Overview of FY 2016-18 Budget Workshops

Introduction

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As we look to the upcoming 2016-17 Fiscal Year, the County's fiscal situation is projected to be positive, and continues to improve at a moderate pace. As federal, state and local revenues have strengthened, the past two budgets have allowed for our ability to restore some previous budget cuts and enabled the expansion of some services to address mandated or emerging needs. In this time period, the County fully funded its General Fund strategic reserve (or 30-day operating reserve) and developed plans to address long-term liabilities, such as paying down unfunded pension and retiree health liabilities over the next two decades, and annually increasing funding toward deferred maintenance needs.

All of this is good news, but caution is still required. In the past, the Board has made difficult choices and tradeoffs to ensure a balanced budget and a healthy financial future. After reducing 580 positions and cutting operations by approximately $60 million in the Great Recession, financial and operational challenges continue. Maintaining fiscal stability and ensuring a balanced budget in the coming years requires continued prudence, realistic expectations and restraint.

This year's budget theme, "Challenges, Choices and Changes Ahead," reflects the need to maintain existing levels of service amid growing demands and high expectations. Given limited available revenues and the need to address existing liabilities and prior funding commitments, we face continued challenges. These prior commitments, which obligate future ongoing revenue, reduce our capacity for significant expansions of programs and services, or other expenditure increases, in the near term. These challenges will require a continued commitment to responsible choices to deliver the level and quality of programs and services desired by the residents of Santa Barbara County. Next year also signifies important changes in the County, with newly elected and appointed leadership, in addition to expected employee retirements.

Yet even with these challenges, your County government continues to strive to provide high quality work, advancing major initiatives and fulfilling priorities to serve Santa Barbara County residents. Significant services are provided day in and day out by County departments, and all have made substantial progress to accomplish goals set by the Board to better serve our communities. These achievements will be discussed in the department presentations and are listed in their draft budget narratives.

Similar to last year, general priorities to guide the budget development process are as follows:

- Continue the Board's prior commitments
- Rebuild our financial reserves and incrementally address organizational needs, addressing the highest needs that meet mandates and core missions

- Create a thriving and engaged workforce
- Create efficiencies through technology and process improvements
- Strategically plan for the future
- Minimize service reductions and impacts to the public, to the extent possible
- Address new and emerging needs

Following the Budget Workshops and receipt of the community's and the Board's input, departments will revise their budgets and work plans for next year, and the County Executive Office will develop the Recommended Budget, to be released in May 2016. Budget hearings are scheduled for the week of June 13, 2016.

The following information is a summary of many of the major countywide issues to be presented at the workshops, which were discussed in more detail in the December 2015 Fiscal Outlook Report. As new information is received, some information will continue to evolve up until the budget hearings.

Projected Revenue and Expenditure Trends

As the national and local economies continue to strengthen, the County of Santa Barbara government continues to experience moderate growth, allowing the County to stabilize its finances, slowly rebuild the organization and address priority commitments and deferred needs.

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Revenue Trends: Overall projected revenue growth is moderate. General Fund growth is in-line with projections, while State funds are stable but lower in some key areas, putting pressure on department services.

Overall (all funds) revenue growth is anticipated at 5.3%. The General Fund, which funds basic services, is expected to grow 1.8% in FY 2016-17. This growth is modest because the current fiscal year includes one-time General Fund revenues, and therefore, a year to year comparison results in only a 1.8% increase.

Property Tax revenue – General Fund growth is closely correlated to growth in assessed property values. Given that the Assessor does not close the roll until June 2016, projections for FY 2016-17 currently estimate an assessed value growth of 4.7%. Assessed property tax revenue from the oil and gas industry are included in the above projections and decreased by 26% in FY 2015-16 (from about $20 million countywide in FY 2014-15 to about $15 million in FY 2015-16); however, oil and gas assessments represent only about 2% of the County's total assessed property values. Looking just at the General Fund, revenues from oil and gas decreased $1.1 million (from $4.4 million to $3.3 million), and Fire District revenues decreased about $0.65 million. The main contributor to the decrease in oil revenues described above was a drop in the price of oil by 46.5%, from over $100 per barrel to approximately $54 per barrel. While several factors impact the tax assessment, the price of oil has modestly rebounded from recent lows, and it is anticipated that the impact on FY 2016-17 assessed values will be less than that of FY 2015-16.

