COUNTY OF SAN LUIS OBISPO BOARD OF SUPERVISORS
AGENDA ITEM TRANSMITTAL

(1) DEPARTMENT Administrative Office	(2) MEETING DATE 10/9/2012	(3) CONTACT/PHONE Dan Buckshi, County Administrative Officer 781-5011	
(4) SUBJECT Consideration of a report regarding the County's financial forecast.			
(5) RECOMMENDED ACTION It is recommended that the Board receive and file this report regarding the County's fiscal forecast.			
(6) FUNDING SOURCE(S) N/A	(7) CURRENT YEAR FINANCIAL IMPACT $0.00	(8) ANNUAL FINANCIAL IMPACT $0.00	(9) BUDGETED? N/A
(10) AGENDA PLACEMENT **{ }** Consent **{ }** Presentation **{ }** Hearing (Time Est. _______) **{x }** Board Business (Time Est__60 min__)			
(11) EXECUTED DOCUMENTS **{ }** Resolutions **{ }** Contracts **{ }** Ordinances **{ x }** N/A			
(12) OUTLINE AGREEMENT REQUISITION NUMBER (OAR) N/A		(13) BUDGET ADJUSTMENT REQUIRED? BAR ID Number: N/A **{ }** 4/5th's Vote Required **{x }** N/A	
(14) LOCATION MAP N/A	(15) BUSINESS IMPACT STATEMENT? No	(16) AGENDA ITEM HISTORY **{x }** N/A Date ______________________	
(17) ADMINISTRATIVE OFFICE REVIEW			
(18) SUPERVISOR DISTRICT(S) All Districts -			

County of San Luis Obispo

TO: Board of Supervisors

FROM: Administrative Office / Dan Buckshi, County Administrative Officer

DATE: 10/9/2012

SUBJECT: Consideration of a report regarding the County's financial forecast.

RECOMMENDATION

It is recommended that the Board receive and file this report regarding the County's fiscal forecast.

DISCUSSION

The purpose of this report is to provide a detailed financial forecast for Fiscal Year 2013-14 and a longer term fiscal outlook. The report is organized as follows:

- Executive summary
- Methodology of the forecast
- Fiscal outlook
- Detailed County General Fund budget forecast for FY 2013-14
- Conclusions
- Economic data and trends- Attachments 1 - 8

Executive Summary:

The forecast for FY 2013-14 is in line with prior years' projections. The anticipated budget gap for San Luis Obispo County is $2.9 million. This forecast assumes that revenues will increase slightly, that labor costs will remain relatively flat, and that a 2% CPI increase will apply to non-labor costs (largely driven by fuel costs). Given the numerous variables at play, the likely range for the gap for the upcoming fiscal year is $0 to $5 million.

FY 2013-14 represents year six of the previously created "Seven Year Pain Plan." While many difficult decisions have been made and many more lie in wait, the upside is that the plan is working. Programs and services have been scaled back but dramatic cuts have been avoided. In addition, layoffs have not occurred as the workforce has been reduced via attrition (-245 FTE or -9%). Lastly, the structural gap is shrinking and if all goes according to plan, it should be closed during FY 2014-15.

This report provides the details for how this forecast was created, the corresponding implications, and recommendations for moving forward. The Budget Goals and Policies, Budget Balancing Strategies and Approaches, and Board priorities will be brought to your Board for review and consideration during November.

Methodology of Forecast:

The purpose of this forecast is to provide the best estimate at this point in time for the fiscal capacity of the General Fund for FY 2013-2014. In addition, this report is intended to provide a longer term outlook with respect to economic conditions, which will impact the County budget in future years. This forecast is only focused upon the General Fund (e.g. does not include non-General Fund departments such as Roads or Libraries) and assumes a Status Quo budget. Generally speaking, a Status Quo budget is defined as one that takes current year staffing and program levels and costs them out for the next year with no material changes (i.e. inflationary increases only and no increases or decreases to staffing levels). Lastly, it is assumed that grants currently received would continue. This is the same methodology that has been used in prior years.

