

**COUNTY OF SAN LUIS OBISPO BOARD OF SUPERVISORS
AGENDA ITEM TRANSMITTAL**

(1) DEPARTMENT Administrative Office	(2) MEETING DATE 10/15/2013	(3) CONTACT/PHONE Guy Savage Assistant County Administrator 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. <u>60 min</u>)			
(11) EXECUTED DOCUMENTS { } Resolutions { } Contracts { } Ordinances { x } N/A			
(12) OUTLINE AGREEMENT REQUISITION NUMBER (OAR) N/A		(13) BUDGET ADJUSTMENT REQUIRED? BAR ID Number: { } 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 This item was prepared by the Administrative Office.			
(18) SUPERVISOR DISTRICT(S) All Districts -			

County of San Luis Obispo



TO: Board of Supervisors

FROM: Administrative Office / Guy Savage
Assistant County Administrator
781-5011

DATE: 10/15/2013

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 2014-15 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 2014-15
- Conclusions
- Economic data and trends- Attachments 1 - 8

Executive Summary:

The forecast for FY 2014-15 is in line with prior years' expectations and reflects a budget that is structurally balanced. After many years of closing budget gaps, the forecast looks to reverse the downward trend and shift to a flat or slightly positive trajectory. 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 energy/fuel costs). Given the numerous variables at play, the likely range for the upcoming fiscal year is \$0 to \$6 million.

FY 2014-15 represents the seventh and final year of the oft described "Seven Year Pain Plan." All of the difficult decisions made in prior years appear to have resulted in the anticipated outcomes and the financial outlook is no longer negative. Programs and services have been scaled back but dramatic cuts have been avoided. The County workforce has been reduced (-261 FTE or -10%) and is providing the services that align with Board priorities, legal mandates, and available funding.

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 in 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 2014-15. 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.

While the forecast does include some anticipated impacts of the Affordable Care Act (ACA), it does not include the potentially negative effects of State budget and recently passed legislation. 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 relatively positive overall budget direction could swing to a projected gap for FY 2014-15.

Fiscal Outlook:

Background and Overview

As noted in prior years' forecasts, the Great Recession officially ended June 2009. The Gross Domestic Product (GDP) expanded just 1.6% in the second quarter of 2013. The average GDP annual growth rate, a key measure of the economy, has remained below 2% since 2000. By comparison, the average rate of GDP growth between 1948 and 2013 was 3.22%. Last year, personal disposable income for the average American grew at an average rate of 3.6%; compared to the 5.8% average from 1990-2008 and 10% average increases in the 1970s and 1980s. The August 2013 unemployment rate improved to 7.3% (nationally) down from 8.1% the prior year. However, the rate remains well above rates associated with a healthy economy. Lastly, the local housing market continues to improve. Despite fixed-rate mortgages jumping to a two-year high in August and consistently rising home prices, August home sales in the County reached their highest amount since before the recession. Overall, the recovery appears to be slow and steady.

Key National Issues

There are several significant issues in Washington that could substantially impact the economy, most of which are not directly 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 or unable to reach a middle ground. As we saw with the recent Federal shutdown, fundamental philosophical differences over the role of government are driving limited productive discussion. Instead, political rhetoric has prevented meaningful, long-term economic and budgetary solutions from being developed. All parties involved agree that the first government shutdown in 17 years will not be too disruptive under short-term conditions. However, serious challenges emerge the longer the shutdown continues.

On the heels of the Federal shutdown, three other topics are emerging that have the potential to significantly impact the County: Quantitative Easing, replacement of Chairman Bernanke, and the federal debt ceiling.

