Attachment A

COUNTY OF SANTA BARBARA

Fiscal Outlook Report Fiscal Years 2016-18

County Executive Office

Budget and Research

December 8, 2015

The Fiscal Outlook Report describes the Economic Outlook and Fiscal Issues facing the County of Santa Barbara over the next two fiscal years. Issues are not meant to be solved in this report, but highlighted for budget and planning purposes.

Fiscal Outlook Report

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Fiscal Outlook Report

INTRODUCTION

The Fiscal Outlook Report is composed of the following two sections:

I. *Economic Outlook*
II. *Fiscal Issues*

The *Economic Outlook* section describes current economic trends and projections at the federal and local levels. This outlook identifies leading economic indicators that drive the County's primary revenue sources such as property, sales, and transient occupancy taxes. This section serves as context for the fiscal issues and framework for budget development.

The *Fiscal Issues* section identifies significant issues that will potentially impact the County within the next two years. The issues are organized into two tiers according to expected likelihood of occurrence.

- Tier 1 Issues are expected to occur within this period and the County or department are proposing to budget for these issues within the recommended budget. These Tier 1 issues are detailed in this report.

- Tier 2 Issues are probable but some aspects of the fiscal issue are uncertain and consequently the County or department will not propose to budget for this item. Tier 2 issues are summarized in table form towards the end of this report and are detailed in Appendix A.

These reports are not intended to solve issues but rather to point them out. During the budget development, a more precise calculation of the impacts and strategies to balance budgets will be created and communicated to the Board. In addition, a five-year forecast will be presented as part of the Budget Preview in March of 2016.

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EXECUTIVE SUMMARY

The national and local economies continue to strengthen and we are nearing full employment levels. In Santa Barbara County, property values and businesses are growing at a moderate rate, allowing the County to carry on rebuilding the organization and finances as we continue to provide residents high quality services. While the budget has stabilized, there will always be more need than funding and the County will continue to fulfill its prior strategic commitments, limiting our growth and flexibility in other areas. In the coming months and years as we address known, evolving, and new issues, we will continue to communicate the changing landscape and allocation of available resources.

Positive Signs

- National and Local labor market is nearing full employment
- Average earnings have risen over the past year and consumer spending is up
- Santa Barbara property values continue to display moderate growth
- Increased federal, state and local funding towards Health and Human Services departments
- Minimal service reductions and impacts to the public during recent years
- Adapting and strategically planning for the future
- New efforts to create a thriving and engaged workforce
- Departments have created efficiencies in operations through process improvements, technology and innovation

Fiscal Issues

Section 2 of this report will focus on the Fiscal Issues that will require additional funding beyond current levels. These are detailed in the coming pages and briefly summarized below:

- Workforce planning and retention
  - Compensation, turnover, recruitment and retention
  - Rising healthcare costs
    - Employee health insurance premiums
    - Cadillac tax on health insurance
    - Workers' Compensation premiums
  - Pension and Other Post Employment Benefit (OPEB) funding
- Existing strategic commitments to prior public safety and infrastructure priorities:
  - Northern Branch Jail operating costs
  - Fire Tax Shift
  - Maintenance needs
- Reduced State funding (gas tax) for Roads
- Mental Health inpatient costs and audit settlements
- Northern Branch Jail – bids and construction
- Technology and software upgrades
- Prolonged drought effects
- Managing expectations

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I. ECONOMIC OUTLOOK

As was reported during last year's Outlook, the national economy appears to be remaining on a positive track. The national labor market is considered to be near-full employment. According to a Reuter's analysis, 34 states are reaching employment highs and thousands of counties have pre-recession unemployment rates (Schneider, 2015). The national unemployment rate is about 5.0% which is a 7.5 year low. The Federal Reserve will likely raise interest rates in December given the strength of the economy. In addition, average hourly earnings rose 0.4% in October, for a 2.5% increase over the prior 12 months, thus being the healthiest pace since 2009 (Schwartz, 2015). Gasoline costs have remained at historically low levels keeping consumer prices low, which help to reduce pressure on inflation. The downward inflation pressure points to a strong dollar as it has gained 16.6% against the currencies of the United States' main trading partners since June 2014 (Mutikani, 2015). Lower gas prices and a strong dollar should lead to more consumer spending, indicative of 3rd Quarter growth of 3.2% in household purchases, which is about 70% of the U.S. Economy (Jamrisko, 2015).

The Gross Domestic Product (GDP) is another indicator of the U.S Economy, and increased at an annual rate of 1.5% in the third quarter of 2015 and 3.9% in the second quarter as visible in the table below from the Bureau of Economic Analysis.

The increases are primarily indicative of a rise in consumer spending, including services, health care, as well as nondurable and durable goods (Aversa, 2015).

Although the local economy is distinct, these national indicators are positive signs for the State and local economies. The Santa Barbara County unemployment rate was 4.3% in September (displayed in the table below), down two percentage points from 6.3% two years ago. The unadjusted rate for California is 5.5%, comparatively. The economy continues to trend positively, but as discussed above, there may not be much room for further decreased unemployment as the rate is nearing full employment.

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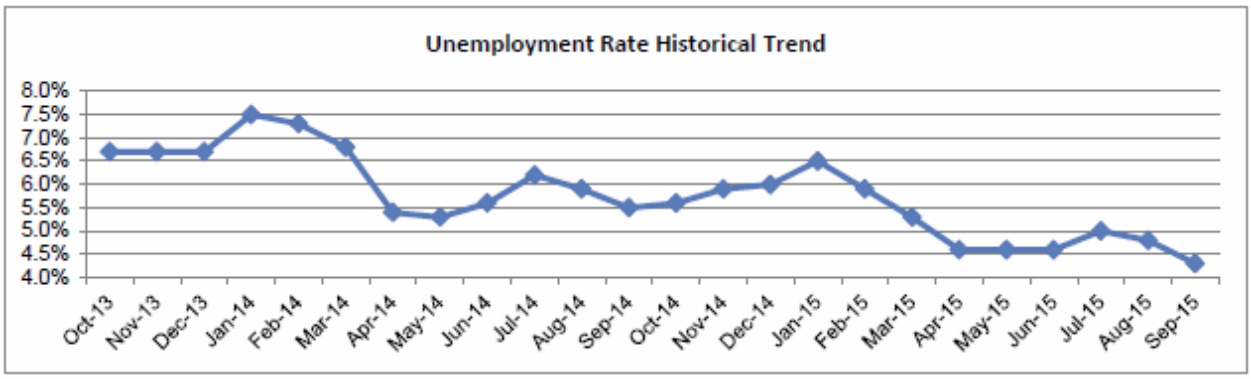
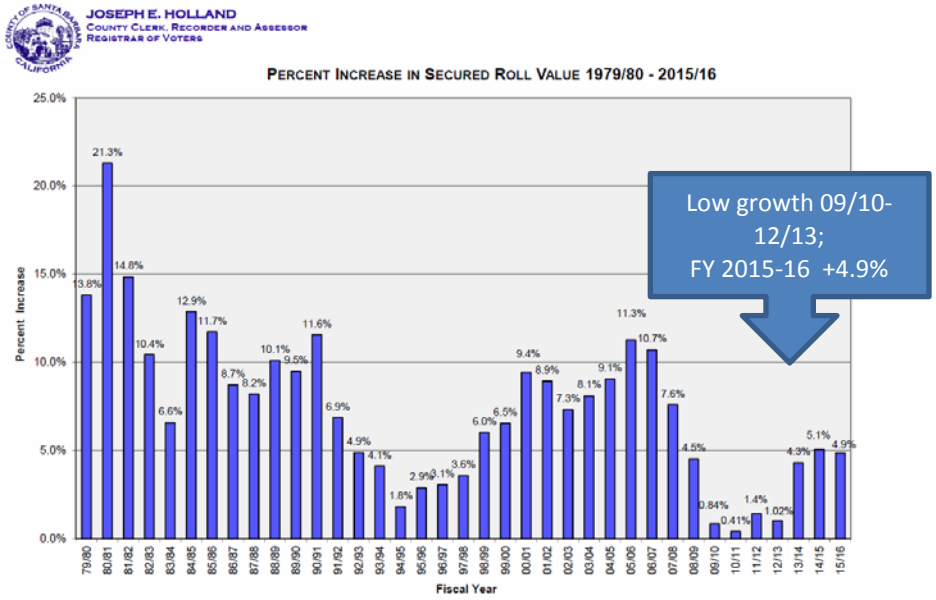


Santa Barbara County Unemployment Rate history – California Employment Development Department

During the 34th Annual Santa Barbara County Economic Summit (June 2015), Peter Rupert, the Chair of the University of California Santa Barbara's economics department, conveyed that Santa Barbara County's economy is looking up and outpacing California. He pointed out that the job market is growing but many of the created jobs are not high paying. In addition, sales jobs are decreasing and farm and labor workers are the highest employment countywide (Potthoff, 2015). Couple low paying jobs and the lack of affordability of the County, this could be a potential risk for the local economy. Nevertheless, the local economy continues to grow.