Transient Occupancy Tax (TOT) and Sales Tax Growth – TOT is projected to grow by 5% ($450,000) to a total of $9.4 million. Sales tax is expected to grow by 16.8% ($1.5 million) to $10.2 million. (This large increase in sales taxes is a one-time anomaly, primarily due to the end of the "triple flip" whereby the State traded local sales taxes for property taxes to pay for economic recover bonds). Later this month, staff will be presenting the Board with a recommendation to place a TOT measure on the November 2016 ballot to raise the TOT from 10% to 12%, consistent with the rate in several cities of the county. If passed by the voters, this would augment the TOT by $1.9 million and would be used to help maintain basic County services that residents use and rely on, such as clean parks, safe public buildings and roads, mental health services and available public safety services.

Prop 172 funds – Prop 172 funds (the 0.5% sales tax for local public safety) will provide approximately $34.3 million in funding for the Sheriff, Fire, Probation, District Attorney and Public Defender departments in the current fiscal year; however, these funds were initially budgeted at $35.5 million and therefore are $1.2 million less than expected levels. This has caused budget pressure in the current and next fiscal year, particularly on the Sheriff and District Attorney's offices and, in part, are contributing to the Sheriff's budget deficit next year and requiring the District Attorney to use its department savings (fund balance) to balance its budget this year, which cannot be sustained in future years.

State funding for roads has declined. The State has provided $2.7 million less for roads. Shortfalls have put pressure on the General Fund to contribute toward maintaining our roads.

State Gas Tax funding - Funding to the County for roads continues to decline. As was the case last year, the state provided $2.7 million less to the County for Roads. The state legislature is still in a special session regarding transportation funding, and the Governor's budget has proposed $3.6 billion, which would mean additional funds to the County, yet the legislature has not completed this transportation funding and reform package. Funding shortfalls caused by reduction in state funding has put pressure on the General Fund to contribute towards maintaining our roads. If no relief is provided by the State, this is an unsustainable situation for local roads, faced by all local governments in California.

Other State funding - State funding is also flat (not growing) or has a cap (spending limit) for some programs, such as Child Support Services, and programs in Social Services. This means no additional funding is provided by the State to cover normal increases in labor costs or supplies and expenses.

Expenditure Trends: Increased employee costs, deferred maintenance needs, high demand for inpatient mental health services, and prior funding commitments continue to be significant factors in next year's budget

Increased employee costs, deferred maintenance needs, high demand for mental health services and prior funding commitments continue to be significant factors in next year's budget.

Employee salary and benefit costs - Total employee salary and benefit costs are expected to increase at 2.4%. However, contracts for the County's largest employee labor groups terminate at the end of fiscal year 2016. Labor negotiations for these successor contracts are expected to begin in the spring. This is a significant financial factor that is unknown at this time.

Other employee-related cost increases -

- *Health care costs* are expected to increase by 11.1% (from $36 million to $40 million), a continuing trend from last year.
- *Workers compensation (WC*) premiums were expected to increase $2 million next year; however, in late March 2016, the rates were revised downward and are now expected to decrease slightly (1 percent decrease from $16.5 million to $16.4 million). Adjustments to the Budget for this decrease will be submitted in June 2016.
- *The General Liability (GL*) fund had incurred favorable loss experience for many years which increased the programs' fund balance and was used to reduce premiums. In 2015-16, we saw a modest increase in rates but were able to offset increases and reduce rates with other savings. Rates in FY 2016-17 are again increasing but there are no fund savings that can be applied to keep rates down, resulting in an increase of about $2.7 million. The CEO's FY 2016-17 Budget will recommend relief for departments that were significantly impacted by this change, and CEO staff is reviewing potential longer-term impacts on departments.