Quantitative Easing Three (QE3) was implemented a year ago by Federal Reserve Chairman Ben Bernanke. QE3 resulted in the Fed buying an additional \$40 billion in mortgage-backed securities each month until improvement was seen in the labor market. In June 2013, Chairman Bernanke announced a potential "tapering" of quantitative easing policies based on continued positive economic data. The tapering included scaling back bond purchases by \$20 billion a month and an indication of potential increases in interest rates should inflation follow a 2% target rate and unemployment rates decrease to or below 6.5%. In late September, the Fed surprised markets by further delaying QE tapering amid concerns that the US recovery may be faltering. The continuing starting and stopping of QE and tapering have had direct impacts to both stock and bond prices.

There is significant discussion about possible replacement of Ben Bernanke when his current term ends in February 2014. Depending on whether or not Chairman Bernanke continues in his current role, a shift in focus on unemployment versus inflationary pressures could result in significant economic impacts.

Discussion around “Fiscal Cliff 2.0” is reaching a fevered pitch as the federal government will hit the debt ceiling sometime in mid-October. A stalemate over the debt ceiling would lead to a further federal government shutdown when the Treasury no longer has the authority to borrow money. Under this scenario, many essential services could cease. President Obama has told GOP leaders that he will not negotiate over the debt limit. Republican leadership has made it clear negotiations are a must. Based on polling of Americans of all parties, cuts to Social Security or Medicare are unlikely targets for cuts. Setting aside debate about defunding of the Affordable Care Act (aka “Obamacare”), that appears to leave other entitlement programs, fiscal reforms, and pro-growth policy changes as likely GOP demands. Many Washington pundits say that more short-term measures will be taken to avoid the stalemate but that little will be done to address long range issues. Regardless, should the debt ceiling not be increased, the trickle down to San Luis Obispo County could quickly be experienced as federal assistance programs is halted.

California

California’s FY 2013-14 budget includes General Fund revenues of \$97 billion, expenditures of \$96.2 billion, and is the most positive one in over a decade. At first glance, the State appears to be on stable fiscal footing following several years of difficult spending cuts. However, numerous budget risks, uncertainties, and liabilities remain. California’s budget plan represents a multiyear approach that is narrowly balanced, maintains a \$1.1 billion reserve, and pays down budgetary debt. The budget does not address significant debt, including unfunded pension and medical liabilities that appear to be in the \$27 billion range. Further, the budget includes \$15 billion in revenue from Proposition 30, which raised sales taxes and increased personal income taxes on high wage earners. These revenue streams have firm end dates (sales tax increases in 2016 and income taxes increases in 2018) and represent a significant future challenge for the State. Consequently, the State’s financial condition continues to be the single largest threat to the County’s budget in both the short and longer term.

County Outlook

The County’s budget outlook fits well with the theme of slow and steady improvement. Economic conditions are improving and our organization’s budget gap has effectively dissipated according to plan. This year’s forecast projects that property values (assessed values) will increase by 3%. This figure is consistent with increases seen in FY 2012-13. As was forecast previously, the projection for the next three to five years for revenue growth remains 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), the County’s primary lever for maintaining a balanced budget remains on the expenditure side of the equation. To survive the Seven Year Pain Plan, programs and services were scaled back; reserves were reduced; a hiring “chill” was implemented; and employee salaries were kept relatively flat. Consequently, a continued close eye on expenditures will need to be kept for several years to come.

Detailed County General Fund Budget Forecast for FY 2014-15:

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

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 2013-14, which would be available for use in FY 2014-15. This number was derived by estimating how much of the General Fund (GF) contingency would be left at the end of FY 2013-14. The FY 2013-14 budgeted GF contingency is \$15.5 million 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 2013-14 fiscal year \$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 vacant positions.

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 2013-14 will increase the amount of FBA available moving into FY 2014-15.

