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:	October 10, 2017
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: Jeff Frapwell, Budget Director

SUBJECT: **FY 2018-23 Five-year Forecast**

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 FY 2018-23 Five-year Forecast, including an early estimate of funding gaps and impending financial challenges faced by the County in the coming fiscal years; and

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

Introduction

The FY 2017-18 budget included service level reductions as a result of expenditure growth, particularly salary and retirement costs, outpacing revenue growth. At the time of budget adoption, it was anticipated that additional service level reductions would be required in the coming years as the growth differential was anticipated to continue. In prior years, the County Executive Office has worked with other departments to present a five-year forecast to the Board of Supervisors later in the fiscal year as a precursor to budget development. However, because of the certainty of budget challenges in FY 2018-19 and beyond, this five-year forecast is being presented earlier in the budget cycle to allow ample time for discussion and development of strategies to close the gap.

Using guidance from the County Executive Office and the assumptions outlined below, departments developed five-year forecasts of revenues and expenditures for the General Fund and other significant operating funds. These forecasts are based on best estimates of expenditure and revenue growth rates available at the time of this report.

As FY 2018-19 budget development approaches, estimates will be refined, and will continue to be refined up until budget adoption to ensure available funds are appropriated responsibly and according to Board priorities. Strategies to address projected budget gaps will be focused on efficiencies and seeking new ways of doing business with an overarching goal of preserving service levels to the extent possible. Department-specific and countywide efforts are already underway to identify strategies and develop implementation plans. Throughout the FY 2018-19 budget development process, the County Executive Office, in collaboration with other departments, will bring proposed cost reduction and revenue enhancement strategies to the Board for consideration, and will keep the Board informed of changes to revenue and expenditure estimates to promote preservation of services and allow maximum flexibility in allocation of resources.

Expenditure Assumptions

Salary and Benefit Growth

The major countywide cost drivers are salaries and benefits, which make up approximately half of total operating costs in the FY 2017-18 adopted budget. In the forecast years, salaries and benefits are projected to compose an increasing share of operating costs, growing from 54% in FY 2018-19 to 58% in FY 2022-23. The largest components of salary and benefit costs are regular salaries, retirement, and health insurance.

Main Drivers of Salary and Benefit Growth

	2018/2019 Fiscal Year Forecast	2019/2020 Fiscal Year Forecast	2020/2021 Fiscal Year Forecast	2021/2022 Fiscal Year Forecast	2022/2023 Fiscal Year Forecast
Salaries, Step/Merit Increases, Etc.	3%	3%	3%	3%	3%
Retirement Contribution	5%	6%	9%	7%	3%
Health Insurance Contribution	5%	7%	8%	7%	7%

As shown in the above table, salaries are assumed to increase by 3% in each of the forecast years as a result of negotiated salary increases, expected step and merit increases, and other required allowances. Memoranda of Understanding for the majority of represented employees are scheduled to expire by the end of FY 2018-19, and any potential future increases may be less than, or exceed, the forecasted amounts, depending on negotiations. For the major funds included in this report, this represents an increase of nearly $45 million from the FY 2017-18 adopted budget to the FY 2022-23 forecast year.

Retirement costs are anticipated to increase by an average of 6% each year, reflecting pension investment return assumptions and expectations regarding existing and future retirees. This amounts to an increase of over $35 million over the five-year period for the major funds in this report. In October 2016, the Board of Retirement approved a change in the assumed rate of return from 7.5% to 7.0%, which was expected to increase the County’s pension contribution amount significantly each year. The cost increases borne out by this change to the assumption rate may be somewhat moderated by the pension fund's higher than anticipated earnings in FY 2016-17 of 10.5%, but it is unknown at this time how that might affect the County's contribution rate, and thus was not included in the forecast assumptions. The Retirement Board will adopt the rate for FY 2018-19 later this fall, and that rate will be incorporated into the FY 2018-19 budget. The Board of Retirement also conducts a triennial actuarial study to determine changes in the assumed rate of return. The next study likely would be completed in 2019. No further decrease in the assumed rate of return is included in this five-year forecast although the Retirement Board could choose to lower the rate again.

