OFFICE OF THE
PLACER COUNTY EXECUTIVE

TO: Honorable Board of Supervisors
FROM: Thomas Miller, County Executive Officer
By Jeff Bell, County Budget Administrator
and Linda Oakman, Administrative Services Manager
DATE: January 22, 2008
SUBJECT: Mid-Year Budget Performance Review

Recommendation

It is recommended that the Board of Supervisors receive the mid-year budget review for fiscal year 2007-08.

Background

Annually, the County Executive Office provides a mid year review of the County Budget's performance to the Board of Supervisors. Following Final Budget hearings in September a Final Budget document was approved by the Board of Supervisors that allocated FY 2007-08 appropriations and staffing levels. Development of this budget factored in State of California budget impacts as well as the rising costs to provide County services. Included with this review are a synopsis of the January State Budget proposal impacts on Placer County and briefing on the FY 2008-09 budget process.

Placer County's population growth and resulting demographic and social changes continually reshape County programs and services. Anticipating these changes provides the basis for sound, strategic planning and financial management when considering future service delivery, staffing patterns and infrastructure needs. The County has navigated this growth dynamic for the past several years, and, although the rate of growth is slowing and in some cases flat or declining, it will continue to position programs and services to be responsive to the needs our population generates. The diversity of development projects proposed for south-county, and the urban nature of these proposals, require strategic planning for infrastructure and municipal levels of service. The demands for countywide services and infrastructure are many, and while building in the county has slowed, it will be essential for the county to position itself for the resurgence of higher population growth rates and density increases in the future.

State of California

Over the last several years Placer County's financial health and the programs and services provided to our constituents has been significantly impacted by the State budget. This year will be no different. Indeed, the 2008-09 Governor's Budget released January 10 identified a $14.5 billion deficit, and

proposed 10% cuts "across the board" with proposed reductions casting a wide swath across state and county services, some of which are highlighted below:

1. State deferral of mandated program reimbursement to counties has had a significant impact on the County as the deferral has resulted in an obligation of over $10.5 million due to Placer County from the State of California as of June 30, 2007. The cost to provide these services in prior years was essentially advanced by the County pending reimbursement by the State. Of this amount, over $9.2 million related to State mandate reimbursements from 2004 and years prior is expected to be received from the State over the next 15 years. During FY 2006-07 the general fund received $3.2 million in SB 90 reimbursements for prior years. The annual revenue due to the County for State mandates is approximately $1.8 million. The FY 2008-09 proposed State Budget does include reimbursements for claims prior to July 1, 2007 and for the third payment towards claims prior to 2004.

2. Initial order of magnitude estimates associated with the 2008-09 Governor's Budget suggest a $8-10 million impact to our County Department of Health and Human Services. This is based on the continued failure of the State to fund annual cost of doing business increases of approximately $5 million. In addition, the currently identified 10% across-the-board program reduction is anticipated to net an additional $3-5 million reduction in programs such as Child Welfare, Child Protective Services, Foster Care, Mental Health, and Adult Protective Services funding.

   Although it is impossible to quantify at this time, it is important to note that any state General Fund reduction may jeopardize the state's ability to claim federal funding. Since the majority of these dollars are pass-through funding, there may be additional significant County impacts. Greater clarity will be gained with executive and state legislative actions taken over the next few months.

3. County departments are in the process of fully analyzing the impacts of the Governor's Budget on their respective budgets, which, given the wide range of departments selected for reductions, may take longer to compile than in previous years. However, it is likely that that these cuts will result in millions of dollars in reductions for programs provided in the county.

In addition to the issues identified above, there are other proposals contained in the Governor's Budget that will have policy and programmatic impacts on counties. For example, one proposal would release 22,000 "low risk" prisoners 20 months earlier than their original release date. This significant surge in released prisoners, some of which will likely re-offend (current estimates are 45-60% of those released re-offend), will further strain local probation supervision and health and human service resources, particularly once they are no longer under state supervision.