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

The table below outlines the assumptions for the FY 2014-15 forecast for **non-departmental revenue**:

<u>Revenue</u>	<u>10-11 Actual</u>	<u>11-12 Actual</u>	<u>12-13 Actual</u>	<u>13-14 Budget</u>	<u>14-15 Forecast</u>	<u>% Diff: 13-14 Bud & 14-15 Forecast</u>
Secured Prop Tax	\$85,585,577	\$85,152,390	\$85,849,449	\$87,090,126	\$91,336,539	4.9%
Unitary Tax	\$7,457,672	\$7,579,341	\$7,838,110	\$7,950,328	\$7,623,289	-4.1%
Supplemental Prop Tax	\$1,048,651	\$863,818	\$1,067,548	\$400,000	\$663,000	65.8%
Prop Tax in lieu of VLF	\$26,959,517	\$26,453,316	\$26,700,191	\$27,234,195	\$27,606,000	1.4%
Prop Transfer Tax	\$1,403,790	\$1,863,925	\$2,177,596	\$1,800,000	\$2,000,000	11.1%
Sales Tax	\$6,164,590	\$7,370,278	\$13,769,517	\$5,500,000	\$7,000,000	27.3%
TOT	\$6,341,996	\$6,333,523	\$7,710,936	\$6,600,000	\$7,725,000	17.0%
<u>All Other</u>	<u>\$11,072,511</u>	<u>\$12,904,127</u>	<u>\$13,457,130</u>	<u>\$12,928,267</u>	<u>\$13,171,157</u>	<u>1.9%</u>
TOTAL	\$146,034,304	\$148,520,718	\$158,570,477	\$149,502,916	\$157,124,985	5.1%

Notes about Non-Departmental Revenue:

The FY 2014-15 secured property tax estimate assumes a 3% increase in assessed values over FY 2013-14 projections. The 4.9% increase over FY 2013-14 Budget shown above includes lower delinquency rates than have been experienced for the past few years and greater than originally budgeted increases in FY 2013-14.

The amount of sales tax received during FY 2012-13 (\$13.7M) was high due to one-time revenues from the solar construction projects in the Carrizo Plain. Additional one-time sales taxes revenues related to solar projects are expected to continue through 2014. Given the one-time nature of the solar project sales revenues, they are not included in this forecast. Best uses for any excess one-time revenues are similar to those executed at the close of FY 2012-13 where FBA was allocated to one-time expenditures such as construction project cost overruns and paying down pension debt. The forecast for FY 2014-15 also includes a sizeable Transient Occupancy Tax (TOT) increase of \$1.1M (17%) based on increased tourism projections.

This forecast assumes that current county tax rates will remain for the foreseeable future (e.g. sales, transient occupancy, and 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 Actual	13-14 Budget	14-15 Forecast	Diff: 13-14 Bud & 14-15 Forecast
Prop 172	\$17,552,055	\$18,523,467	\$19,470,814	\$21,044,833	\$21,562,302	\$22,688,794	5.2%
Realignment	\$18,227,153	\$17,678,536	\$7,756,965	\$23,373,343	\$20,358,786	\$22,356,615	9.8%
Health Agency	\$42,017,885	\$43,345,750	\$58,523,607	\$48,519,641	\$54,842,858	\$55,464,844	1.1%
Social Services	\$72,012,975	\$78,175,248	\$73,676,720	\$73,676,720	\$80,100,711	\$84,658,417	5.7%
<u>Other</u>	<u>\$56,062,416</u>	<u>\$65,465,744</u>	<u>\$59,189,550</u>	<u>\$56,586,719</u>	<u>\$57,256,309</u>	<u>\$57,256,309</u>	<u>0.0%</u>
Total	\$205,872,484	\$223,188,745	\$218,617,656	\$223,201,256	\$234,120,966	\$242,424,979	3.5%

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.).

This forecast does not take into account financial impacts from the Affordable Care Act as they relate to MediCal expansion, which could positively impact the Health Agency budget. Not enough information is known at this time in order to build any changes into the forecast.

The changes in dollar amounts for Health Agency and Social Services are largely driven by shifts in funding related to 2011 State/County Realignment. 2011 State Realignment (AB 109) continues to be an issue for California counties. For FY 2013-14 and FY 2014-15, 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.

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. For FY 2014-15 "Other" revenue was assumed to be flat from FY 2013-14 budget.