Pension funding – There is not a significant, projected increase in the County's retirement contribution rate for FY2016-17. However, a recent presentation on the pension portfolio on March 1, 2016 indicated potential risks as we look beyond to FY2017-18. The pension portfolio stood at a -5.0% return as of January 31, 2016, which will be smoothed in to the rates over for the next five years, along with any investment gains. Should gains not materialize to completely offset this loss, a greater County contribution will be required after FY 16-17. Also, should the pension board change its assumed rate of return (currently at 7.5%), this will also require more funding from the County. The pension board will make its decision this coming fall, after it conducts its three-year experience study. These changes could potentially result in a 1% to 2% increase in FY2017-18, equating to $3.3 million to $6.6 million in additional County costs ($1 million to $2 million in Discretionary General Fund).

Retiree Health – In recent years, the Board approved a budget policy to address current requirements and the unfunded liability. This year, the Board formalized that policy and approved a plan to pay down the unfunded liability by contributing 4% of payroll annually. This plan would eliminate the unfunded liability by 2034, if all investment return assumptions are met. In next year's budget, funding is included to reflect this policy.

In recognition of the need to address infrastructure and building maintenance needs, the Board developed a policy to set aside 18% of available discretionary revenue, which will result in $2.5 million for FY 2016-17. Ongoing funding will build over time as additional General Fund contribution is added annually.

Deferred Maintenance – In recognition of our aging infrastructure and facilities, the Board developed a policy of annually setting aside 18 percent of available revenue to fund deferred maintenance needs. This has resulted in $2.5 million of ongoing, dedicated maintenance funding in FY 2016-17, which is in addition to a minimum of $3 million annual funding previously authorized by Board policy for these needs. It is envisioned that the ongoing funding will build over time as additional General Fund is added annually, so that $100 million will have been accumulated over 10 years.

Unbudgeted emergency repairs for County buildings, however, have increased $1.3 million this past year for items such as transformer replacements, generators and sewer lines. These unplanned emergency repairs will likely continue in the near future until ongoing funding builds and deferred maintenance levels stabilize. More one-time funding will likely be needed in the near term for these needs.

Road maintenance also has seen a need for increased funding. In the past, the County's roads were funded from federal, state and regional funding sources. Measure A, passed in 2008, provides regional funds to the County, but it is less than local road funding provided by its predecessor, Measure D. The state provides Gas Tax (Highway User Tax Account or HUTA) funds, which have diminished in the last two years. As a result, many counties are in the same predicament as Santa Barbara. Over 77% of California Counties have Pavement Condition Index ratings in the 50-70 range ("at risk"). (In Santa Barbara County, the overall PCI is 59, with a higher PCI rating in more urban areas (66) to compared rural areas (55)).

To help ensure roads are maintained at a safe level, in FY 2015-16 the County provided one-time General Funds to road maintenance of $1.4 million in addition to the dedicated 18% maintenance funding. While the issue is being debated in the State Legislature, there is no certainty of improved funding. Without improved state assistance in FY 2016-17, contribution from the General Fund again is being requested. General Services, Public Works and Community Services departments will discuss this issue in the presentation "Special Issue: Update on Maintenance" as part of the Budget Workshops.

Unfunded or underfunded capital improvement projects – The County has a large list of unfunded capital items; some are new capital improvements, such as new facilities, while others are capital replacement of systems to address significant deferred maintenance. Prior to the recession, the General Fund contributed $0.5 million annually for various capital projects, and several larger projects employed debt financing. Many of the capital projects were improvements to replace aging or obsolete buildings and fix major systems. In FY 2013-14, the County stopped allocating $0.5 million for capital and shifted these funds for maintenance needs.

The County now has a long list of capital projects requiring significant funding. A Capital Executive Committee was re-established this year to establish criteria for ranking non-Public Works capital projects (buildings, parks etc.) in an effort to prioritize needs. The results of a preliminary evaluation identified 12 high priority projects totaling $22.3 million. (There is significantly more unfunded projects but these are considered the highest need). Available one-time funding should be considered to start rebuilding a capital improvement program for the County. The Capital Improvement Projects plan will be presented to the Board in May 2016. A "Special Issue" evaluating possible debt financing for capital projects will be presented at the Budget Workshops.

