MEMORANDUM
OFFICE OF THE
COUNTY EXECUTIVE
COUNTY OF PLACER

TO: Honorable Board of Supervisors

FROM: Holly Heinzen, Interim County Executive Officer
By: Graham Knaus, Finance and Budget Operations Manager

DATE: March 27, 2012

SUBJECT: County Budget Strategy Workshop

Action Requested

The Board is requested to take the following actions:

1. Receive an update on County revenue and expenditure trends and discuss options for strategic direction.

2. Consider approach to the Budget and Financial Policy to best meet current and future fiscal challenges and direct staff to return with a multi-year budget and financial strategy to meet the intent of the Budget and Financial Policy over the next few years.

Background

County Financial Policies

The County Financial Policies were initially adopted in 2003 and have been revised periodically to reflect changing requirements and county needs. The policies have promoted financial stability and long-term planning related to preparation and management of the County budget. These policies include the Budget and Financial Policy, Other Post Employment Benefit (OPEB) Policy, and Debt Management Policy. These policies have been an integral component to creating a successful County approach to respond to the economic downturn. In addition, they have provided a broader context of budget and financial planning to appropriately position County staff to work within parameters set by the Board and to ensure a fiscally sound short-term and long-term framework to the Budget.

The OPEB Policy will be discussed separately on today's agenda. This item will discuss the Budget and Financial Policy which is the primary county financial policy to guide the approach to development of the County Budget.

Budget and Financial Policy

The Budget and Financial Policy, as revised by the Board June 7, 2011, is intended to guide the budget and long-term financial planning related to preparation and management of the County budget. The policy was integral to the County's ability to successfully respond to the economic downturn that occurred over the last several years. In addition, the policy provides the County Executive Office with a broader context of budget and financial planning to appropriately manage County finances in keeping with parameters adopted by the Board that ensure a sound short-term and long-term financial strategy. The Budget and Financial Policy generally includes the following guiding principles:

- Development of the annual Budget shall adjust for short-term and long-term revenue and expenditure trends and will recognize and plan for opportunities and avoid risks.
- One-time revenues shall be used to fund one-time costs whenever possible.
- The County Budget shall be developed within a conservative approach that creates flexibility and opportunities for smoothing during periods of economic growth or decline.

While the development of the County Budget adhered to the Budget and Financial Policy to the greatest extent feasible, in order to maintain services during the economic downturn, the Board allocated diminished revenues with a focus toward county priorities. To achieve this objective, the Board suspended *General Fund* contributions to reserves and road overlay projects, reduced capital infrastructure contributions, deferred building maintenance, and redirected funds for other county priorities to mitigate large fluctuations in funding and service levels. The Board has created greater cost sharing to mitigate some labor cost pressures related to health benefits and pension costs. In addition, the Board has implemented costs savings ideas and alternative service delivery models to leverage remaining limited resources and minimize service impacts.

The economy appears to have stabilized to some degree although cost pressures continue to exist and the revenue outlook remains less certain than before the economic decline. Just as the Board's long-term planning prior to the economic downturn created flexibility to mitigate significant impacts, moving towards a more stabilized and re-benched economy may dictate the need to develop and implement a comprehensive budget strategy for the future. This strategy would identify sustainable service and staffing levels, as well as design a phased approach to meet the full intent of the Budget and Financial Policy and strengthen the County's ability to withstand future economic fluctuations.

Use of 1-time Solutions

During the recession, as declining discretionary revenues were reprioritized to address critical operational issues, balancing the annual County Budget relied more on using one-time revenues for ongoing purposes. The reliance of one-time funding solutions to cover ongoing operations has successfully enabled the County to smooth significant revenue declines since FY 2007-08 while balancing the County Budget, however, this reliance cannot be sustained indefinitely. The use of one-time revenues to fund ongoing expenses peaked in FY 2009-10 at $20.9 million and has dropped in each of the past two years to $13.2 million in the current year. These actions resulted in contraction in most *General Fund* supported department budgets.

At this time, the Board may want to consider how best to balance operations across county functions to ensure sustainable operations in the years ahead. Continuing to reduce the use of one-time solutions for ongoing operations is a critical component of ensuring a long term sustainable financial operations model. The long term goal, as outlined in the Budget and Financial Policy, is eliminating the use of one-time solutions for ongoing operations as part of having a sustainable business model for county operations.

Revenues

As has been previously discussed with the Board, county revenues have declined since FY 2007-08. Specifically, between FY 2007-08 and FY 2010-11, per capita revenues have declined 7.4 percent, and are now 8.0 percent below the per capita amount in 1978, as adjusted by inflation.

In response to decreased revenues, the Board has chartered a measured course by using a portion of *General Fund* reserves in FY 2008-09, FY 2009-10, and FY 2010-11 and mitigating some long term cost pressures related to health and retirement. The measured course has enabled the County to maintain critical service levels to the greatest degree possible while also resulting in responsible balanced budgets throughout the economic downturn.