Another more direct proposal is one that is intended to address the state budget and cash shortfall by delaying payment on a number of HHS programs. Some of the larger programs included in this proposal are Social Services Payments (except SSI/SSP, and IHSS), Mental Health Managed Care payments, County Administration of Medi-Cal payments, and Early and Periodic Screening, Diagnosis and Treatment (EPSDT) payments. By delaying these payments several months, the state increases its amount of cash, while counties essentially await payment for services provided.

The Governor did not propose the suspension of Proposition 1A, which outlines property tax protection provisions for local governments, and under which property taxes could be reduced by up to 8%. However, it is too early in the state budget process to suggest that suspension proposals are permanently off the table. On a positive note, the Governor's Budget proposes to fully fund Proposition 42 next year (which requires revenues resulting from state sales and use taxes on the sale of motor vehicle fuel be used for transportation purposes), the amount for Placer County is still to be determined. The County Executive Office continues to monitor the progress of State budget, and changes to county funding that result from the State's adoption of its budget will be reflected in the County's budget.

FY 2007-08 County Budget

Significant economic indicators in Placer County have either changed or continued to decline somewhat since the FY 2007-08 Budget was passed in September. The housing market has continued to slow, and single family dwelling unit permits are down 17% when compared to last year, with overall construction revenues remaining flat. Sales tax revenues are also down about 5% when compared to this time last year. Finally, Property Tax revenues are generally tracking slightly higher than was budgeted, but are well below the year-over-year increase the county has experienced in previous years.

Recognizing the effects of these economic indicators on the county, and in anticipation of a growing state budget shortfall on the horizon, the County Executive Office carefully watched county revenues and expenditures through the beginning of the fiscal year, and took steps in early fall to prepare for the actions that would be needed to live within its means in FY 2008-09. Specifically, in October department heads were advised budgets were going to be tighter in the coming fiscal year, and in November were advised not to hire behind vacating positions unless they were of a critical nature. In early December, more formal and detailed review procedures were put in place to ensure each proposed hire is reviewed under more stringent criteria on a case-by-case basis. Additionally, departments were directed to more critically evaluate expenditures and to defer discretionary purchases, as well as to find additional programmatic savings and efficiencies.

FY 2008-09 County Budget

Development of the FY 2008-09 County Budget is a complex ten month process that requires policy direction from the Board of Supervisors. This year, in light of anticipated revenue estimates, the process will require the identification of funding reductions and programmatic savings, while maximizing efficiencies in operations and providing a high level of service to the public. This will require a thorough review and financial analysis by Executive Office staff, and will require significant Board direction outlining its priorities for the county. Significant steps in the process include:

1. Strategic Planning Workshop with the Board of Supervisors on March 18th.
2. Development of a balanced County Budget by the County Executive Office.

3. Proposed Budget presented to the Board for consideration of adoption in June.
4. Board of Supervisors Budget Workshops in August.
5. The County Budget's Public Hearing in August.
6. Final Budget presented to the Board for consideration of adoption in September.

At the Strategic Planning Session, scheduled for March 18th, staff will provide a more detailed analysis of the county financial position to the Board, and the session will provide a forum for the staff to solicit Board direction on short and long range budget and policy issues that will subsequently be used as a basis for development of the Proposed Budget in June. The Final Budget will be presented to the Board in September. Throughout the process, in addition to when the budgets are adopted, the Board of Supervisors will have numerous opportunities to influence budget development including during the January 22nd presentation, the March 18th Strategic Planning Session and three days of Board Budget Workshops in August.