Expenditure Forecast:

This section forecasts the cost of a Status Quo budget for FY 2014-15. 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, 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 increases. Given a total forecast between \$0 and \$6 million, any salary and benefit increases granted to employees could shift the overall budget from a small surplus to a budget gap. To illustrate this point, a 1% increase in salaries for all employees would cost approximately \$2.3 million annually. Should the low end of the forecast (\$0) be realized and a 1% salary increase be granted, a \$2.3 million budget gap would result. Because salary and supply costs are such a significant portion of departmental budgets, efforts to close the gap would likely include the need to lay off recently hired staff.
- 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 2014.
- No rate increase for the Pension Obligation Bonds.
- A \$500,000 increase in liability costs. Historically, \$3 million per year was set aside as liability insurance. In FY 2013-14, only \$500,000 was charged and previous surpluses were relied upon to close the gap. It is assumed that the surplus will be exhausted by the end of FY 2013-14 and that a slow return to historical costs will be needed.
- A \$250,000 increase in depreciation for Fire equipment. This figure is more in line with historical costs when smoothed over multiple years.
- No worker's compensation charge changes. Although currently budgeted figures are lower than historical averages, the calculation used for FY 2013-14 was applied to FY 2014-15.
- A \$5.6 million increase in health care related expenses incurred in the implementation of AB109, CalWORKS, Workforce Investment Act (WIA), CalWIN, and Foster Care changes. For each of these expenses, there is a corresponding increase in revenues. This figure includes new or increased expenses to the Health Agency and Department of Social Services (DSS).
- A 7.3 million adjustment to account for one-time transfers to reserves made in FY 2013-14. This includes transfers out to the Health Agency trust account, General Government Building Replacement reserves, Tax Reductions reserves, and CIP/Facilities Planning reserves.
- A 2% Consumer Price Index (CPI) increase for all other, non-labor related costs.
- 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.

The assumptions noted above result in the following expenditure forecast:

\$230,917,959	FY 2013-14 Adopted GF Salary and Benefits
\$164,871,735	FY 2013-14 Adopted GF Other costs
\$721,965	Pension rate increase (+0.5%)
\$500,000	Liability increases
\$250,000	Fire equipment depreciation
\$5,630,000	Health care expenses and increases within Health Agency and DSS
\$-7,363,652	One-time expenses made in FY 2013-14
\$3,155,162	Increase in other, non-labor related costs (+2% CPI)
<u>\$15,947,327</u>	<u>4% Contingency</u>
\$414,630,496	Total Expenditures forecast for FY 2014-15

Budget Changes:

Per the assumptions noted above, the forecasted, structurally balanced budget for the General Fund for FY 2014-15 is:

\$418,549,964	Total financing sources (revenues)
<u>\$414,630,496</u>	<u>Total financing uses (expenditures)</u>
\$3,919,468	Total forecast available

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

- \$1.6m Non-Departmental Revenue
- \$2.4m Departmental Revenue
- \$2.3m Salaries and Benefits
- \$1.6m Non-salary Costs

Given the numerous variable involved, it is likely that the FY 2014-15 General Fund will end the year with a surplus between \$0 and \$6 million.

Conclusions:

Overall, the County’s FY 2014-15 budget is structurally balanced. FY 2014-15 represents the seventh and final year of the “Seven Year Pain Plan.” All of the difficult decisions made in prior years appear to have resulted in the anticipated outcomes and the financial outlook is no longer negative. Throughout the difficult Pain Plan years, the Board of Supervisors and County staff at all levels have done an outstanding job of implementing fiscal reforms that helped to pursue our collective vision of a Safe, Healthy, Livable, Prosperous, and Well-Governed Community.

ATTACHMENTS

1. Attachment 1
2. Attachment 2
3. Attachment 3
4. Attachment 4
5. Attachment 5
6. Attachment 6
7. Attachment 7
8. Attachment 8