Health insurance costs are anticipated to increase by an average of 7% per year, based on recent trends in the health care insurance marketplace, driven primarily by the rising cost of prescription drug coverage and in-patient hospital services. This amounts to an increase of about $14 million over the five-year period for the major funds in this report.

Other Growth Areas

The annual set-aside for Northern Branch Jail (NBJ) operations is increasing according to the terms established in the funding plan implemented in FY 2011-12. The contribution of $9.1 million in FY 2017-18 will grow to $19.3 million by FY 2022-23. This report, in accordance with the funding plan, assumes that the costs of operating the NBJ remain in line with projections developed in FY 2015-16. The County Executive Office and Sheriff's Office are updating those projections and, if needed, will bring proposed changes to the funding plan to the Board as part of the FY 2018-19 budget process.

In June 2014, the Board directed staff to implement a maintenance funding plan that would direct 18% of unallocated discretionary general revenues towards maintenance projects to address deferred maintenance needs. This forecast assumes that this allocation will increase by 10% in each of the forecast years, growing from $3.3 million in the FY 2017-18 budget to $5.3 million in the FY 2022-23 forecast year. This is in addition to SB 1 transportation funding and other projected maintenance funding by the departments from sources other than General Fund Contribution (GFC). An additional $3.1 million in one-time maintenance funds provided in the adopted FY 2017-18 budget are not assumed to continue in the forecast years; however, allocating a portion of available funds towards maintenance is always a consideration during the budget process, and will certainly remain so in the upcoming years.

Additional factors may impact expenditures in the forecast years that are not included in this report, either because they are not quantifiable or not certain enough to reasonably assume, and these will be monitored on an ongoing basis to ensure funding needs are planned for and addressed adequately. In the recent past, these factors have included increasing Sheriff overtime costs, capital needs at the Main Jail, inpatient psychiatric bed shortages, unanticipated Goleta Beach remediation measures, and potential direction to reclassify funding awarded in the FY 2017-18 adopted budget on a one-time basis to an ongoing basis. In addition, the forecast assumes no department program or staff expansions.

Revenue Assumptions

Departments were directed to assume that GFC allocations remain at the FY 2017-18 adopted budget levels throughout the forecast period, thereby producing budget gaps where projected departmental revenue levels are unable to keep pace with projected expenditure growth. A portion of growth in discretionary general revenues has historically been allocated to departments to offset all or some of their projected budget gaps. Given the severity of fiscal constraints facing the county and competing needs yet to be identified as part of the fiscal outlook report to be presented within the next several months, there may be a need to deviate from this historical practice. For the purposes of this forecast, however, general revenue growth is presented at the fund level in the forecast years in order to clearly illuminate the impacts of revenue assumptions. Three revenue growth scenarios for discretionary general revenues were calculated: a best case, most likely, and worst case projection. In the most likely scenario, major revenue assumptions are as follows:

- Secured property taxes are expected to increase by just over 4% per year, reflecting 4.5% annual growth adjusted downward for the Fire tax shift in the first two forecast years. It is anticipated that the Fire tax allocation will reach the 17% target in late FY 2019-20. (Growth in the current year is projected to be 5.5%; however, the Assessor has attributed a part of this growth to a spike in new construction and a clearing of the Prop 8 adjustments backlog, one-time increases that are not expected to continue in future years.)
- Sales tax is expected to grow by 3% in each forecast year.
- Transient Occupancy Tax (TOT) revenue is expected to increase by approximately 3% per year, with anticipated short-term rental losses of $1.9 million offset by the opening of the Miramar and State Street hotels in the 2018-19 timeframe.

Other revenue assumptions include 3% annual growth in Prop 172, the public safety sales tax revenue, and limited growth in realignment revenues.