To quote the Auditor Controller's Financial Highlights report released August 26th, "The housing market continues to rebound. The growth rate of the increase in home prices has moderated somewhat over the past, yet still is on an upward trajectory. Employment continues to grow and new businesses are springing up and so commercial vacancy rates are very low." Furthermore, property taxes are the County's largest discretionary revenue source and the overall property tax assessed value will increase 4.9% for FY 2015-16.

Santa Barbara County housing prices have experienced three years of greater than 4% growth in the assessed values of Santa Barbara properties. The following chart displays the increase in the value of properties in the County from one year to the next expressed in percentages. We anticipate a similar rate of growth, 4% - 5%, in the next two years.



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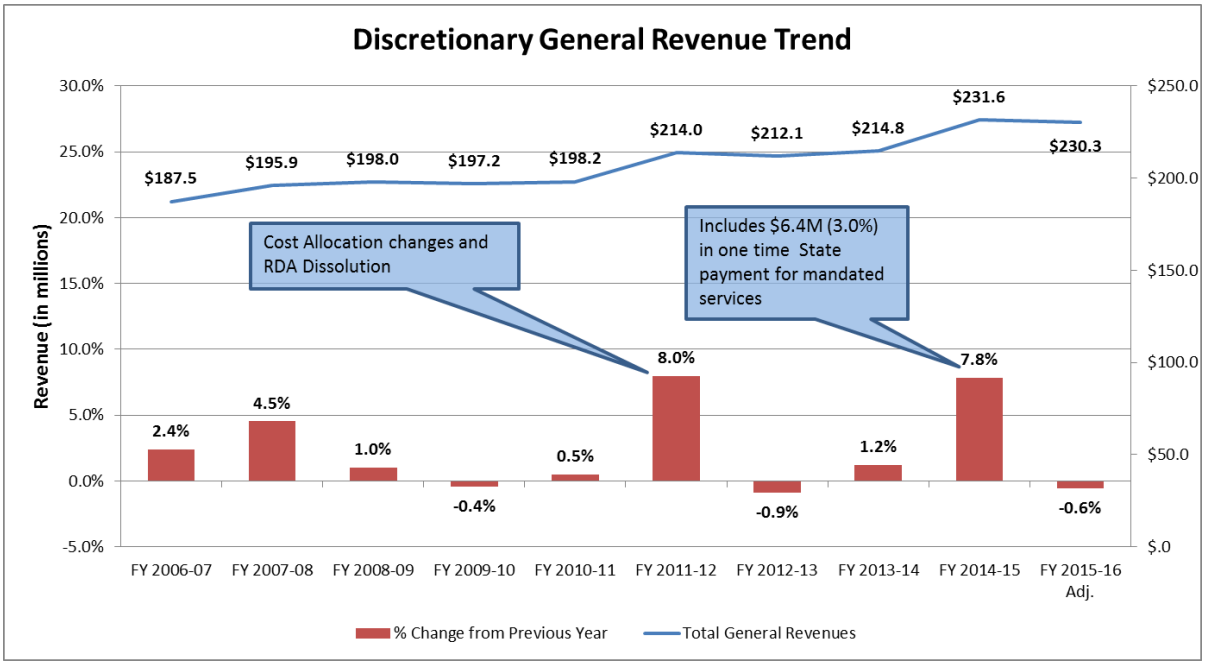
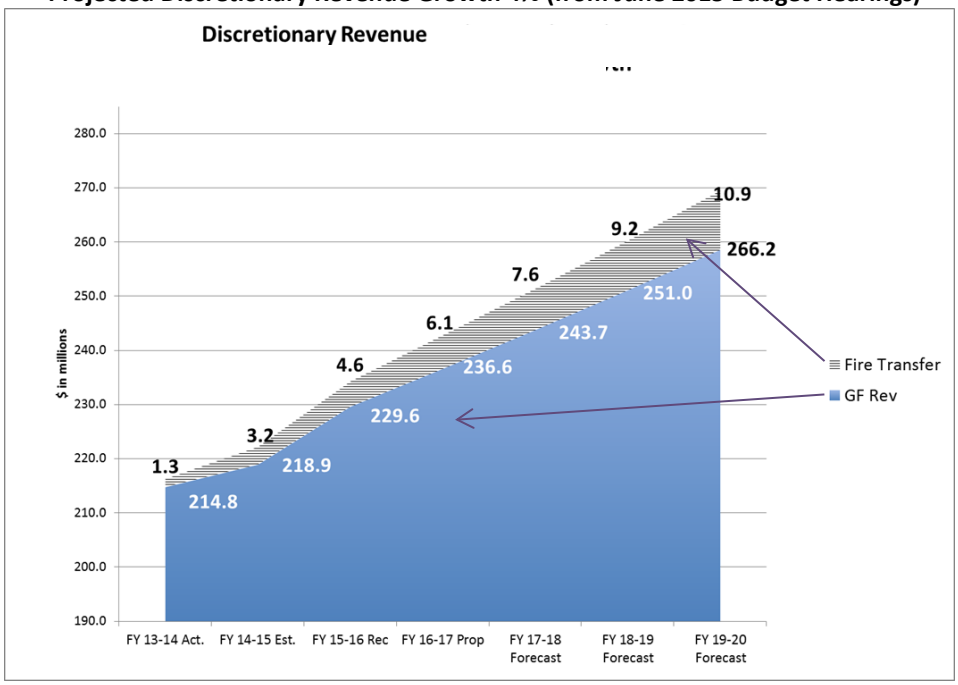
This countywide growth in property values will mean positive growth in the County's Discretionary General Fund revenue. However, that growth will be adjusted downward by 25% to account for the shifting of property tax from the General Fund to the Fire District.



The two graphs below were presented during the June 2015 Budget Hearings. The first graph reflects continued moderate growth in revenue is expected. The gray area at the top of the graph indicates the amount of Discretionary growth allocated to the Fire District as a result of the Fire Tax Shift.

Projected Discretionary Revenue Growth 4% (from June 2015 Budget Hearings)



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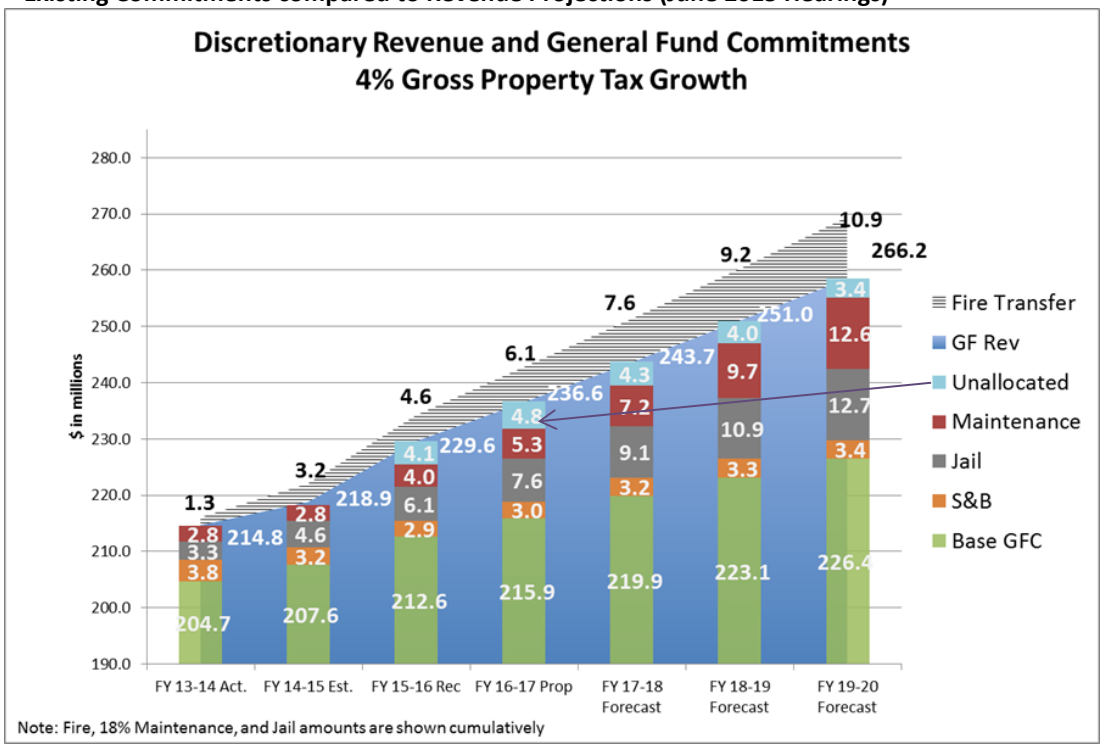
The second graph illustrates the County's preexisting commitments which limit significant investments in other areas. Both charts assumed 4% growth in Property Taxes. An updated revenue forecast will be provided during the FY 2016-18 Budget process. At 4% growth, there is estimated $4.8 million in unallocated Discretionary General Fund revenue. As the following pages show, however, there is significant need for identified fiscal issues that exceed this amount.