It is also important to note that potential negative effects of the State budget are not included in this forecast. *Put another way, the assumption is that any loss of revenue from the State would be accompanied by a commensurate reduction of expenditures (i.e. program and service level reductions would be made).* If it is decided that local funds would be used to backfill any portion of State revenue reductions, the projected gap for the FY 2013-14 County budget would increase by that same amount.

Fiscal Outlook:

Background and Overview

Slow and steady are the best way to describe this year's outlook. As noted in prior years' forecasts, the Great Recession officially ended June 2009 but the recovery has been slow. Gross Domestic Product (GDP), which is a key measure of the economy, has been growing at a rate of about 2%. By comparison, the average rate of GDP growth between 1947 and 2012 was 3.25%. The unemployment rate has improved to 8.3% (nationally) from 9.1% a year ago but remains well above rates associated with a healthy economy. Lastly, it appears that the housing market has bottomed out as the number of sales as well as sales prices have increased in many areas of the country, however, the market remains soft. In sum, the recovery is slow and fragile.

Key National Issues

There are several significant issues in Washington that could substantially impact the economy, most of which are not economic in nature. The level of political polarization remains troubling. This issue was highlighted in last year's forecast and conditions have not much changed since. It appears the two major political parties are unwilling and unable to reach a middle ground. As a result, long-term economic and budgetary solutions remain elusive. Along these lines, this year is a presidential election year and the balance of power in the White House and Congress is at stake. Depending upon the outcome of the elections, the gridlock may or may not change.
Due to the soft recovery, the Federal Reserve continues to take action in an attempt to provide economic stimulus. Recently, Federal Reserve Chairman Ben Bernanke announced the implementation of Quantitative Easing Three (QE3). This program will result in the government purchase of financial assets (in this case, mortgage backed securities) from commercial banks and other financial institutions in an attempt to keep long term interest rates low, which in theory would promote more lending and economic activity. As the name indicates, this is the third round of this form of stimulus since 2008. The other primary lever for the Federal Reserve is short-term interest rates. Given that short term interest rates (the Federal Funds Rate) remain near zero (0.25%), it appears that not much more can be done on this front.

One of the biggest discussion points amongst Washington pundits is the potential "Fiscal Cliff." The "Fiscal Cliff" is the confluence of four events that will occur on Jan 1, 2013 if Congress and the President do not take action beforehand. The four components include:

- Expiration of the Bush era tax cuts
- Expiration of extended unemployment benefits
- Expiration of payroll tax holiday
- $1.3 trillion of automatic spending cuts (sequestration)

In and of themselves anyone of these events would negatively impact the economy, combined they could be catastrophic. It appears that little headway will be made on these issues prior to the November election and after the election many "lame duck" politicians will be in place. That being said, it seems unlikely that the "Fiscal Cliff" will be allowed to occur. On the other hand, it also seems unlikely that long term solutions will be enacted. Many Washington observers prognosticate that short-term measures will be taken to avoid the catastrophe but that little will be done to soothe longer term concerns.

California

Similar to prior years, California's budget woes continue. During the current year (FY 12-13), the State faced a $16 billion gap. Roughly half was closed via expenditure reductions and the other half via assumed tax increases (~$5 billion) and short-term gimmicks (~$3 billion). The tax increase will go before the voters in the upcoming November election and current polling numbers are hovering around 55%. Even if the measure passes, the State will be facing a multi-billion dollar gap for the upcoming year and if the measure fails, the gap will widen by an additional $5 billion. The State's financial condition continues to be the single largest threat to the County's budget.

County Outlook

The County's budget outlook fits well with the theme of slow and steady. Economic conditions are improving, albeit slowly, and our organization's budget gap is shrinking according to plan. This year's forecast projects that property values (assessed values) will increase by 1.5%, which would be the largest increase in several years. Overall revenues are projected to increase about 1%. The projection for the next three to five years for revenue growth is between 1% and 3%.