This forecast did not assume additional revenues or expenditures that may result from potential cannabis operations in the County, as a regulatory framework and potential ballot measure are still being evaluated at this time.

Projected Budget Gaps in Major Operating Funds

Based on the expenditure and most-likely revenue assumptions described above, and if GFC were applied per historic practice, the FY 2018-19 General Fund deficit is projected at $6.0 million, with a deficit of $11.1 million projected in the major special revenue funds. It is forecast that these gaps would grow to $15.1 million and $50.3 million, respectively, by FY 2022-23, if not structurally addressed. These projected budget gaps are the result of expenditure growth outpacing revenue growth in the General Fund and other major operating funds. The table below presents the projected budget gaps by General Fund department and by major special revenue fund.

Major Operating Fund Gaps with Most Likely Revenue Scenario ($ in millions)

Fund 0001 - General Fund	2018/2019 Fiscal Year Forecast	2019/2020 Fiscal Year Forecast	2020/2021 Fiscal Year Forecast	2021/2022 Fiscal Year Forecast	2022/2023 Fiscal Year Forecast
011 -- Board of Supervisors	(0.1)	(0.2)	(0.3)	(0.5)	(0.6)
012 -- County Executive Office	(0.4)	(0.6)	(0.9)	(1.1)	(1.3)
013 -- County Counsel	(0.2)	(0.4)	(0.6)	(0.8)	(1.1)
021 -- District Attorney	(0.6)	(1.4)	(2.4)	(3.6)	(4.4)
022 -- Probation	(2.4)	(3.7)	(5.5)	(7.3)	(8.5)
023 -- Public Defender	(0.3)	(0.7)	(1.2)	(1.6)	(2.0)
032 -- Sheriff	(2.4)	(4.9)	(8.8)	(12.4)	(15.0)
041 -- Public Health	(0.0)	(0.2)	(0.7)	(1.1)	(1.3)
051 -- Agricultural Commissioner/W&M	(0.0)	(0.0)	(0.2)	(0.4)	(0.5)
052 -- Parks	(0.2)	(0.5)	(0.8)	(1.2)	(1.5)
053 -- Planning & Development	(0.2)	(0.2)	(0.4)	(0.5)	(0.6)
054 -- Public Works	-	-	-	-	-
055 -- Housing/Community Development	(0.1)	(0.2)	(0.3)	(0.3)	(0.4)
057 -- Community Services	(0.1)	(0.1)	(0.2)	(0.2)	(0.2)
061 -- Auditor-Controller	(0.4)	(0.7)	(1.1)	(1.5)	(1.8)
062 -- Clerk-Recorder-Assessor	(0.7)	(1.5)	(1.4)	(2.3)	(2.5)
063 -- General Services	(1.7)	(2.0)	(2.5)	(3.0)	(3.4)
064 -- Human Resources	(0.2)	(0.3)	(0.6)	(0.7)	(1.0)
065 -- Treasurer-Tax Collector-Public	(0.3)	(0.7)	(1.0)	(1.3)	(1.5)
990 -- General County Programs	(1.7)	(1.9)	(4.4)	(5.7)	(7.5)
General Fund Gap Subtotal	(12.2)	(20.2)	(33.2)	(45.5)	(55.2)
GFC Allocation*	6.3	13.8	23.3	32.3	40.1
Remaining GF Gap	(6.0)	(6.4)	(9.9)	(13.2)	(15.1)

*Includes General Fund set asides for S&B Growth, NBJ Funding Plan and 18% Maintenance Policy