Mental Health Inpatient Beds and New Behavior Wellness Programs – The County's inpatient mental health costs continue to increase. The County has a psychiatric hospital limited to 16 beds (due to federal regulations regarding reimbursement). The County is paid by federal and state sources for some, but not all, costs associated with the hospital. For those costs not reimbursed, the Mental Health Fund, General Fund and/or other mental health funds must pay for those costs.

The County's inpatient mental health costs continue to increase. Additional funding for "step down" community beds was provided last year, and those beds, along with new crisis intervention services, appear to be assisting. However, there is still a department budget deficit due to increasing inpatient costs.

Last year, the County provided $3 million of one-time funds over the budgeted allocation to the department for inpatient costs. Additional ongoing funding of $1 million was also provided for "step down" community residential beds, where PHF patients that are no longer acute could then be housed in a less restrictive setting. Those beds appear to be assisting, along with new crisis services implemented this year. Given these new beds have only recently started, the Department has still been over budget in this area, and the County provided an additional $2 million of one-time funds during the third quarter of FY 2015-16.

Next year, the Department projects a budget deficit of $2.8 million to keep the same number of beds for inpatient services, but a need of $1.6 million in additional funding, as the benefits of the new services should be materializing. Expenditures will be monitored to track the benefit of new beds added during this current year and their ultimate impact on the need for additional beds.

Priority Initiatives - Prior Commitments of Funds –
The Northern Branch Jail (NBJ): In recognition of the need to develop a modern, safe and secure new jail for the County, the County approved a 376-bed new jail outside the City of Santa Maria. Final approval of bids is expected in the next few months. The new jail will be operational by 2018 and represents a significant ongoing commitment of future General Fund revenue. While the State provided construction funding, the jail will cost an additional approximately $17 million to operate in FY 18-19 annually, funded by the General Fund. The County's funding plan guides the setting aside of ongoing amounts of GF to cover the costs and in FY 2016-17, this amount equates to $7.6 million of ongoing funding, with a total of $18.6 million in the operations

Prior funding commitments, serving high priority needs - Northern Branch Jail, Fire Services, and Maintenance - obligate future ongoing revenue which reduces our capacity for significant expansions of programs and services, or other expenditure increases, in the near term.

fund. The Sheriff will be presenting a "Special Issue" report on the NBJ transition staffing plan as part of the Budget Workshops.

Fire District Property Tax Shift – Fire services are vital to Santa Barbara County, and its history of fires are reminders of the constant danger given our geography and climate. To ensure adequate staffing, equipment and fire station facilities, the County shifted future property tax revenue from the General Fund to the Fire District. The target is 17% of property taxes to the Fire District (from about 14.3% in FY 2012-13). To do this, a formula was developed that shifts a quarter growth in property taxes until the 17% target is reached (projected in FY 2019-20). The new revenue gained by the Fire District through this shift of taxes would otherwise have been General Fund revenue. As part of this tax shift agreement, the Fire District also forgoes a share of other revenue it had previously received.

The current allocation of property taxes in FY 2015-16 is 15.7%. In FY 2016-17 the shift will result in $6.5 million more to the Fire District than would have occurred without the tax shift. The shift is expected to result in an additional $11.5 million annually to the Fire District by the time the 17% target is reached in FY 2019-20. To date, this new revenue has been used to improve fire safety throughout the County. Future expenditures are anticipated to largely address significant capital needs of the department. The Fire Department will provide a progress report on use of these funds as a "Special Issues" presentation at the Budget Workshops.

Maintenance Funding – See above

Common Themes in Departments Draft Budgets and Work Plans for FY 2016-18

A few common themes among departments in their preparation of the FY16-18 budget:

Challenge of accommodating increased salary and benefit costs – The General Fund provides funding for a share of the increased employee costs, based on expected levels of non-General Fund typically received by the department. General liability and health care costs have increased for many departments. Some departments with flat or reduced revenue sources, or less charges for service, are challenged to cover these increased employee costs.