Existing Commitments compared to Revenue Projections (June 2015 Hearings)



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II.FISCAL ISSUES

A. Tier 1 Fiscal Issues:

In recent years the biggest financial concerns were minimal revenue growth and increasing benefit costs. Revenues are now increasing at moderate levels and pension contribution rates have stabilized; however other benefits, particularly those associated with health care costs continue to rise at rates higher than inflation. The current Tier 1 Fiscal Issues for FY 2016-17 and FY 2017-18 are shown below as incremental amounts above existing funding levels. The two columns at the right indicate the amount of Discretionary General Revenues that will be required for the specific issue.

Tier 1 Issues: Expected occurrence within the next two fiscal years						
	Issue	FY 2016-17 Impact	FY 2017-18 Additional Impact	Onetime or Ongoing	FY 2016-17 Discretionary Impact	FY 2017-18 Discretionary Impact
		($ in millions)				
1	Health Insurance	$ 4.2	$ 4.5	Ongoing	$ 1.4	$ 1.5
2	HUTA Revenues – Gas Tax Swap True-Up for 14-15	2.5	-	Onetime	2.5	-
3	Compensation & Workforce Planning	2.1	2.3	Ongoing	0.7	0.7
4	ADMHS Inpatient System	2.0	-	Ongoing	2.0	-
5	Northern Branch Jail Operations Funding	1.5	1.5	Ongoing	1.5	1.5
6	Deferred Maintenance Backlog	1.4	1.9	Ongoing	1.4	1.9
7	Workers' Compensation	1.1	0.6	Ongoing	0.4	0.2
8	Retiree Healthcare (OPEB)	0.8	0.8	Ongoing	0.3	0.3
9	Jail Management System Replacement	0.1	0.8	Onetime	0.1	0.8
10	Cadillac Tax	-	2.3	Ongoing	-	0.7
	Total	**$ 15.7**	**$ 14.7**		**$ 10.2**	**$ 7.6**

1. Health Insurance

We expect significant increases in health insurance premiums to continue because of overall increases in healthcare costs. Despite improvement, the County costs are still above the experience level of others in our risk pool. The overall cost increases are largely due to rising specialty drug prices and high inpatient (hospital) treatment costs.

Health insurance premiums continue to rise throughout the State ranging from 10% to 19%. The primary drivers are the rising costs of specialty drugs and high inpatient treatment costs.

Since moving to the California State Association of Counties - Excess Insurance Authority (CSAC-EIA) Health program in 2010, implementing the County's Employee Health Clinic Program, and introducing other health-benefit cost cutting strategies, the County's health plan's loss ratio has continued to decrease and now stands at a six-year average of 99.9%. Although this is a great improvement over 159% in 2009, it is still 11.3% above the risk pool's loss ratio of 88.6%. As the County's loss ratio is above the risk pool's loss ratio, the County received an overall increase of 15.2%, of which 13.8% is based on claims experience and 1.4% is a result of Affordable Care Act (ACA) related fees and costs. Actual individual plan increases range between 13.7% and

15.2 %, with the plan on which County Contributions are based increasing 13.8%. Our actual healthcare rate increases in recent years have been in the 4.0% to 15.3% range and, as stated above, the increase for calendar year 2016 is 13.8% ($4.2 million).

Based on the uncertainty surrounding the new ACA and rising health care costs, a rate increase of 15.0%, in calendar year 2017 and 12.0% in calendar year 2018 will be included with the recommended budget. Using these increases would result in an increase of $4.2 million for FY2016-17, and an additional $4.4 million in FY 2017-18.

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2. Highway User Tax Account (HUTA) Revenues – Gas Tax Swap True-Up for FY 2014-15

An estimated State reduction of $2.5 million in gas tax payments is expected in FY 2016-17. The department will receive the State's assumption of HUTA revenues for FY 2016-17 in the spring of 2016. This will impact operations and maintenance activities such as pavement patching, traffic safety, tree trimming, culvert cleaning and concrete repairs.

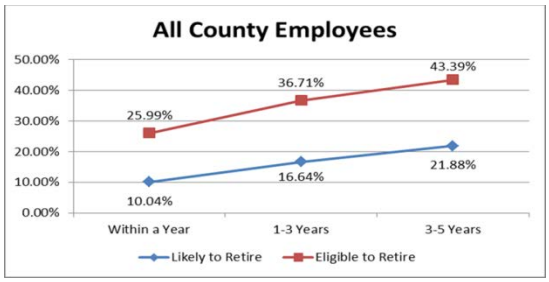
These annual gas tax (Highway User Tax Account, or HUTA) payments are made based on Board of Equalization (BOE) estimates of fuel to be sold, and the price per gallon. The Transportation Division of Santa Barbara County received $4.2 million in new HUTA payments in FY 2014-15. The BOE periodically reviews their estimate and reconciles to actual amounts. This 'true-up' resulted in a net reduction of $367 million across the state, which translated to an estimated reduction for Santa Barbara County of approximately $2.3 million for FY 2015-16. Based on the very low price of gasoline currently, forecasts are suggesting that FY 2016-17 will be yet another down year from the prior year. At this point, old HUTA payments are estimated to remain flat (at the lower "trued up" level) and new HUTA is estimated at 80% of the FY 2015-16 allocation or an additional $240,000 reduction for FY 2016-17, resulting in a cumulative revenue loss of $2.5 million. The department will receive the State's assumption of HUTA revenues for FY 2016-17 in the spring of 2016.

Public Works' Transportation Division uses State Gas Tax (HUTA) to fund its operations and road maintenance work. Shortfalls in FY 2015-16 HUTA revenues were restored on a one-time basis by the Board during budget hearings. This $2.0 million restoration avoided service level reductions for the current fiscal year. If FY 2016-17 HUTA revenues aren't adjusted upward at the State or are not restored by other revenue sources, it will impact maintenance activities such as pavement patching, traffic safety, tree trimming, culvert cleaning and concrete repairs. Impacts from the lost revenue will be reduced maintenance service levels. For example, every $1.0 million reduction equates to approximately six maintenance worker positions or 2/3 of the materials purchased annually for maintenance activities such as pavement patching, traffic safety, tree trimming, culvert cleaning and concrete repairs. Replacing the lost revenue with one-time funding would allow operations to continue at current levels. The other option is for the department to exhaust its reserves. In the Spring of 2016, when the next BOE true-up comes out, the County will have a better indication of whether this is a one-time cost or a trend is developing where ongoing funding would be needed to maintain service levels. These reductions have occurred for two consecutive years at this point.

3. Compensation & Workforce Planning

Employee compensation and benefit costs make up 57% percent of the County's operating expenditure budget. One of the Board's adopted policies is to focus on attracting, retaining and developing a high performing workforce. During the post-recessionary years, County employees contributed in many ways including unpaid furloughs and compensation concessions. For many employee bargaining units, recent contracts restored merit increases that had been frozen during the recession. As the economy improves, there will be increased pressure to adjust wages and/or benefits to keep pace with inflation and the market (pay of surrounding public agencies or comparable counties). Significant turnover is expected as 22% of employees are likely to retire in the next 3-5 years. This level of change provides opportunity to develop tomorrow's leaders but also risk to replace long term employees' knowledge and experience.