Major Special Revenue Funds					
0010 -- First 5 Child & Families Comm	(0.5)	(0.5)	(0.7)	(0.7)	(0.8)
0015 -- Roads-Operations	-	-	-	(4.5)	(8.9)
0042 -- Health Care	(0.5)	(1.7)	(2.9)	(4.3)	(5.7)
0044 -- Mental Health Services	(0.3)	(1.0)	(1.8)	(2.7)	(3.3)
0048 -- Mental Health Services Act	(3.2)	(4.5)	(5.4)	(6.2)	(6.9)
0049 -- Alcohol and Drug Programs	-	-	-	-	-
0055 -- Social Services	(4.1)	(8.2)	(12.1)	(16.0)	(19.6)
0056 -- SB IHSS Public Authority	(1.7)	(2.1)	(2.5)	(3.0)	(3.4)
0057 -- Child Support Services	(0.4)	(0.8)	(1.3)	(1.7)	(2.1)
0058 -- WIOA-WDB	(0.1)	(0.3)	(0.4)	(0.5)	(0.5)
0069 -- Court Activities	(0.9)	(1.1)	(1.3)	(1.5)	(1.6)
Special Revenue Funds Gap Subtotal	(11.5)	(20.3)	(28.3)	(41.0)	(52.8)
GFC Allocation for S&B Growth	0.4	0.9	1.5	2.0	2.5
Remaining Special Revenue Funds Gap	(11.1)	(19.4)	(26.9)	(39.0)	(50.3)

Remaining Discretionary General Fund after Allocations	3.8	7.2	9.3	11.7	15.3

Most General Fund departments and major special revenue funds are projecting deficits in anticipation of state and federal revenue levels that will not keep pace with increases in salaries and benefits, as well as the assumption of flat GFC discussed above. The GFC Allocation in the table above represent the portions of general discretionary revenue growth that would typically be allocated to general fund departments and major special revenue funds based on historical practice. With this historical allocation, there remains unallocated general revenue growth, which would be available to offset a portion of the remaining gaps or be used for other purposes in accordance with Board policy. Though special revenue fund gaps are reported here, it has not been past practice to fully offset deficits in state- and federally-funded programs with general discretionary revenues.

The forecasted gaps presented are based on the best information available at the time of the writing of this report, and based on discretionary revenues using the most likely growth scenario. Best and worst case scenarios were also developed:

- The best case scenario assumes approximately 5% annual growth in property taxes, and 4% in sales taxes and TOT revenues, and would add an additional $4.2 million to available discretionary General Fund, for a total of $8.0 million in unallocated discretionary General Fund in FY 2018-19.
- The worst case scenario assumes approximately 4% annual growth in property taxes, and 2% in sales taxes and TOT revenues, and would reduce the unallocated discretionary revenue to $2.3 million in FY 2018-19.

These additional scenarios are presented to provide an estimated range of growth in discretionary General Fund revenues. Projections will continue to be refined in anticipation of the FY 2018-19 budget development process.

Remaining Discretionary General Fund after Allocations: Three Growth Scenarios ($ in millions)

	2018/2019 Fiscal Year Forecast	2019/2020 Fiscal Year Forecast	2020/2021 Fiscal Year Forecast	2021/2022 Fiscal Year Forecast	2022/2023 Fiscal Year Forecast
Best Case	8.0	14.1	18.2	22.9	29.0
Most Likely Case	3.8	7.2	9.3	11.7	15.3
Worst Case	2.3	4.3	5.7	7.5	10.4

General Fund

The forecasted FY 2018-19 budget gap of $12.2 million (without any general discretionary revenue growth offset) is largely driven by deficits in the Probation Department, Sheriff's Office, General Services Department, and General County Programs, which together account for 67% of the gap. Within all general fund departments, the projected gaps result from salary and benefit growth and relatively flat state and federal revenues. The gap in General County Programs, however, is driven by growth in the NBJ funding plan, as well as the assumed growth in the 18% Maintenance Plan, as previously discussed. If the historic GFC allocation practice were followed, including funding the ongoing growth in the NBJ plan and 18% Maintenance Plan, $6.3 million of general revenue growth would be allocated to General Fund departments in FY 2018-19, bringing the remaining General Fund gap to $6.0 million. If all available discretionary revenue in FY 2018-19 were allocated to General Fund departments, that would eliminate nearly all of the General Fund projected budget gaps. However, when special revenue funds are not projected to be able to cover expenditure increases with departmental revenues, as is the case with the funds in the table above, the County considers all operating fund gaps during the GFC allocation process.