While these increases are good news, they are certainly not great news. Given the limited options to increase revenues (about 70% of revenues are derived from the Federal/State governments and property taxes), our primary lever for balancing the budget remains on the expenditure side of the equation. This being the case, our expenditures will need to remain essentially flat for several years to come.

Detailed County General Fund Budget Forecast for FY 2013-14:

This forecast is broken into two broad categories, financing sources (money coming in) and expenditures (money going out). Within financing sources there are three categories:

- Fund Balance Available (FBA), which is the money available at the end of one fiscal year for use in the next fiscal year
- Non-departmental revenue (e.g. property taxes, sales, and transient occupancy taxes)
- Departmental revenue (e.g. state/federal funding, grants, fees).

In California county budgets, the latter are attached to a specific departmental budget while the former two are available to balance the "bottom line."

Expenditures are also broken into three categories- labor costs, non-labor costs, and contingencies (money set aside for unforeseen events).

The attachments to this document display trends for key non-departmental revenue sources, building permits, foreclosure activity, and unemployment rates. The revenue charts display the trends in actual dollar amounts as well as the percent change from year to year.

- Attachment 1 displays trends for non-departmental revenues as a whole
- Attachment 2 displays the trends for assessed property value within the County, which is the basis upon which the County receives property tax revenue
- Attachment 3 displays the trends for property transfer taxes. This revenue is a leading indicator of sales activity as it is received when a change in ownership occurs
- Attachment 4 displays trends for sales taxes
- Attachment 5 displays trends for transient occupancy taxes (hotel bed taxes)
- Attachment 6 displays building permit trends
- Attachment 7 displays housing foreclosure trends
- Attachment 8 displays unemployment trends

Revenue Sources- Fund Balance Available (FBA):

The first funding source for the General Fund is Fund Balance Available (FBA) from the prior year. FBA is the money that is left at the end of one fiscal year that can be rolled over as a funding source for the next fiscal year. It comprises contingencies not spent, revenues that come in over budget, and expenditures that come in lower than budget.

The assumption is that FBA will be $19 million at the end of FY 2012-13, which would be available for use in FY 2013-14. This number was derived by estimating how much of the General Fund (GF) contingency would be left at the end of FY 2012-13. The FY 2012-13 budgeted GF contingency is $15,043,207 and it is assumed that only $1.5 million of this would be spent (roughly 10%) and the remainder would fall to FBA. Also, it is assumed that departments will end the 2012-13 fiscal year $5.5 million under their collective amount of budgeted General Fund support. This component of FBA is largely attributable to salary savings as a result of the County's "hiring chill."

It is worth emphasizing that FBA varies significantly from year to year and is difficult to forecast because it is influenced by every line item in the overall budget (there are over a thousand line items). It is also worth noting that any cost savings measures taken during FY 2012-13 will increase the amount of FBA at year-end.

Revenue Sources- Non-Departmental Revenue (Discretionary Revenue):

The table below outlines the assumptions for the FY 2013-14 forecast **for non-departmental revenue**:

Revenue	**09-10 Actual**	**10-11 Actual**	**11-12 Actual**	**12-13 Budget**	**13-14 Forecast**	**Diff: 12-13 Bud & 13-14 Forecast**
Secured Prop Tax	$85,914,937	$85,585,577	$85,152,390	$84,541,381	$85,009,502	0.6%
Unitary Tax	$7,344,050	$7,457,672	$7,579,341	$7,695,240	$7,695,540	0.0%
Supplemental Prop Tax	$1,508,775	$1,048,651	$863,818	$750,000	$750,000	0.0%
Prop Tax in lieu of VLF	$27,251,673	$26,959,517	$26,453,316	$27,000,000	$27,000,000	0.0%
Prop Transfer Tax	$1,437,561	$1,403,790	$1,863,925	$1,600,000	$1,600,000	0.0%
Sales Tax	$5,672,514	$6,164,590	$7,370,278	$5,500,000	$6,000,000	9.1%
TOT	$5,582,396	$6,341,996	$6,333,523	$6,200,000	$6,400,000	3.2%
All Other	$11,531,092	$11,072,511	$12,904,127	$12,678,856	$13,934,417	9.9%
TOTAL Non-Dept Rev	**$146,242,998**	**$146,034,304**	**$148,520,718**	**$145,965,477**	**$148,389,459**	**1.7%**