The County of Santa Barbara's most valuable resource is its employees - the people who deliver services to the community and internal clients. In the coming years, as the economy continues to improve and more County employees consider their retirement and other employment options, the County faces significant talent shortages in the available workforce. This issue is identified by County executives as one of the most important internal issues at this time.

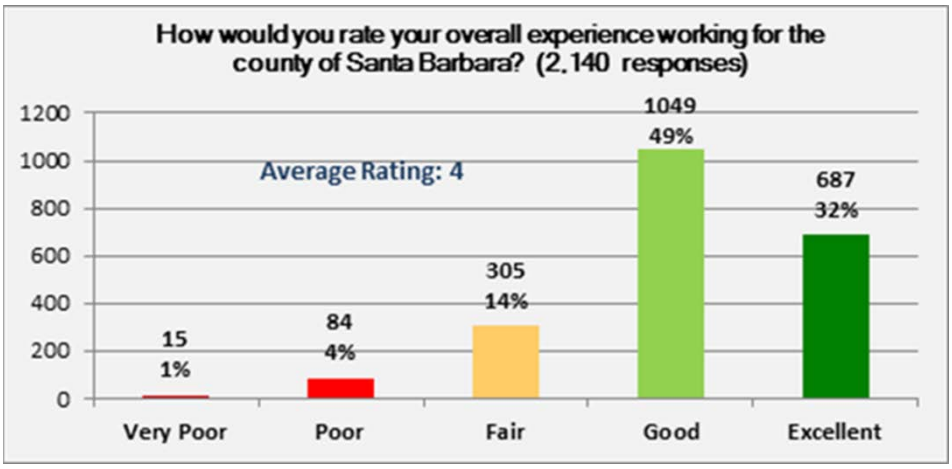


With this in mind, Human Resources will work with all County departments to develop and implement strategies designed to get the right people, with the right skills, in the right job, at the right time and retain them in the organization. Several of these strategies are in development and include:

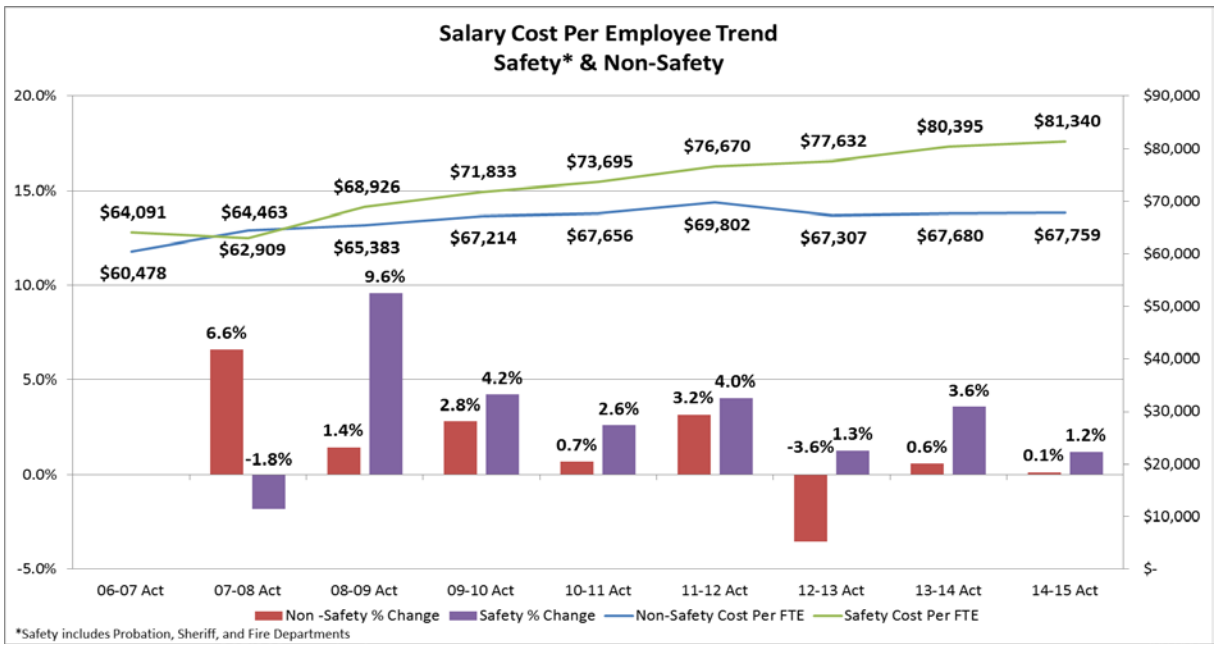
- Ensuring competitive pay and benefits with comparison counties
- Creating an inviting workplace culture where employees want to remain (e.g. "stay interviews")
- Knowledge transfer, cross-training, and employee skill development programs (including a mentoring program included in this year's budget)
- Job classifications that are flexible and reflect the changing nature and developing aspects of the current work environment
- Well defined career paths within the County
- Programs to retain employees eligible to retire and incent them to delay retirement
- Recruiting/marketing of County jobs to Millennials

While there is much to do, a recent HR survey indicates that 81% of those surveyed have a good or excellent experience working at the County (see graph below). As we evaluate and

implement new programs, we welcome the County's new Human Resources Director, Lori Gentles to provide leadership in this critical area.



Additional funding may be needed to address market adjustments and/or equity issues. This report identifies approximately $2.1 million in additional funds beyond recent levels that would be necessary for a 3% wage increase. The graph below demonstrates that County wages for non-safety employees have remained relatively flat in the post recessionary period and wages for safety employees have risen modestly.



4. Alcohol, Drug and Mental Health Services (ADMHS) Inpatient System

Increased costs for the Inpatient System of Care (for contracted beds when the Psychiatric Health Facility [PHF] is full) which began in FY 2013-14 are expected to continue in the short-term due to increased demand and court ordered placements of individuals referred for

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Incompetent to Stand Trial (IST) assessments and restorations. ADMHS is starting new programs and increasing mental health beds within the County to enhance services that are anticipated to reduce the number of contracted inpatient beds in the near future.

During FY 2012-13, ADMHS developed policies and procedures related to the involuntary hold process which reflected changes to the time limit clients will spend in emergency rooms. The result of this change combined with an overall increase in the demand for inpatient services has been an increase in the number of contracted acute inpatient beds provided by the County. The resulting increase in costs for the purchase of contract beds is shown below.

Fiscal Year	Inpatient Contract Bed Costs
2010-11	$1,991,824
2011-12	$1,680,000
2012-13	$1,903,650
2013-14	$4,071,821
2014-15	$6,954,255
2015-16 “Projected”	$7,026,910

To counter the increasing costs and bed needs, ADMHS is utilizing increased General Funds and State grant funds to start new programs in FY 2015-16 to enhance services that will likely reduce the inpatient impact. The County has developed a multi-department Incompetent to Stand Trial (IST) work group to try to reduce IST client stays in acute care facilities. The Crisis System redesign, starting with a South County Crisis Stabilization Unit and Crisis Residential Unit, funded with SB 82 Grants were opened in the 1st and 2nd quarters of FY 2015-16. The redesign will have a total of 28 new beds or slots to reduce the inpatient demand by creating alternative crisis and step down beds with the intent to enhance our capacity and reduce the number of contracted beds. ADMHS has also strengthened the Outpatient System by improving access and quality of care which may also reduce the need for crisis beds. Furthermore, the Department is collaborating with community partners, such as Cottage and Marian Hospitals, to better serve these clients.

The FY 2015-16 Adopted Budget for contracted inpatient beds assumed the above new programs would be in place at the beginning of the fiscal year and the budget was therefore reduced to $4.8 million. This $4.8 million budget was funded in part with $2.0 million in one-time funding from the General Fund. The exact benefits of the new services and beds won’t be known for some time, so the Department has identified the potential need for $2.0 million in ongoing funding, from the General Fund, for contracted inpatient beds.