Roads-Operations
The Roads Operations Fund projects expenditure growth to outpace revenue growth throughout the forecast period as a result of salary and benefit increases. In the first three years of the forecast, the fund relies on available fund balance to fully offset the gap, and to partially offset the gap in the fourth year. This is a balancing strategy that has been employed in prior years but won't be sustainable if assumed growth rates are realized. Without a fund balance draw in FY 2018-19, the forecasted budget gap would be $0.5 million.

Health Care
Realignment revenue and payments and reimbursements from state and federal programs are not expected to keep up with the increased costs of salaries and benefits and medical supplies.

Mental Health Services Fund
The Mental Health Services Fund projects a gap of $0.3 million in FY 2018-19, increasing to $3.3 million in FY 2022-23. In addition to salary and benefit increases, this reflects the loss of a one-time $1.2 million allocation from the General Fund in FY 2017-18 for additional beds at mental health facilities. However, the projection does assume, consistent with past practice, that the $1.0 million set aside in General County Programs each year for mental health needs, per Board policy, is transferred to this Fund.

Mental Health Services Act Fund
The Mental Health Services Act Fund forecasts a $3.2 million gap in FY 2018-19, growing to $6.9 million in FY 2022-23, reflecting salary and benefit growth as well as revenue losses. The revenue losses primarily result from a $2.4 million decrease in state funding for SB 82 Crisis Triage grants as well the depletion of MHSA reserves available to cover MHSA operations. The forecast also assumes continuation of grant-funded programs when grant funding is exhausted, including $0.7 million in state funding for the Mobile Crisis West grant, which could be mitigated by securing new grant awards or discontinuation of service. As a result of recent changes by the state in regard to billable activities, the Behavioral Wellness Department is analyzing Medi-Cal billing practices to ensure maximum reimbursement for all programs, and the gaps projected in the forecast years will likely be impacted positively by changes in reimbursement eligibility.

Social Services
The projected gaps in forecast years are driven by nearly flat revenues offset by increased salary and benefit costs. Revenue projections are in line with state revenue projections for all social services programs, for which caseloads are expected to remain flat or decrease. The only revenue source expected to realize growth is in the area of 2011 Realignment, but only very modest growth is anticipated. The Social Services Department is committed to working with state agencies to maximize revenue moving forward, which could decrease the forecasted gaps.

IHSS Public Authority Fund
Assumed increases of 5% a year in the Maintenance of Effort (MOE), combined with flat revenues and exhaustion of fund balance, drive the forecasted budget gaps. Recent negotiations between the

California State Association of Counties and the State on the IHSS MOE cost allocation methodology resulted in costs to the County being slightly more favorable in FY 2017-18 than originally budgeted. However, the longer term projections of the State shifting more IHSS costs to counties results in significant gaps in the coming years, $1.7 million in FY 2018-19, growing to $3.4 million FY 2022-23. While the increased cost to the county is estimated at 5% per year in each of the forecast years, the actual increase amounts will be dependent on sales tax revenue, and will range from 0% to 7% in FY 2019-20 and beyond.

First 5, Child Support Services, and WIOA
These funds do not receive GFC, and are wholly dependent on state and federal revenues. Their gaps are driven by increasing salary and benefit costs in contrast to static revenues. Although these gaps are included in this report, the County does not traditionally provide any General Fund dollars to these Funds during the budget process as a way to balance their budgets.

Court Activities Fund
Recent legislation will prevent courts from suspending someone's driver's license because of unpaid fees, fines, and penalties. It is anticipated that such revenues accounted for in the court activities fund will decrease by 20% to 30% as a result of this change, leading to a gap of $0.9 million in FY 2018-19, growing to $1.6 million by FY 2022-23.