Notes about Non-Departmental Revenue:

The FY 2013-14 secured property tax estimate assumes a 1.5% increase in assessed value (which incorporates an assumed CPI increase of 2% relative to Prop 13) and a delinquency rate of 2.8%, which is 1% more than the 1.8% rate that actually occurred during FY 2011-12. The 1.8% was considerably lower than historical norms (2.5% to 4%) and it is anticipated this rate will increase during FY 12-13 and FY 13-14.

The amount of sales tax received during FY 11-12 ($7.37M) was high due to one-time adjustments by the State as well as work completed at the Diablo Canyon Power Plant. Accounting for these variances, the standard sales tax received for FY 11-12 was $5.5 million. The forecast for FY 13-14 is to hold steady with the adjusted amount received during FY 11-12 plus $500K for upcoming work planned at Diablo Canyon Power Plant.

Only a small portion of the sales tax revenue that is anticipated to be received as a result of the two large solar plants being built in the Carrizo Plain is included in this forecast. The amount forecasted is equal to the amount of expense included in the Sheriff, Fire, and Planning & Building Departments' (Code Enforcement) budgets (approximately $1.3M). The remainder is not included in this forecast as the plan is for this revenue to be set aside in a reserve in order to pay for increases in County provided services associated with the solar plants.

The increase to "All Other" revenue is a result of a $600K increase to the "Triple Flip" funding received from the State and $600K of increased funding as a result of the State legislative changes to redevelopment agencies.

This forecast assumes that current county tax rates will remain for the foreseeable future (e.g. sales, transient occupancy, utility users tax rates would not be increased).

Revenue Sources- Departmental Revenue:

The following table outlines the assumptions for **departmental revenue**. Departmental revenue is received by departments and is generally restricted in use for specific purposes.

Revenue	**09-10 Actual**	**10-11 Actual**	**11-12 Actual**	**12-13 Budget**	**13-14 Forecast**	**Diff: 12-13 Bud & 13-14 Forecast**
Prop 172	$17,552,055	$18,523,467	$19,470,814	$19,766,019	$20,574,317	4.1%
Realignment	$18,227,153	$17,678,536	$16,345,946	$16,995,179	$17,165,131	1.0%
Health	$42,017,885	$43,345,750	$46,949,370	$51,818,850	$51,818,850	0.0%
Social Services	$72,012,975	$78,175,248	$73,536,242	$78,015,025	$78,015,025	0.0%
Other	$56,062,416	$65,465,744	$62,315,284	$58,398,997	$58,398,997	0.0%
Total	**$205,872,484**	**$223,188,745**	**$218,617,656**	**$224,994,070**	**$225,972,320**	**0.4%**

Notes about Departmental Revenue:

The estimates for the Health Agency and Department of Social Services were provided by the respective departments. The figures noted above for the Health Agency only include those which are part of the General Fund (e.g. does not include County Medical Services Program (CMSP), Driving Under the Influence, etc.).

The changes in dollar amounts between FY 11-12, FY 12-13, and FY 13-14 for Health Agency and Social Services are largely driven by shifts in funding related to 2011 State/County Realignment.

The FY 2010-11 actual amount for “Other” revenue includes the repayment of the $6 million General Fund loan for the Los Osos wastewater project. This figure is not included in subsequent years.