In FY 2015-16 a new policy provides $1.0 million to be available for mental health inpatient bed costs in excess of budget when no departmental funds are available. Absent any other need that may arise, this could partially offset the $2.0 million need resulting in $1.0 million for contracted inpatient beds in FY16-17. However, the full $2.0 million is shown as a fiscal issue until the benefit of the new services is known.

5. Northern Branch Jail Operations Funding Plan

The County continues to set aside incrementally increasing appropriations from General Fund discretionary revenues for the Northern Branch Jail operations scheduled to begin in FY 2018-19. In November 2015 the Board directed staff to continue with only the AB900 jail project, and not the SB1022 jail project; and to continue with the existing Northern Branch Jail Operations Funding Plan at the current levels. The original funding plan calls for an additional $1.5 million of General Funds to be added to the existing funding each year in FY 2016-17 and FY 2017-18.

To address jail overcrowding conditions, limit the early release of persons convicted of crimes, and to upgrade and replace aged existing facilities; construction of a Northern Branch Jail has been approved. The project scope is for a 376 bed jail facility, of which 32 beds are for medical and mental health needs. Construction of the new facility is estimated to cost approximately $96.1 million and is funded in large part by a State conditional award totaling approximately $80 million and the balance with County General Funds. The NBJ will be built on a portion of the 50 acre property located at Black and Betteravia Roads just outside the City of Santa Maria.

Annual operating costs upon opening of the jail were originally estimated at $17.3 million, which is net of staffing and other costs transferred from existing jail facilities. Using these estimates, the Jail Operations Funding Plan started in FY 2011-12 and set aside incrementally increasing appropriations from General Fund discretionary revenues.
Subsequent to the original funding plan, the operating costs for the existing jail and the AB 900 facilities were revised by Sheriffs' staff, reviewed by CEO staff and reviewed by an independent consultant, Carter Goble Associates (Consultant). The estimated operating cost per the Consultant were within $30,000 of the revised Sheriffs' staff figures, although the Consultant figures included adding 20 new staff for shift relief at the Main Jail. On November 17, 2015, the Board directed staff to continue with only the AB900 project, and not the SB1022 project; and to continue with the existing Northern Branch Jail Operations Funding Plan at the current levels. The Board did not take action on the implementation of additional staffing for shift relief at the Main Jail; however, under either scenario, the existing NBJ Operations Funding Plan would be sufficient. If the County does not proceed with the recommended hiring of additional staff for shift relief, it is anticipated that there would be some net savings after considering overtime and Workers' Compensation adjustments; however, these figures were not generated by the Consultant. For purposes of this report, we have assumed shift relief is added and we are using the Consultants operating costs.

The following table illustrates the Jail Operations Funding Plan, including:

- Base General Fund Contribution (GFC),
- The annual incremental General Fund Contribution
- Transitional staffing costs
- Additional maintenance costs for the new facility
- The Consultants operating cost figures, and
- The fiscal year-end fund balance in the North County Jail Operations Fund,

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Assuming shift relief is provided and service levels are enhanced at the Main Jail a one-time surplus of $1.3 million is attained by FY 2022-23. However, none of the operating numbers below account for deferred maintenance costs of the Main Jail that will remain in operations (see Deferred Maintenance section below).

11/17/15 Carter Goble Associates (CGL) Consultant's Report - AB900 w/Shift Relief Operational Maintenance Budget of $800k in 2018-19 *($ in millions)*									
	Original Existing Funding Plan					CGL Operating & Main Jail Shift Relief Costs			
Fiscal Year	GFC Base	GFC Increase	Total GFC	County Match	Transition & Maint. Cost	Operating Costs	Shift Relief	Total Operating Costs	Fiscal Year-end Balance
2011-12	$ -	$ 1.0	$ 1.0	$ -		$ -		$ -	$ 1.0
2012-13	1.0	1.0	2.0	(3.0)		-		-	-
2013-14	2.0	1.3	3.3	-		-		-	3.3
2014-15	3.3	1.3	4.6	-		-		-	7.9
2015-16	4.6	1.5	6.1	-	(0.3)	-		(0.3)	13.7
2016-17	6.1	1.5	7.6	-	(2.7)	-		(2.7)	18.6
2017-18	7.6	1.5	9.1	-	(10.5)	-		(10.5)	17.2
2018-19	9.1	1.8	10.9	-	(0.8)	(14.1)	(2.2)	(17.1)	11.0
2019-20	10.9	1.8	12.7	-	(0.8)	(14.5)	(2.3)	(17.6)	6.1
2020-21	12.7	2.2	14.9	-	(0.8)	(14.9)	(2.4)	(18.2)	2.8
2021-22	14.9	2.2	17.1	-	(0.9)	(15.4)	(2.4)	(18.7)	1.2
2022-23	$ 17.1	$ 2.2	$ 19.3	$ -	$ (0.9)	$ (15.8)	$ (2.5)	$ (19.3)	$ 1.3

6. Deferred Maintenance Backlog

Deferred maintenance needs are significant and as a result, the Board approved a Maintenance Funding Plan, effective July 1, 2015 which is projected to provide $24.7 million in accumulated new funding over the next five years to help address the need. In ten years, it was estimated that $100 million in new funding would be accumulated. This was calculated at 4% growth in property taxes, and will be updated in the budget process.

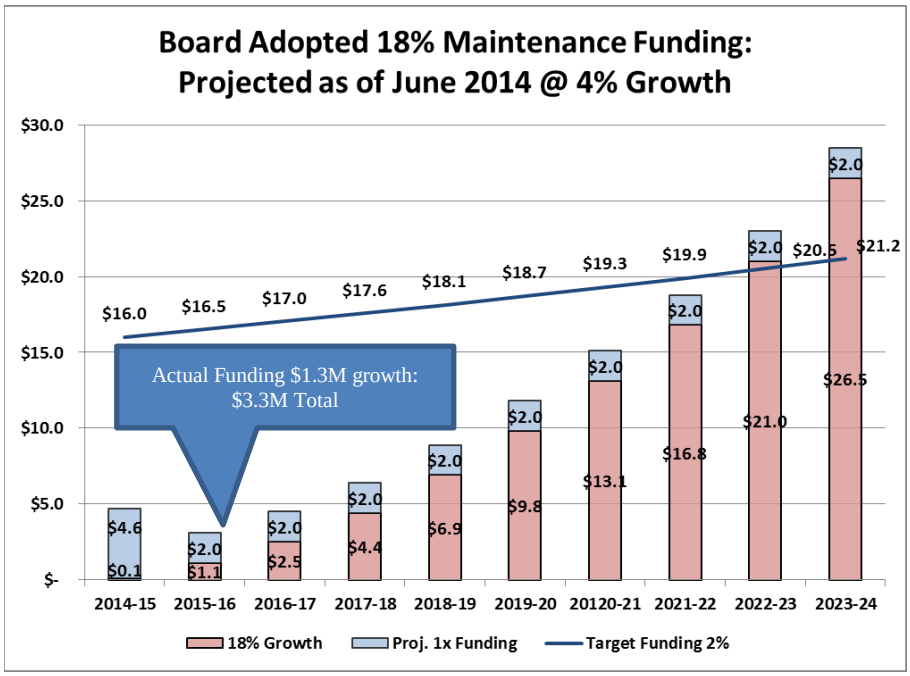
The County of Santa Barbara's deferred maintenance has grown over time while funding has remained relatively static. In June 2014, the Board directed staff to implement a maintenance funding plan that would increase ongoing General Fund Contributions (GFC) for maintenance projects by allocating 18% of unallocated Discretionary General Revenues towards maintenance projects. It is envisioned that the ongoing funding will build over time as a new layer of additional GFC is added annually.

The estimated backlog of Deferred Maintenance projects at June 30, 2015 is approximately $345 million ($252 million in Public Works pavement, bridges, drainage, concrete/other and an estimated $93 million in Parks and General Services). The $93 million for Parks and General Services reflects Observed Deferred Maintenance of $73.0 million, $10.0 million of extrapolated/unobserved maintenance and an additional $10 million for Main Jail maintenance (per Marx-Okubo Report). Public Works has indicated that to maintain the existing Pavement Condition Index, an additional $9.0 million in annual funding would be needed.

The Facilities Condition Assessment Reports (Jorgensen and Marx-Okubo reports) identified

observed deferred maintenance needs for County parks, buildings, and facilities and breaks them out by group and recommended timeline to complete.