Retirements and Workforce (Succession) Planning – Retirement of experienced managers, supervisors or technical experts is causing concern by departments. The loss of experienced employees without sufficient knowledge transfer can result in reduction in response times, inconsistency, and liability regarding state and federal regulated programs. This trend was identified over two years ago, and departments where this will have a substantial impact have developed their own programs or initiatives to address the change. Human Resources will be continuing efforts to develop effective workforce initiatives to help departments address this issue.

Software updates and new data systems – Over half of the departments are implementing or will be implementing software systems to address a need for increased efficiency, update obsolete or outdated software, respond to state or federal regulations or accommodate new trends. Some departments have sufficient fund balance savings to cover the cost; others are or will be requesting additional funding from the General Fund or other sources.

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Security Upgrades in facilities – Recent events have put a spotlight on employee security and safety. In January 2016, the County developed an internal security team of representatives from Risk Management, County Executive Office, Sheriff, General Services, District Attorney and Human Resources to develop short, medium and longer-term recommendations. While that has been in progress, several departments have requested facility improvements to their public areas. Some departments have their own funding for these changes; other departments need additional General Fund. General Services has submitted a funding request to represent these departments.

Service Level Reductions and Budget Expansion Requests

As in the prior year, with an improving fiscal situation, there are fewer service level reductions proposed. No layoffs are currently anticipated.

As in the prior year, with an improving fiscal situation, there are fewer proposed budget reductions than in past years. No layoffs of staff are currently anticipated.

Service Level Reductions – Service level reductions are proposed when departments are without sufficient revenue to meet current expenditure levels. Reductions are proposed by the following departments:

Sheriff – $1.0 million reduction based on closure of the Santa Maria Jail (existing personnel would move to vacancies in the Main Jail and 6.0 vacant FTE's would be unfunded).

Public Works – $2.5 million reduction in contracted road maintenance planned work; $0.8 million reduction in vacant staff, supplies and equipment for road operations (due to loss of gas tax funding).

Behavior Wellness – $2.8 million reduction in current level of inpatient beds (existing funding is insufficient for current demand); requesting $1.6 million to help restore.

Child Support – reduction of 1.7 positions through attrition, due to higher salary/benefit costs and no increase in State revenue.

County Counsel – reduction of 1.0 vacant Senior Deputy County Counsel due to increased salaries and benefit costs and reduction in overhead revenues.

County Counsel and Child Support reductions would have significant impacts on their operations, given the relatively small size of these departments. The CEO has previously augmented departmental budgets with structural imbalances, high general liability or workers compensation increases to avoid layoffs. While these reductions would not result in layoffs, they would have significant service impacts. In recognition of this, the CEO will evaluate these reductions and make adjustments to ensure continuity of service, pending Board input at the Workshops; these changes would then be reflected in the Recommended Budget released in May.

Request for Budget Enhancements - After reductions made in the Great Recession, departments continue to face financial and operational challenges of new or changing regulations, reductions in state or federal funding, and other activities beyond local government's control that increase their workload. These pressures require a refocus of staff and resources, requiring a reduction of existing work, reassignment or re-prioritization of efforts, or an increase of resources.

Departments continue to face operational challenges of new or changing regulations, reductions in funding, and other activities beyond local government's control that increase their workload. Many are requesting expansions to their budgets. There is not enough funding to address these requests.

Many departments are requesting expansions to their budgets for additional funding, totaling $17.1 million in ongoing General Fund and $11.6 million in one-time General Fund funding. There is obviously not enough funding to address these requests in the near term, and expectations will need to be adjusted.

Summary

As we prepare our budgets for next fiscal year, the County is in a positive financial position but faces significant "Challenges, Choices and Changes Ahead." Given growing demands for service, high expectations, and existing liabilities - yet limited available revenues and prior funding commitments - difficult choices and tradeoffs are still required. But even with these challenges, the County continues to provide a high level of service and make progress on many initiatives to better serve our community.

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Following the Budget Workshops and receipt of the community and Board's input, departments will revise their budgets and work plans for next year, as appropriate, and the County Executive Office will develop the Recommended Budget, to be released in May 2016. Final budget adoption hearings are scheduled for the week of June 13, 2016.

On behalf of the County departments, we look forward to discussing our accomplishments and our draft operational plans and budgets.