At the same time total available revenues have declined, the composition of those revenues and expenditures has changed. Revenues have been reprioritized to some degree to Public Safety and Health and Human Services enabling the Board to partially offset significant department revenue declines impacting Board priorities and increases to mandated costs. The reprioritization has been a function of targeted discretionary *General Fund* augmentations as well as maintaining contributions to these priority service areas at the same time total available revenues have declined. As such, the discretionary *General Fund* share supporting Public Safety has increased from 34.9 percent in FY 2007-08 to 48.2 percent in the current year. The discretionary *General Fund* share supporting Health and Human Services has increased from 13.3 percent to 20.2 percent over the same period.

The balance of current and future service demands and costs to available revenues may create the ongoing need for a comprehensive approach to prioritize the use of limited resources. Doing so must also recognize that, in many cases, revenues and service and staffing levels are unlikely to return to pre-recession levels for years to come.

Expenditures
Total County expenditures have effectively decreased $46.9 million (5.9 percent) since FY 2007-08 ($120.0 million since FY 2008-09) to more closely align expenditures with drops in revenue as displayed in Table 1 below.

Table 1

Net Budget			
Fund	**FY 2007-08 Final Budget**	**FY 2011-12 Final Budget**	**$ Change**
General Fund	$ 373,082,095	$ 359,140,241	$ (13,941,854)
Public Safety Fund	123,165,206	133,909,571	10,744,365
Public Ways and Facilities Fund	133,959,180	144,093,972	10,134,792
Capital Projects Fund	128,392,446	74,648,702	(53,743,744)
Other Funds	29,793,939	29,718,302	(75,637)
All Operating Funds	**$ 788,392,866**	**$ 741,510,788**	**$ (46,882,078)**

On a per capita basis, expenditures have declined, decreasing 10.7 percent between FY 2007-08 and FY 2010-11 and are now 2.1 percent below the per capita amount in 1978, as adjusted by inflation.

Moving forward, the County will continue to incur normal cost-of-doing-business increases (rent, utilities, transportation, etc.) as well as targeted cost pressures such as the following:

- <u>Measure F:</u> Measure F was a local ballot initiative that directs increases to public safety salaries that has been in effect since 1977. The Measure requires annual adjustments to deputy sheriff salaries based upon comparable position salaries in El Dorado, Nevada, and Sacramento counties. The fiscal impact varies each year, but has ranged from an annual $800,331 this year to $1,654,342 in 2009.

- Retirement: On March 14, 2012, the California Public Employees' Retirement System (CalPERS) lowered the 7.75 percent discount rate currently used for actuarial valuations to 7.50 percent. Actuarial valuations are performed annually to determine plan liabilities and the contribution rates necessary to adequately fund them. The discount rate used by CalPERS was last reviewed in March 2011 when CalPERS voted to keep the discount rate at 7.75 percent. The changes will impact the County budget beginning FY 2013-14 at an estimated total annual cost across all funds of $3 million.
- Health Benefits: The costs to maintain health benefits continue to rise, impacting employer's budgets in the public and private sectors throughout the country. The County Budget has faced significant increases for several years including an estimated 9.5 percent increase that goes into effect January 1, 2013. Health premium costs are anticipated to continue to escalate above the rate of inflation and will place ongoing cost pressure on the County Budget.

As a service organization, much of what the County does requires human resources to perform, whether as County employees, contractors, or other service delivery models. The size of the workforce changes over time based on workload and service delivery demands, the methods used to provide these services, and funding impacts from Federal and State sources.

This fiscal year, county hiring has picked to replace retired employees and address service demands including AB 109 (Public Safety Realignment). As such, there have been 89 year-to-date hire approvals compared to 54 throughout all of last year. The increase in hiring places downward pressure on the estimated FY 2012-13 fund balance carryover, a key assumption used to build that Budget. Of the 89 new hires, 77 are related to filling priority Public Safety positions (59 or 66.3 percent) and mandated or critically needed Health and Human Services positions (18 or 20.2 percent). Approved FY 2011-12 hires are displayed by functional area in Table 2 below.

Table 2

Funded Positions by Functional Area

Functional Area	FY 2011-12 Funded	Ext. Hires Approved as of 3/1/12[1]	% Vacant Funded[2]
General Government	313	3	7.7%
Finance	138	6	2.2%
Health & Human Services	713	18	12.6%
Land Use[3]	497	3	7.2%
Public Safety	681	59	4.1%
Total Funded Positions	**2,342**	**89**	**7.7%**

[1] Total countywide external hires expected to be offset by retirements.

[2] % vacant funded reflects all approved external hires.