The Maintenance Funding Plan approved by the Board, as part of the FY 2015-16 Budget Development Policies, projects $24.7 million in new funding during the 5 year period ending FY 2019-20 (excluding the estimated $2.0 million per year of one-time funding). These projections were based on estimated property tax increases of 4% per year (before the 25% Fire District Tax shift). As described in the Policy, these funds will be allocated to departments based on existing needs and priorities. The additional funding, per policy, will be calculated and allocated to departments in December. The following chart reflects the Plan approved by the Board.



Staff will continue to review additional options to provide funding for critical deferred maintenance needs. One time funding, the use of Certificates of Participation (bonds) for capital maintenance needs as well as Federal and State program funding are being considered.

7. Workers' Compensation

Workers' Compensation premium costs are increasing. The frequency of claims is below the average of our benchmark counties and is at our lowest in the past 15 years but the severity of claims (cost per claim) continues to rise and is on the high end compared to benchmark counties. As a result, the County will incur increased insurance premiums from our carrier which will be passed on to all departments.

Workers' Compensation (WC) claims involve injuries which often span many years. The County was self-insured for WC claims incurred through 06/30/10 (tail claims). In the initial years after 2010, the development of these claims was much worse than initially projected and created a

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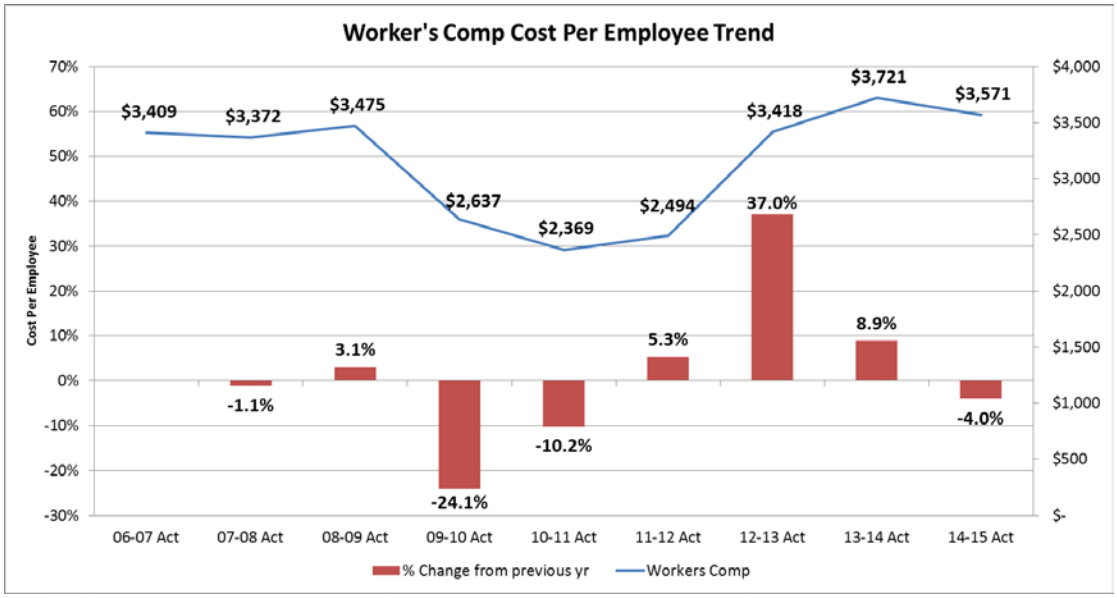
$7.9 million deficit in the fund as of FY 2011-12. A recovery plan was implemented and we are ahead of schedule with this plan with a projected deficit of $839 thousand at the end of FY 2015-16.

The underlying issue that created the deficit appears to be a drop in claim reserve levels which reduced County costs starting in FY 2008-09 through FY 2011-12 but understated reserves from their ultimate liability.



The FY 2009-10 claim reserves were the basis for initial premium pricing with our insurance carrier, CSAC-Excess Insurance Authority (beginning 7/1/2010). As claims close out at amounts greater than reserves, the carrier will adjust premiums rates to correct for deficiencies from prior years. This combined with an increasing number of employees has resulted in a 14% increase in our actual FY 2015-16 premiums assessed to the County from CSAC and a projected 22% increase in FY 2016-17.

Policy Year	Insurance Premiums	Increase (Decrease)	Variance
2010/11	$ 9.1		
2011/12	$ 8.5	$ (0.6)	-7%
2012/13	$ 10.1	$ 1.6	19%
2013/14	$ 10.1	$ -	0%
2014/15	$ 12.2	$ 2.1	21%
2015/16	$ 13.9	$ 1.7	14%
2016/17	$ 17.0	$ 3.1	22%

We anticipate future premiums will increase, but at a diminishing rate. The frequency of claims in SB County has been improving and the number of claims in 2014-15 was the lowest in more than a decade (see graph below); however, the severity or cost per claim is on the high end at $11,001* per claim versus a benchmark average of $8,234. Risk Management together with

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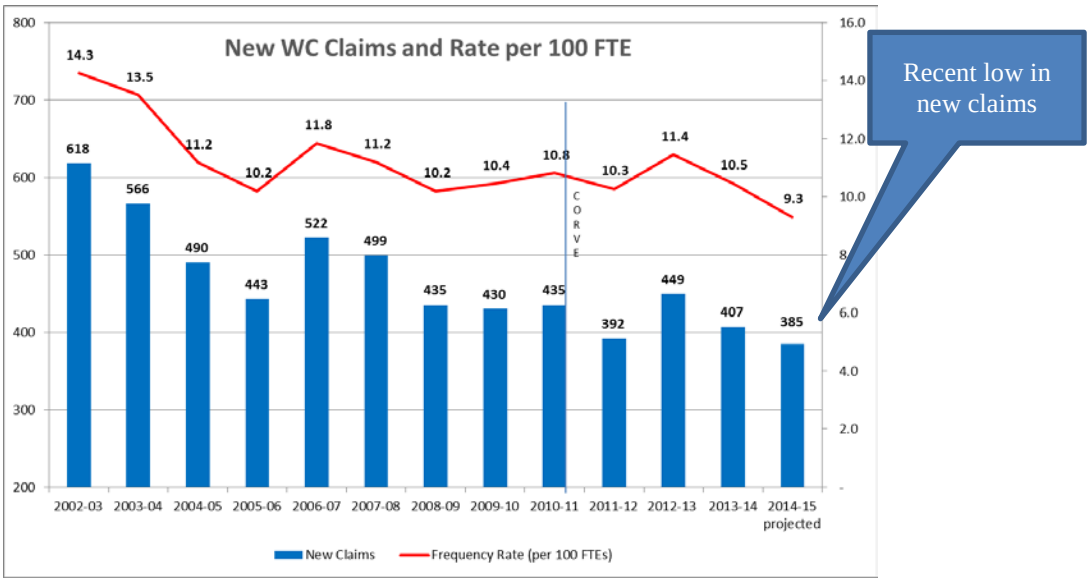
CSAC-EIA are exploring the degree to which Santa Barbara County medical costs impact the claim severity and will evaluate possible cost containment measures.

**** Actuary caps the loss at $100,000 per claim for this comparative analysis.***



8. Retiree Healthcare OPEB

For the fourth consecutive year, the County will continue its plan to increase the annual contribution rate toward Other Post-Employment Benefits (OPEB) costs by 25 basis points each year to gradually increase funding and reduce our liability. The Board took actions to terminate OPEB benefits for all new General Members in 2012. The County is working with SBCERS and an actuary to develop a plan to fully fund the liability within a reasonable timeframe; expected in the first quarter of 2016.

The Santa Barbara County Employees' Retirement System (SBCERS) administers a cost sharing multiple-employer defined benefit post-employment healthcare plan, which the County participates in. This Other Post-Employment Benefit (OPEB) Plan provides medical benefits to eligible retired County employees and their eligible dependents. The County determines the contribution rate to the Retirement System to fund the retiree healthcare program. Prior to FY 2013-14, the County had adopted an employer contribution rate of 3% of covered payroll which was intended to cover annual premium costs paid by the plan, also known as the "Pay as you Go" method. The result of the County's "Pay as you Go" funding approach was that the County accumulated a large unfunded liability for retiree medical benefits. The unfunded liability was $175.3 million as of the last actuarial study, completed February 2015, using June 2014 data.
In 2012, the Board took actions to terminate OPEB benefits for new General Members, which will reduce future annual required contribution costs; however, OPEB benefits for Safety Members were not adjusted. In FY 2013-14, the Board approved a Budget Policy that established an increased contribution of 25 basis points (approximately $800k) each year in order to gradually increase funding and reduce the liability.

