAL FUND SUMMARY (Attachment A)

As of December 31, 2021, the General Fund had a projected year-end net positive variance of \$6.8 million. This is the result of favorable results in most General Fund departments, including reportable positive variances in General Revenues, Probation, and Treasurer-Tax Collector, partially offset by a reportable negative variance in the Sheriff's Office and other minor variances.

General Revenues (Department 991) projects a positive year-end variance of \$4.7 million, 1.4% over total budgeted revenues, shown in detail in the table below. This variance is due primarily to higher than budgeted Property Transfer Taxes, Transient Occupancy Taxes and Sales and Use Taxes, offset by lower than budgeted Interest Income, an Unrealized Loss on Investments, and Property Taxes. Cannabis Cultivation and Retail Taxes are also projected to come in lower than budgeted, but are not contributing to the projected year-end variance, as explained later in this section.

Property Transfer Taxes are projecting higher than budgeted by about \$2.7 million, driven by the continued strength of a robust real estate market, sustained high demand for home purchases, and historically low mortgage rates. Transient Occupancy Taxes are also a major contributor to the positive variance as they project to exceed the budgeted amount by about \$2.6 million due to the public's pent-up demand for travel and the County's status as a highly desired tourist destination, despite the ongoing pandemic. Sales and Use Retail Taxes also continue to weather the impacts of COVID and project a year-end surplus of \$2 million over what was forecast at the time the FY 2021-22 budget was adopted. This is largely due to sustained e-commerce growth as consumer behavior continues to shift away from brick and mortar establishments, and an uptick in growth due to holiday shopping. Supply chain disruptions and the increasing costs of goods due to inflation are certainly present and are somewhat of a headwind to consumers, but retail spending remains strong nonetheless and solid growth is projected to continue through the end of the fiscal year.

These unanticipated revenues are offset by reductions in Interest Income, which is projecting to end the year below budget by about \$1.2 million driven by a sharp decline in the treasury pool interest rate since the onset of the pandemic. Further offsetting revenues is an Unrealized Loss on Investments recorded in the amount of \$1.3 million, through the second quarter. Per Generally Accepted Accounting Principles (GAAP), a change in the value of an investment due to its increase or decrease in market value is required to be recognized in net income even though the investment has not yet been sold, and is therefore considered to be unrealized. While the negative \$1.3 million amount is reported as of December 31, 2021, this number could change, either up or down, by the time the fiscal year ends on June 30, 2022, and it is that final unrealized loss (or gain) that will impact the closing position of General Revenues. Property Tax revenues are also projecting a slight negative variance of \$322 thousand driven by delinquent penalty amounts coming in lower than budgeted. When developing the current year's budget, staff projected and budgeted slightly higher property tax delinquency penalty amounts with the expectation that more delinquencies would occur due to the impacts of the pandemic. However, property owners are largely making timely property tax payments and therefore have paid less penalties than anticipated.

Cannabis Cultivation Tax is currently projecting \$6 million less than what was anticipated when the FY 2021-22 budget was adopted in June. This projected decrease is attributable to the oversupply of wholesale cannabis product and resulting price compression that continues to persist locally and statewide, much as it did early on in other states that legalized adult-use cannabis prior to California, such as Colorado and Oregon. As a result of the Board recently approving staff's recommendation to join the California

Cannabis Authority (CCA), the County now has access to cannabis entities' operations which provides insight into the state's inventory accounting platform, Track-and-Trace, and the associated data and analytics for all licensed operators in our County. This information will help augment staff's efforts in developing more accurate cannabis tax revenue projections both in the budget development process and on a quarterly basis. Cannabis Retail Storefront Tax is also currently projected to end the year under budget by \$567 thousand. This decrease is due primarily to the timing of when each of the six retail operators are expected to complete the land use entitlement and business licensing processes. Staff currently projects that one operator will complete the County's processes and commence operations in the fourth quarter of 2021-22, with the remaining five anticipated to open their doors throughout the next fiscal year.

Given the projected shortfalls in Cannabis Cultivation and Retail Taxes, staff has assumed a corresponding decrease in the budgeted transfer to General County Programs, which totals approximately \$6.6 million. If this shortfall materializes, it will be covered by the \$3.3 million in the cannabis tax fund balance that was unallocated and carried over from FY 2020-21, with the remaining \$3.3 million coming from the cannabis prudent reserve (\$4.7 million). Staff continues to monitor cannabis tax receipts closely and will update projections when new information is available.