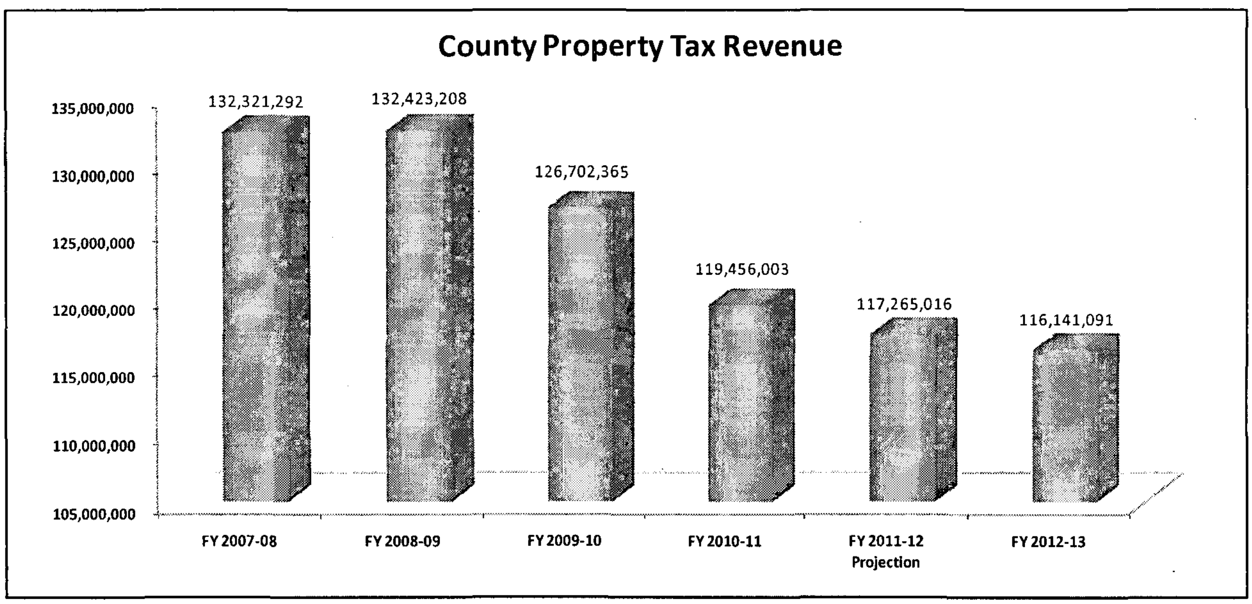
[3] Includes two hires in the Agricultural Commissioner Department, one in Public Works.

As the pace of hiring increased, so has the number of employee retirements. In fact, retirements in the current year are expected to completely offset these external hires resulting in a similar sized workforce that has evolved from four years of decline. What has changed is where the workforce has been allocated across county functions; workload demands and staffing have increased in some areas while decreasing in others. In addition, reprioritization of diminishing discretionary *General Fund* revenues to meet mandated service requirements has increased organizational strain in some service areas, particularly departments that have absorbed increased labor and other costs with limited resources and staffing.

Revenue Outlook
County discretionary revenues are projected to decrease further in FY 2012-13 although the rate of decline has tapered off significantly. Through the budget process, these discretionary revenues were reprioritized in response to the economic downturn to offset revenue reductions in County service areas such as Health and Human Services and Public Safety.

Although discretionary and other revenues continue to struggle, revenues in Health and Human Services and Public Safety are anticipated to have some increases. These are the two largest service areas that received *increased* discretionary *General Fund* support during the economic downturn. The increased discretionary *General Fund* support to these service areas was necessitated to address Board service priorities during the recession as other supporting revenues declined. The increase in targeted revenues supporting these two service delivery areas, at the same time discretionary *General Fund* revenues continue to decline, will trigger discussion about maintaining the level of *General Fund* support in service areas that have their own growing revenue base. Long-term, revenues will need to be balanced with Board priorities to maintain service levels across county service areas while also retaining Board flexibility to address priorities put on hold over the last several years.

Although there are some positive signs of reaching the bottom of the economic decline, property taxes, the County's largest discretionary revenue source, continues to struggle. Since FY 2008-09, Property Tax revenue has declined $15.2 million (11.4 percent) and is expected to decrease an additional $1.1 million in FY 2012-13 as displayed in the below chart.



Property tax revenue is expected to stay flat in FY 2013-14 followed by modest annual growth in subsequent years as the escalating property values experienced in the first part of the 2000s are unlikely to return. *Instead*, Revenues are expected to decline slightly before entering a slow crawl from the bottom. This slow revenue growth will lag expected increases in labor and other expenses requiring a continued strategic, fiscal management approach to meet Board priorities and balance the budget.

Staff will return to the Board during the August Budget Workshops with an updated long-term fiscal model including refined current and future revenue and expenditure projections.