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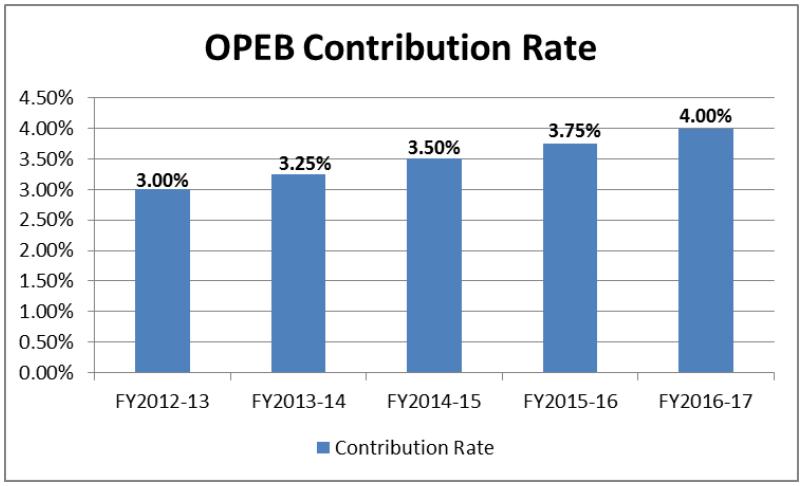
The table below demonstrates the increase in contribution rates utilized in recent years. The recommended contribution rate for FY 2016-17 will increase to 4.0% or about $13.5 million, which is $5.5 million above the actual benefit payment of $8.0 million in FY 2013-14.



The County is working with SBCERS and their actuary to develop a funding plan that would fully fund the OPEB liability within a reasonable period of time. It is anticipated that funding options will be presented to the Board in the first calendar quarter of 2016. At that time, staff will provide options for fully funding this liability and related costs to be incorporated into the FY16-17 budget.

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9. Jail Management System Replacement

A new Jail Management system is needed to replace outdated technology and in order to support more than one location. The total cost is estimated to be $860 thousand, and funds are not currently available.

The existing Jail Management System (JMS) was installed in 2005. This existing 10 year old system works on an outdated client-server technology and does not take advantage of current internet-based efficiencies. In addition, the current system supports only one location and will not support the proposed North Branch Jail when it is constructed and operational in 2018.

The project to replace the Jail Management system is in the needs assessment stage, whereby existing staff are developing the parameters of what a new system should look like. Currently there is no additional impact on the budget. The next stage of the project requires the hiring of a consultant to assist in transforming the needs assessment into an RFP. Once the RFP is completed, bidding for the project will be completed and the actual installation and conversion of data will occur.

The anticipated cost of the JMS is in the area of $750,000 with a consultant to the project to cost about $110,000. This puts the total cost at $860,000. This is an estimate only as the project is early in the development stages. The Sheriff's Office does not have fund balance

available to apply to the purchase. Given the significant expense of the Main Jail and new Northern Branch Jail Project, this software replacement system is important because inmate records must be maintained on a timely basis with access from both facilities (Main Jail & Northern Branch Jail).

10. Cadillac Tax

The "Cadillac Tax" is an excise tax on employer-sponsored health coverage under the Affordable Care Act (ACA) that imposes an annual 40% excise tax on employer sponsored health insurance plans with annual premiums exceeding $10,200 for individuals or $27,500 for a family starting January 1, 2018. The excise tax would be paid by the employer. If the County does not modify its medical plans, there is a risk the County would be required to pay the tax. The estimated annual impact upon the effective date is $4.6 million; however, the mid-year impact to FY 2017-18 is projected to be $2.3 million, unless action is taken to reduce the liability.

If no action is taken, the excise tax will be levied. To eliminate the impact, staff will review existing medical plans and work with various Bargaining Units directly or as part of contract negotiations to evaluate changes to existing health plan coverages.

If changes to employee health plans are not made to address the tax and the County becomes liable for the payments, funding to pay the tax must be found within the existing County Budget. This would have a significant effect on both General Funds and Special Revenue Funds. These additional funding requirements will impact the departments' ability to deliver current services; the full impact cannot be determined at this time.

Pension Fund Stability Update (not in Tier I Table):

Pension Costs have been one of the largest Fiscal Issues in every year since the Reports' inception. In the past two years, the rates have now stabilized. While there is no projected increase to retirement contribution rates (hence not included in the Tier I Table), there remains a large unfunded liability, which is predicted to be fully amortized in 15 years, if assumption rates are realized. Further, there is a possibility that the assumed rate of return will be reduced from 7.5% which would increase the unfunded liability and increase the County's contribution rate.

This issue utilized information received from Santa Barbara County Employees Retirement System (SBCERS) to obtain contribution rates, liabilities and rates of return used in this report. A summary of significant results follows:

($ in millions)	June 30, 2015	June 30, 2014	Change
Actuarial Liability	$ 3,231.1	$ 3,098.0	$ (133.1)
Market Value of Assets	$ 2,532.5	$ 2,513.6	$ 18.9
Unfunded Actuarial Liability	$ 698.6	$ 584.4	$ (114.2)
Funding Ratio - Market Value	78.4%	81.1%	-2.7%
County Contribution Rate	36.55%	37.94%	-1.39%

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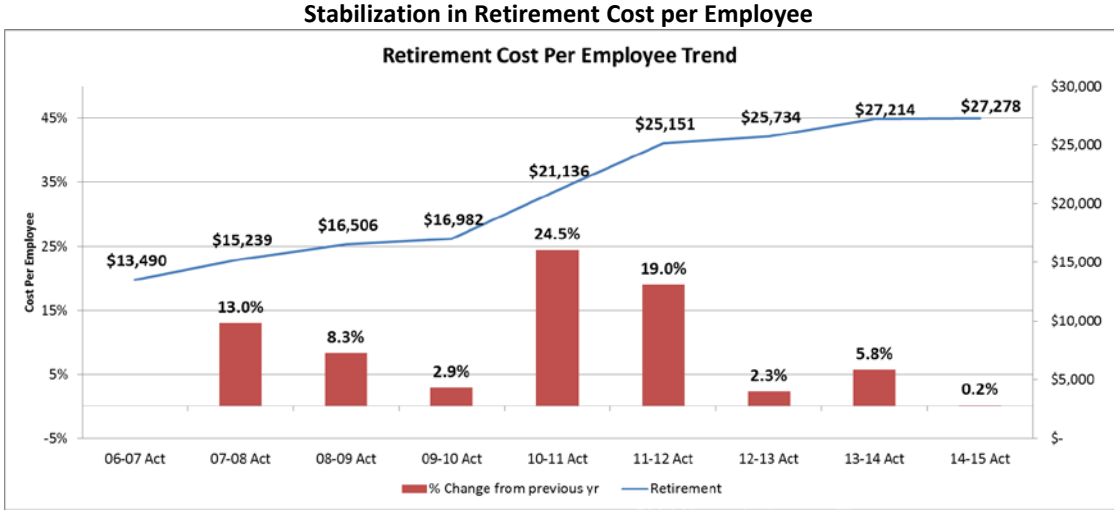
Increasing pension contribution rates (rates) have been one of the largest Fiscal Issues in every year since the Reports' inception but have recently stabilized. The stabilization is in part due to large recessionary investment losses now being fully absorbed into the rates, the Public Employee Pension Reform Act (PEPRA) in 2013 and no changes in the assumed rate of return in recent years. For the first time in many years, the County's overall FY 2015-16 contribution rates declined and will again decline in FY 2016-17 to a net rate of 36.6% of qualified wages.

While the rates have stabilized, they are impacted by many factors including investment gains and losses which are smoothed into the rates over 5 years. In FY 2013-14, the fund had an investment gain of 15.0% and in FY 2014-15 the investment return was 0.8% (vs. the assumed rate of return of 7.5%). The returns for the past two years act to offset each other in the rates; however, the most recent investment return of 0.8% (6.7% below the assumed rate of return) will have an immediate impact on the Unfunded Actuarial Liability (UAL). The UAL has increased to $698.6 million at June 30, 2015 (from $584.4 million in the prior year). The Pensions funding ratio at Market Value is now at 78.4% (was 81.1% last year).