The County Executive Office staff met with each department head and their senior management team beginning in mid-December to discuss next year's program and / or service delivery options. At these meetings, departments were challenged to begin to take proactive measures now in anticipation of the funding difficulties that the state and county will face in the fiscal year that begins July 1st. Specifically, they were directed to hold positions vacant, filling only those of a critical or 24-hour care nature, meet or exceed the amount of carryover funding that they had in last year's budget this year, and challenged to build their budgets with flat or reduced revenues. Essentially, departments were directed to create their FY 2008-09 operating budgets with the same level of resources as were provided in FY 2007-08. In addition, departments were directed to create 3% and 5% budget reduction scenarios, pending the outcome of the State budget and economic conditions in the upcoming year.

These proactive steps are designed to afford departments the maximum amount of time to plan for the reductions that will be necessary to close an estimated $23 million General Fund shortfall for FY 2008-09. By maintaining higher fund balances in the current year, they can soften the landing anticipated as the state reductions alluded to above are implemented.

While there will likely be numerous proposals for program augmentations, the County will not likely have the ability to fund many (or even some) of the department requests due to limited new and reduced revenue projections, State budget impacts, and other funding considerations identified for next year. Indeed a more likely scenario will be a need to further reduce departmental expenditures to balance the budget.

County Budget Funding Considerations

As was alluded to above, for Placer County to provide the same level of service in FY 2008-09 as has been provided in the current year, the county would need $23 million more General Fund revenue than is currently estimated available. Over half of the costs associated with this shortfall are attributable to salary, benefits, and other cost increases. The remainder is attributable to ongoing Board Policy regarding reserves and a difference in available carryover funding from the 2007-08 fiscal year. In working to achieve a balanced budget for FY 2008-09, the county will

also emphasize maintaining critical programs and services, preserving current staffing and service levels where possible, and reducing expenditures to match anticipated revenues where necessary.

The County has two labor agreements: Placer County Public Employee Organization (PPEO - contract period ends June 30, 2010) and Placer County Deputy Sheriff's Association (PCDSA - contract expired on December 31, 2006). Management and confidential employees that are not represented by either of these groups have been closely linked with PPEO agreements and timelines for their salary and benefit adjustments. These labor agreements will continue to impact the County Budget and the allocation of available resources. Until the DSA agreement is finalized the total cost of these agreements for the next fiscal year remains uncertain, however next year's salary and primarily health care and pension benefit increases are estimated at $18 million.

Other Post Employment Benefits (OPEB)

On December 11, 2007 your Board approved an election to pre fund the County's OPEB liability for retiree healthcare. Over the past three fiscal cycles your Board has directed $25.9 million be accumulated in a trust fund to fund the OPEB Annual Required Contribution (ARC). The first payment of $25.9 million was paid to an irrevocable trust on January 15, 2008. Funds continue to be collected as a percentage of pay to fund the ongoing ARC. The percentage of payroll will increase each year until the actuarially determined ARC is fully funded from payroll collections.

While pre-funding the obligation was a first step, an equally important step was to ease the pressure of OPEB benefits on the County by increasing employee contributions to health insurance plans. Given that the County's OPEB promise was made through labor agreements, this action could only be achieved through collective bargaining. Through negotiations, a cost shift in the County's provided health benefit occurred effective January 1, 2008 when the majority of the County's workforce began to cost share their health insurance benefits on a 90/10% ratio. This new health insurance cost sharing agreement marks a significant change from past practice, and is critical to limiting future County OPEB liability exposure.

Capital Infrastructure

Capital facility construction is dynamic and activities such as planning, estimated costing and funding, and project prioritization are reviewed periodically. To that end, Facility Services and Executive Office staff evaluated and then updated facility project data for projects pending construction under the original Capital Facilities Financing Plan[1], and identified recommended priority projects to incorporate. In order to accommodate the rising cost of construction, land acquisition, and other project costs, staff were challenged with identifying additional, realistic funding alternatives that would support timely construction. On August 7, 2007, the Board of Supervisors affirmed $403 million in capital facility construction priorities through FY 2015-16 with an additional $298 million required in subsequent years, and provided direction to staff to proceed with capital financing recommendations for these projects. Staff anticipates that the

[1] Capital Facilities Financing Plan was first approved by the Board of Supervisors in May 2002 and then reaffirmed by the Board of Supervisors in July 2006.