The special revenue funds above forecast a total gap of $11.5 million in FY 2018-19, growing to $52.8 million in FY 2022-23. The historic GFC allocation policy would allocate $0.4 million to some of these funds, reducing the total gap to $11.1 million in FY 2018-19. This remaining gap, coupled with the $6.0 remaining General Fund gap, totals $17.1 million, and, as the table above shows, there is estimated to be $3.8 million left of unallocated discretionary General Fund to apply towards that gap.

Looking Forward – Renew '22

This five-year forecast is intended to serve as a backdrop to the FY 2018-19 budget development process. The numbers presented in this forecast are preliminary and will certainly change throughout the coming months leading up to budget development; however, they provide a starting point as we look forward towards closing the anticipated budget gap. Over the next five years, retirement and other personnel-related costs will continue to rise, state and federal revenues will continue to provide uncertainty, and service demands will continue to change and, in some cases, expand. Though discretionary revenues are growing at rates higher than those seen in the years immediately following the 2008 downturn, the County will be challenged in the coming years to align revenues and expenditures.

This challenge provides the County with an opportunity to evaluate operations and develop rebalancing strategies to strengthen and enhance the way services are delivered to customers in alignment with community and Board priorities. In FY 2016-17, the County Executive Office and several department directors began the Rebalancing and Resiliency Project to identify options to increase revenues and reduce expenditures to create a sustainable balanced budget over the next few years. Many county staff members participated in focus groups and contributed ideas to this process.

In FY 2017-18, the project team began implementation planning for a fully integrated countywide initiative called Renew '22. The Renew '22 initiative integrates the rebalancing project, action plans from the internal strategic plan, and action items from the strategic communications plan. The integration of these planning efforts through Renew '22 is intended to allow the county to thrive as an organization in these times of fiscal uncertainty. This will require transforming the way we do our work over the next few years.

Renew '22 has two main elements. The first is a deeper examination of the ideas identified in the rebalancing project that are interdepartmental and will have countywide effects. The second element involves identifying and analyzing department-level strategies that, if implemented, best position the departments to succeed given our fiscal projections.

The County Executive Office has presented Renew '22 to department directors, assistant department directors and fiscal officers, and labor union representatives. Employees at all levels of the organization are actively involved in developing strategies to re-vision our organization, re-balance our resources, re-design how we do our work, respond to residents and customers with the highest quality of service within our means, and retain high-performing employees and prepare the next generation of leaders. These elements of Renew '22 are depicted in the graphic below:

Departments and the County Executive Office are working together in the five color teams shown above to proactively identify opportunities to reduce costs and enhance resources. Current and future initiatives will include exploration of cost reduction options, including consolidations, multi-department cooperative arrangements, information technology innovations, and multi-agency partnerships.

Revenue enhancement strategies are also being explored, including departmental fee analyses to bring fee revenues in line with full costs and development of new and enhanced revenue streams. In addition, the Board and county departments are actively exploring cannabis regulation as a potential new revenue stream, which may generate significant ongoing revenues.

Renew ‘22 recognizes that retention of high-performing employees and succession planning is central to a successful transformation in how the county serves the community. The yellow team is developing new workforce initiatives and new employment models to promote employee engagement, collaboration, development, accountability, and innovation.

Some rebalancing efforts have already been implemented, including a centralized hiring review process and elimination of funding for outside agencies. Additional efforts are underway, such as analysis of space consolidation options including future need for owned or leased buildings, negotiating full cost recovery service contracts, and updating departmental service fees.

As Renew ‘22 teams continue to analyze rebalancing strategies and develop implementation plans, the County Executive Office will review specific action plans, timelines, and resource requirements for implementing rebalancing ideas, and will bring forward recommended actions to the Board for consideration in advance of budget development.

Authored by:

Rachel Lipman, Fiscal & Policy Analyst