Fiscal and Policy Challenges

Analysis and discussion of fiscal and policy challenges will continue over the next couple of months with the Board and departments. The existing manageability of the County Budget is due to the availability of adjustments to resolve at least some of the challenges and reflects the County's sound financial health amidst continued declining discretionary revenues. This is due to the Board's longstanding conservative approach to managing County finances. However, there are larger, more sustained fiscal and policy challenges that could substantially impact the *General Fund* and/or county operations. These and other challenges are summarized below and will be discussed in future Board meetings and integrated into the budget approach over the next several years as directed by the Board.

- South Placer Adult Correctional Facility: Timing, demands and approach to opening and operating the facility. Options being developed to be presented to the Board for discussion in June.
- District Attorney Crime Lab: The current agreement between the Placer District Attorney's Office and Department of Justice for the testing of forensic evidence samples has proven to be inadequate to meet the prosecution needs of the District Attorney's office. Given the financial status of the State of California and the Department of Justice, they have been unable to perform work in a timely fashion and there appears to be no hope that this situation will improve. Alternate arrangements have been explored and currently there are no viable alternatives available to the District Attorney's Office. Discussions are underway to explore public and private alternatives, including the possibility of establishing a local crime lab and, once explored, will be presented to the Board for further discussion.
- Infrastructure and Deferred Maintenance: Identification of infrastructure and deferred maintenance needs across county functional areas to align needs with funding within Board established priorities. Could include Public Works Projects, road overlay, Capital Projects, Deferred Maintenance, Information Technology Strategic Plan, and the impacts of the dissolution of redevelopment on infrastructure related project funding.
- Other Funds:
  - Library Fund: Sustainability of funding and operations following several years of declining dedicated property tax revenues and state funding. To be presented as a budget workshop item in April.
  - Fire Protection Services: In recent years, the County Fire Control Fund has experienced some decline in Secured Property Tax, however, this appears to have stabilized somewhat. With respect to the County Service Areas, the Board of Supervisors received reports in December 2011 on the financial constraints for North Auburn Ophir Fire and Dry Creek CSAs, and the effects of more severe revenue declines impacting those districts. Recently, your Board took action to address those impacts, including authorizing placement on the June ballot, a special tax to support fire protection in North Auburn Ophir Fire District. At this time, the Cal Fire Contract is planned for full funding FY 2012-13 and staff will be returning to your board with that contract in April.

- Road Fund: The Road Fund remains sound in the aggregate and supports proceeding with capital projects, transportation planning, a number of road maintenance programs, miscellaneous water quality programs, and public services. Federal and State funded construction projects include completion of the Foresthill Bridge Seismic and Paint Project, Cook Riolo Bridge Replacement, Alpine Meadows Road Bridge Replacement, Kings Beach CCIP, Auburn-Folsom Road Widening and Highway 49 Beautification. Road maintenance, including elements of road overlay, has in recent years been supported by Proposition 1B, ARRA funding, or a General Fund contribution (which was suspended in FY 2008-09). Beginning FY 2012-13, Proposition 1B funds and ARRA funding for road maintenance are depleted, and there is currently no identified funding source for road overlay going forward. This issue will be incorporated into a future Board item related to infrastructure and deferred maintenance needs.

Conclusion and Next Steps

The Board has paved a long history of sound financial stewardship that has included getting out in front of significant economic changes to the greatest degree possible. Doing so has positioned the County to better prepare for ups and downs in the economy. The County revenue base appears on the cusp of transitioning from several years of decline to hitting the bottom followed by slow and gradual growth.

Cost pressures such as the cost of health benefits and retirement are likely to continue to increase beyond the level of discretionary revenue growth for at least the next couple of years. This dynamic creates a prime strategic opportunity to direct revenues and manage costs to best ensure a sustainable County operation, reflective of the guiding financial policies and Board priorities. In addition to normal operations, large local challenges, such as those mentioned above, pose significant fiscal and policy issues that may color the approach to FY 2012-13 and beyond in order to reflect Board priorities while ensuring sustainable service levels.

The Board is requested to take the following action:

1. Direct staff to return to the Board with a strategic budget plan that:

   a. Affirms the Budget and Financial Policy and provides a plan to achieve full implementation over the next several years;
   b. Develops a phased approach to meeting the County Financial Policies to minimize outstanding liabilities while balancing ongoing operational priorities;
   c. Recognizes potential revenue changes across county service areas and prioritizes them where appropriate to ensure sustainable levels of support;
   d. Reflects the sustainable level of *General Fund* support to county priorities;
   e. Addresses priority areas impacted by the economic downturn including infrastructure, road overlay, deferred maintenance, open space, and other priorities.

Additional information about the county budget can be found at the following link:

http://www.placer.ca.gov/Departments/CEO/LatestBudgetInformation.aspx