Capital Facilities Financing Plan will need to be reviewed periodically due to the dynamic nature of the construction and finance markets, changes in construction costs, and economic conditions.

Funding for these projects has been identified as coming from a variety of sources, including State and Federal Grants, Capital Facility Impact Fees (CFIF), securitization of the Master Settlement Agreement revenues, debt proceeds (Certificates of Participation) and General Fund contributions and reserves. As of the mid 1990's, your Board implemented the CFIF collection process in the unincorporated areas of the County and since then has secured the approval for collection in all of the cities in the County. This fee is applied to new development to offset the cost of capital facilities required to accommodate growth. Your Board has also had the foresight to set aside over $33 million in capital infrastructure reserves over the last decade, has made ongoing contributions to the operating budget for facility construction projects, and has dedicated securitized funds from the Master Settlement Agreement in the amount of $53.3 million for building construction.

As a result of these efforts, several large capital projects are currently under construction or have recently been completed. The Community Development Resource Center ($30 million) and the Auburn Justice Center ($36.3 million) are now occupied. The South Placer Courthouse (estimated at $53 million), the Children's Emergency Shelter ($11.5 million), and the Cabin Creek facility ($8.9 million) are expected to be completed in this fiscal year. On the planning horizon are several additional facilities identified for construction over the next 2-4 years: Burton Creek Justice Center ($20 million), South Placer Jail ($75 million / Phase I), West Placer Animal Control Shelter ($16 million) and a number of other facilities. While the County has General Fund reserves available, and can use impact fees to pay for part or all of these construction projects, additional funding will be needed and financing alternatives are being identified.

FY 2007-08 Expenditure and Revenue Review

Placer County budgets are developed prior to the beginning of the fiscal year and are built with assumptions that are relevant when the budgets are prepared. On September 18, 2007 your Board adopted the County's Final Budget in the amount of $792 million dollars, which included $529 million for operations, $134.5 million for road and bridge projects and $114.9 million to fund facility construction projects. A performance budget review measures how well the budget is functioning under current conditions and identifies areas of concern. This budget review compares the two years of FY 2006-07 and 2007-08 for the period ending December 31.

The General Fund – (Fund 100)

The *General Fund* is the largest county fund, and it underwrites most countywide operations either directly as the "net county cost" of General Fund budgets, or indirectly through contributions to other funds. General Fund financing requirements have been developed to maintain essential services and programs, however with the development of the budget funding restrictions were necessary to balance the budget.

As of December 31st the General Fund budget continues to perform reasonably well compared to budget. The secured property tax revenue is increasing but the rate of increase has slowed and the projected revenue for FY 2007-08 is subject to a downward adjustment resulting from requests for property reassessments. The slowing in the real estate and building sector markets has resulted in a decline in supplemental property tax and several other revenue receipts during FY 2007-08, most notably, construction permit and real estate transfer tax revenues.

Expenditures as a percent of budget are higher at this time in the current year than in the previous year Employee related expenses are expected to continue to trend upward in future years due to existing and new agreements with labor.

The General Fund consists of about 45 appropriations, managed by 22 departments. As can be seen in the following table, for the period ending December 31st the General Fund's operating revenue receipts were consistent with the prior year's performance at approximately 42% of budget respectively.