2011 State Realignment (AB 109) continues to be a concern for counties. For FY 2013-14, it is anticipated that program revenues and costs transferred from the State will roughly equate, however, there is no assurance this will be the case in future years. This issue is a significant concern and focal point for counties around the State given that this realignment represents a tremendous programmatic and financial risk for counties.

This forecast does not take into account Federal healthcare reform, which could substantially impact the Health Agency budget. Not enough information is known at this time in order to build any changes into the forecast.

Expenditure Forecast:

This section forecasts the cost of a Status Quo budget for FY 2013-14. Generally speaking, a Status Quo budget is defined as one that takes current year staffing and program levels and costs them out for the next year with no material changes (i.e. inflationary increases only and no increases or decreases to staffing levels and no new or expanded service levels). Lastly, it is assumed that grants currently received would continue.

The assumptions built into the expenditures forecast are as follows:

- No salary and benefit increase. Any salary and benefit increases granted to employees would increase the forecasted budget gap dollar for dollar. To illustrate this point, a 1% increase compensation for all employees would add $2.2 million to the budget gap.

- A 1% pension rate increase to be split 50/50 between the County and employees (the impact to the County budget forecast is a 0.5% rate increase). This is only an estimate as the updated actuarial evaluation of the Pension Trust will not be available until late spring or early summer 2013.

- A 0.75% rate increase for the Pension Obligation Bonds. This increase is in alignment with the payment schedule and is also a result of having fewer County positions. As the number of employees has shrunk over the past few years, the charge per employee has increased in order to cover the fixed cost.

- Assumes that worker's compensation charges, which are currently lower than historical averages will continue at this lower rate for FY 2013-14.

- A 4% General Fund Contingency will remain in place. The Board adopted budget goals and policies call for a 5% Contingency; however, this was lowered to 4% as part of the short-term solutions to balance the budgets for FY 2009-10 and beyond.

- A 2% Consumer Price Index (CPI) increase for all other, non-labor related costs.

The assumptions noted above result in the following expenditure forecast:

$224,165,244	FY 2012-13 Adopted GF Salary and Benefits
$152,036,605	FY 2012-13 Adopted GF Other costs
$712,621	Pension rate increase (+0.5%)
$1,068,932	Pension Obligation Bonds increased charges (+0.75%)
$3,040,732	Increase in other, non-labor related costs (+2% CPI)
$15,240,965	4% Contingency
$396,265,099	**Total Expenditures forecast for FY 2013-14**

Budget Gap:

Per the assumptions noted above, the forecasted budget gap for the General Fund for FY 2013-14 is:

$393,361,779	Total Financing Sources (revenues)
$396,265,099	Total Financing Uses (expenditures)
$2,903,320	**Total Budget Gap**

It is important to note the sensitivities of the forecast. For example, a 1% change to the various forecast elements has the following impacts:

- $1.5m Non-Departmental Revenue
- $2.3m Departmental Revenue
- $2.2m Salaries and Benefits
- $1.5m Non-salary Costs

Given the numerous variable involved, it is likely that the gap for the FY 2013-43 General Fund will be between $0 and $5 million

Conclusions:

FY 2013-14 represents year six of the County's Seven Year "Pain Plan." As such, the upcoming year is expected to continue to be challenging but less so than prior years. The plan is working and as a result, the County's budget should be structurally balanced by the end of FY 14-15. The Board of Supervisors and County staff at all levels have done an outstanding job of implementing this plan in order to pursue our collective vision of a Safe, Healthy, Livable, Prosperous, and Well-Governed Community.

ATTACHMENTS

1. Attachment 1- Total Non-Departmental Revenue Trends
2. Attachment 2- Total Assessed Property Value Trends
3. Attachment 3- Property Transfer Tax Trends
4. Attachment 4- Sales Tax Trends
5. Attachment 5- Transient Occupancy Tax (TOT) Trends
6. Attachment 6- Building Permit Trends
7. Attachment 7- Foreclosure Trends
8. Attachment 8- Unemployment Rate Comparisons