Discretionary General Revenue Summary (in thousands):			
Source	Adjusted FY 2021-22	Projected FY 2021-222	Variance Proj vs. Adjusted
Property Taxes	\$ 165,915	\$ 165,593	\$ (322)
Sales and Use Retail State Tax	12,537	14,562	2,025
Cannabis Cultivation Tax	18,431	12,394	(6,037)
Cannabis Retail Tax	625	58	(567)
Transient Occupancy Tax	12,116	14,735	2,619
Property Transfer Tax	4,458	7,207	2,749
Interest Income	1,938	706	(1,232)
Unrealized Gain/Loss on Investments	(79)	(1,365)	(1,286)
All Other Revenues	111,858	111,980	122
Total Discretionary Revenues	\$ 327,799	\$ 325,870	\$ (1,929)
Decrease to Cannabis Fund Balance	\$ 19,056	\$ 12,452	\$ (6,604)
All Other Transfers	308,743	308,743	0
Projected Fiscal Year End Variance	\$ -	\$ 4,675	\$ 4,675

Probation is projecting a positive variance of \$2.6 million, 3.6% on a total budget of \$72.5 million, primarily due to staffing vacancies resulting in salary savings projected at \$1.7 million by year-end. The department is working to fill these vacancies. The remainder of the variance is due to increased Vehicle License Fee-driven 2011 Realignment (\$803 thousand) resulting from unbudgeted growth received for the Juvenile Justice Crime Prevention Act (JJCPA), a restricted revenue source for which the department will fund balance any surplus by year-end. Additionally, there are savings in Professional and Special Services (\$675 thousand) resulting from lower community-based organization service (CBO) levels in the fall. It is anticipated that with the uncertainty of COVID-19, CBOs will continue to underspend their contracts.

Treasurer-Tax Collector-Public Administrator also projects a positive variance of \$393 thousand, due primarily to Salary Savings (\$290 thousand) and less than budgeted Services and Supplies expenditures (\$100 thousand).

Sheriff's Office is projecting a negative variance of \$1.9 million for the fiscal year, 1.0% on a total budget of \$177.9 million, primarily due to a shortfall in State inmate revenues (\$424 thousand) as well as overtime (\$1.3 million) to fill behind vacancies, of which approximately \$286 thousand may be reimbursed for mutual aid. Some costs can be offset by a drawdown of Courts fund balance due to increased personnel for high profile cases (\$100 thousand). Additionally, some expenditures related to COVID-19 may be eligible for reimbursement from American Rescue Plan Act (ARPA) restricted funding that is currently set aside for direct response costs. The CEO's Office is working with the department to identify eligible expenses.

As reported in the first quarter budget status report, various factors have contributed to the Sheriff's Office projected negative variance, including longtime departmental staffing challenges, a current high number of Custody Deputy vacancies (19) and staff on extended leave (23). The department is working to fill these vacancies, with a Custody CORE Academy of 10-11 trainees starting in late January. It is worth noting that as of December 26, 2021, the department had only one Sheriff Deputy vacancy in patrol. Resources were further stretched during COVID-19 outbreaks in August through early October and in December, which led to staff illnesses and quarantine. Many of these factors contributed to the need for overtime without corresponding savings in regular salaries and benefits. In accordance with policy, the department will be expected to keep within overall budget limitations through expenditure reductions or identification of alternative resources, including potentially a request prior to year-end for a transfer from General Fund contingencies to balance if necessary.

SPECIAL REVENUE AND OTHER FUNDS SUMMARY (Attachment B)

No reportable variances for second quarter.

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		\$12,700,000	(\$5,270,600)	\$7,429,400	

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 C)

During the second quarter, the County collected \$2.3 million in cannabis gross tax receipts. The County completed seven enforcement actions against illegal cannabis activities: 9,886 plants and 2,313 pounds of cannabis product were confiscated totaling an estimated street value of \$7.2 million. The County also issued five new cannabis business licenses.

To date, the County has approved enough cultivation acreage in land use entitlements to exceed the acreage cap in the unincorporated inland area. Five operators with approved land use entitlements were placed on the waiting list. Two of these operators have since been added to the Eligibility List since one applicant withdrew their land use entitlement and business license applications. The acreage cap in Carpinteria is predicted to be committed in July 2022. Operators submitted a total of 178 business license applications through the second quarter, of which 32 have been issued. The majority of these pending business license applications remain in process, largely due to: 1) applicants that have been approved for a land use entitlement, but have not yet been issued a final, un-appealable entitlement, as many applications are being appealed after approval, and 2) applicants that have not yet obtained required building permits to construct new buildings, or change the use of existing buildings. Further details can be found in Attachment C.

Attachments:

A – Financial Summary Report – General Fund

B – Financial Summary Report – Special Revenue and Other Funds

C – Cannabis Taxation, Compliance and Enforcement, Second Quarter FY 2021-22

Authored by:

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