Revenue

	FY 2006-07					
	Budget	Revenue Received at 12/31	% of Bud.			
General Fund	326,919,188	136,502,086	42%	343,822,901	143,560,603	42%

Total FY 2007-08 General Fund revenues were budgeted 5% higher than the prior year, with actual receipts 5.2% more this year than were received at this same time last year. In FY 2007-08 the categories with the largest dollar **increases** over prior year receipts are:

Category	Midyear Collection Increase
Secured Property Tax	$3.8 million
VLF/Property Tax in Lieu	$1.2 million
Intergovernmental (exclude VLF[2])	$1.4 million
Charges for Services	$1.2 million

In FY 2007-08 the category with the largest dollar **decline** is:

Category	Midyear Collection Decline
Supplemental Property Tax	$611,640

[2] Vehicle license fee (VLF) is collected for Health and Human Service programs by the State Controller through the annual auto registration process. The general purpose VLF is now allocated though the property tax system.

Secured Property Tax

Secured property tax is a significant revenue source for the General Fund and is apportioned as a result of levies made against the secured roll of the County for the current fiscal year. Placer County's property tax is used to support countywide public safety, health and human services, public works, land development, and finance and administrative functions. Property tax also fills the gap when there are shortfalls in state and federal funding, provides for prudent reserves and operating contingencies, and provides necessary funding for capital construction projects. Property tax growth of 6.5% was budgeted for fiscal year 2007-08. Based on December collections total property taxes received should be $1 million in excess of the budgeted amount subject to year end adjustments due to reassessments. At the end of FY 2006-07 property tax receipts were $3.5 million in excess of budget.

Triple Flip – Sales Tax Revenue

California voters approved a deficit bond measure that included the "triple flip". The flip reduces the local Bradley Burns sales tax by one-quarter percent, increases the State sales tax by this amount and replaces the local sales tax reduction with property taxes from the countywide Education Augmentation Revenue Fund (ERAF). Jurisdictions receive three-quarters of their sales tax allocation with the difference backfilled by the County Auditor in December and April from expropriated ERAF monies. The Department of Finance (DOF) estimates Placer County's "triple flip" amount at $3.7 million, and in December 2007 the General Fund received $2 million of these funds. The "triple flip" is a temporary measure that should last for about a decade and end when the bonds are repaid by the State of California.

Sales tax revenue includes the net amount received from the levy of a sales and use tax under the Bradley-Burns Uniform Sales Tax Law (specifically the .75% of the total 7.25% collected). Allocation of the total sales tax of 7.25% collected within Placer County is as follows: 5.25% - State general fund; .75% - unincorporated (Bradley Burns), .25% countywide transportation (Bradley Burns); .50% County mental health & welfare realignment and .50 % public safety (Proposition 172). The County General Fund's sales tax revenues received through December 31st 2007are about 5% or $222,062 lower than at this time last year.

Interest Revenue

Interest revenues are generated by the Treasury on pooled investments that are allocated based upon each customers proportionate share of cash. All investment transactions and decisions are made in full compliance with the California Government Code and Placer County's Statement of Investment Policy. The effective rate of return earned by the Treasury through December 31, 2007 was 4.94% vs. the 4.83% earned this same time last year. However, the interest rate is declining due to reductions in the Federal Reserve Rate.

Real Property Transfer Tax

Real property transfer tax revenue is collected at "change in ownership", or transfer of a present interest in real property. As a result of the robust real estate economy, this revenue stream grew rapidly from $2.7 million in FY 1999-00 to its peak in FY 2004-05 of $6.7 million. Last year, revenue collections were down at $4.36 million (from $5.8 million in FY 2005-06) and are continuing to drop

this fiscal year. While budgeted conservatively at $3.9 million staff estimates it will still be between $300k to $500k short of budget.

Supplemental Property Tax

Supplemental property tax includes all taxes apportioned as a result of supplemental levies made against the secured and unsecured property of the County in the current fiscal period. These revenues are directly affected by the slowing in the housing market. With current trending it appears the revenue will meet budget but is expected to be approximately $1 million lower than FY 2006-07.

Construction Permits

Construction revenues are collected on commercial and residential building permits issued in the unincorporated area by the County. Building permit activity is one indicator used to measure and forecast economic conditions. As of December, single family dwelling permits are down 17% over the previous year's activity. Over the past two years, the decline in single family dwelling units has approached 50%. For FY 2007-08, overall construction revenues are flat through December, as compared with the same period of time last year. Commercial permits, as well as an increased volume of single family dwelling unit applications in December prior to the January 1, 2009 fee increases has helped revenues. Other planning related permits and map approval applications are generally level and less affected by the fluctuations in the construction industry. Overall, construction revenues are 55% of budget through December.

Intergovernmental Revenues (excluding VLF)

When the Board adopts the Final Budget it is prior to notification of the State's final allocation amounts. For the last several years, State revenues have remained relatively flat, despite the significant rise in costs to provide services, which required Health and Human Services to significantly reduce staff and other resources in order to manage programs within the available funding. As of December 31st, most intergovernmental revenue receipts are on track, and collections are $1.5 million more than at this time last year. Given that these revenues represent 35% of total General Fund revenues, staff monitors them closely.

In conclusion, General Fund revenue performance remains steady at approximately 42% of budget at December 31st.

Expenditures

	FY 2006-07					
	Budget	Expenses & Encumbrances at 12/31	% of Bud.			
General Fund	360,569,248	156,722,857	43%	380,485,455	173,445,088	46%

As can be seen in the table for the period ending December 31st, General Fund expenses were slightly higher than the prior year's performance at approximately 46% of budget (up from 43%). Actual expenditures are higher when compared with last year at $148 million ($16 million more than the prior year). Encumbrances at $25 million reflect obligations from construction, road and

other projects where contracts are entered into, but are paid upon completion of specific completion steps or phases as identified in the agreement.

Two categories of expenses make up the majority of General Fund expenses: salaries and benefits (43%) and services and supplies (22%). As a percent of budget, salary and benefit expenditures are trending slightly higher than the previous year (42%, vs. 41%) with dollars spent $8.3 million more ($68.9 million vs. $60.7 million). Services and supplies are also higher as a percentage of budget (58% vs. 56%) although dollars spent are at the same level ($48 million). The services and supplies budget is 3% less ($2.9 million) than FY 2006-07.

At the end of the year, savings realized in expense categories and excess revenue receipts make up a significant portion of fund balance carryover to assist in balancing next year's budget. Carryover fund balance is *not* used to fund ongoing operations, but instead is used to fund one-time expenses such as capital improvement, equipment, automation or road projects, contributions to reserves and operating contingencies.

Public Safety Fund –(Fund 110)

The Public Safety Fund is financed through a combination of General Fund and the Public Safety Sales Tax. Current projections for Public Safety Sales Tax suggest that it is trending from 3-5% below the FY 2007-08 budgeted revenue. Recent changes to recruitment and hiring practices have resulted in increased staffing and lower fund balance carryover. The lack of revenue and lower carryover fund balance will likely result in additional General Fund pressure to maintain current public safety service levels. In addition, the State anticipates reductions in the Juvenile Justice Crime Prevention Act funding and the Juvenile Probation and Camps funding which supports probation services to juvenile offenders and their families.

Other Operating Funds – (Funds #103 through 190)

In addition to the General Fund, the County manages twelve other governmental operating funds and two capital project funds. Other operating funds consist of 18 appropriations, managed by 11 departments. Most revenue and expenditure performance is on par with that of the prior year for the periods ending December 31st. The largest of these operating funds include the Public Safety Fund, the Road Fund, the Capital Projects Fund and Capital Securitization Fund.

Of particular note, one part of the overall plan to address State cash flow concerns March through August 2008, wherein the State will postpone transfer of local gas tax resulting in a projected $2,076,000 revenue reduction for FY 2007-08 in the Road Fund (Road Maintenance). It is anticipated that the Road Fund reserves would have to cover the impact until reimbursement is received. The ultimate amount and timeliness of payment of Prop 42 could potentially offset County cash flow and buffer reserves. However the amount and timing for that transfer is unknown at this time.