Stabilization in Retirement Cost per Employee



In October 2015, SBCERS Board considered lowering the assumed rate of return and while the motion didn't pass it may be considered again next year during the tri-annual review of economic and demographic assumptions. If the assumed rate of return decreases from 7.5% it would increase the UAL and the contribution rates. A 25 basis point change in the assumed rate of return is projected to increase the County's contribution rate by 0.6% to 1.5%, depending on the specific assumptions. This could equate to $2.1 million - $5.2 million in additional pension costs in the year of change, with additional increases in subsequent year as changes are smoothed over a five year period.

Oil Impacts Update (not in Tier I Table):

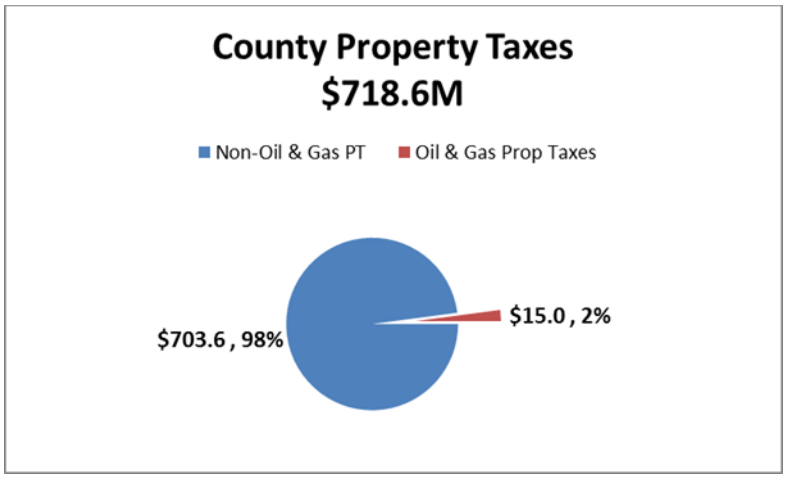
As a result of the May 2015 oil spill, the Line 901 has been closed by the Petroleum and Hazardous Materials Safety Administration ("PHMSA"), Line 903 has been scheduled to be purged under PHMSA's supervision, and certain oil producers in the area presently are unable to

extract (produce) oil from their wells. There is a concern that the "shutdown" will negatively impact County property tax revenues.

The Refugio oil spill occurred on May 19, 2015, just north of Refugio State Beach in Santa Barbara County, California. The oil spill came from a pipeline owned by Plains All American Pipeline that typically moves crude oil produced by offshore platforms from the onshore receiving plants along the coast to another pipeline that transports the oil further inland. The onshore spill flowed through an adjacent highway drainage culvert, with crude oil reaching the ocean. Both the cause of the oil spill and the actual volumes of oil spilled onshore and offshore are still being investigated.

The County collects property taxes from personal and commercial property owners within the County, including oil companies. Taxes are assessed as of January 1 of each year (lien date) to generate tax revenue for the fiscal year starting on the following July 1, thus, revenues for the period of May 19th through December 31st will be assessed in May or June of 2016 and will generate revenue to the County for the period of July 1, 2016 – June 30, 2017.

Property taxes for the entire county, including schools, County General Fund, cities and special districts totaled $718.6 million in the current Fiscal Year 2015-16. Of this total, only $15.0 million or 2.1% was generated from oil and gas sources. While the amounts are relatively small, the impact on smaller entities (specific schools or special districts) may be more significant. The graph below demonstrates oil and gas property tax revenues in relation to other sources of property tax revenues.



Both the federal Oil Pollution Act of 1990 and California's Lempert-Keene-Seastrand Oil Prevention and Response Act state a damages category for "loss of taxes." We therefore expect that, if there is a loss of property tax revenues from the oil spill, the County and others that receive property tax revenues will be able to claim against Plains for those lost property tax revenues.

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B. Tier 2 Fiscal Issues:

Tier 2 Fiscal Issues are detailed in Appendix A of this Report, the table below highlights the probable fiscal issues.

Tier 2 Issues: Probable occurrence within the next two fiscal years				
	Issue	FY 2016-17 Impact	FY 2017-18 Additional Impact	Onetime or Ongoing
		($ in millions)		
10	Elections Systems	$ 2.0	$ -	Onetime
11	Wireless Network Access	1.1	-	Onetime
12	Assessor Property System	0.7	-	Onetime
13	Water Shortage or Drought	0.4	0.4	Ongoing
14	ADMHS Cost Report Settlement Issues	Unknown	Unknown	Ongoing
15	Sheriff Overtime and Staffing Levels	Unknown	Unknown	Ongoing
	Total	**$ 4.2**	**$ 0.4**	

CLOSING COMMENTS/CONCLUSIONS:

The County has a solid economic foundation with revenues expected to increase. Property taxes (our largest form of discretionary general fund revenue) have also been improving and are expected to grow over the next two years.

Increasing revenues will help to offset some increasing expenditures; however, the County has ongoing funding commitments to: the Fire District through a tax shift, Northern Branch Jail Operations fund, Strategic Reserves, Pension & Other Post-Employment Benefits and additional maintenance funding.

Beyond the issues already mentioned in this report, new matters continue to emerge and evolve that will be evaluated and addressed as appropriate.

In conclusion, the County has an opportunity to strategically address current and future needs with careful consideration and calculated prioritization of issues and available resources. This report will hopefully serve to advance our discussion of these developing Fiscal Issues.

Fiscal Outlook Report

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15	Sheriff Overtime and Staffing Levels	Unknown	Unknown	Ongoing
	Total	**$ 4.2**	**$ 0.4**	

10. Elections Systems

The current vote tabulation system in use by Santa Barbara County (Accu-Votes) was purchased in 2000 and is in need of replacement. The Accu-Votes have exceeded their expected useful life of seven years and present increasing operational risks as these machines continue to age. The deployment of the Accu-Votes at polling locations was discontinued several years ago and all poll ballots are tabulated in-house on election night to reduce the number of units used per election. This allowed the opportunity to replace units with mechanical issues, which must be quarantined for two years. As the units continue to age, there will be a higher degree of mechanical failures and the back-up units will eventually be depleted. Any new voting system in California must pass federal and state certification. In 2014, a new regulation went into effect for certification in California that exceeds the standards for federal certification. This new regulation may limit the number of vendors bringing forward systems for certification in California, and potentially drive up system costs. It is anticipated that new systems meeting state standards may become available during Fiscal Year 2016-17. Should this occur, the County will look to begin the acquisition process in early 2017. The potential cost of a new system is estimated at $2.5 million with potentially $2.0 million of grant funds available from the Help America Vote Act (HAVA) Fund.

In addition to a new County vote tabulation system, Elections needs to acquire certain equipment to comply with the State requirements of conditional voter registration that will likely become effective during Fiscal Year 2016-17. Currently, the close of registration is the 15th day before the election. Conditional voter registration will allow individuals to register to vote by conditional registration and vote by provisional ballot in the election offices from the 14th day before the election through Election Day. To comply with the new State requirements, additional voting equipment will need to be acquired in 2017 to accommodate voter registration through Election Day and higher issuance of provisional ballots. The cost of new equipment is estimated to cost $285,000. Additional staff resources may also be required to implement new systems and equipment; however the cost cannot be reasonably estimated at this time.

Assuming the $2.0 million in HAVA grant funds are available combined with existing departmental fund balance; the Department should have the necessary funding for both the vote tabulation system and the equipment for conditional voter registration. The Tier 2 amount of $2.0 million assumes that the HAVA grant funds are not available.

11. Wireless Network Access

A refresh of the existing County wireless infrastructure was completed in FY 2013-14. Wireless equipment acquired in support of the refresh totaled $231,000. The goals of the project were achieved which included: aging hardware was replaced, the County is positioned for future wireless growth, the end user experience was simplified, and security enhancements were achieved.

The County user community continues to demand ubiquitous wireless coverage for the increased efficiency that mobile applications deliver. Providing universal coverage requires increasing the distribution and density of wireless access points. Expanded coverage to all major County campuses (Santa Barbara Downtown Locations, Calle Real Campus, Betteravia Complex, Foster Road, Lompoc Civic Center, Cook Street, and Solvang Civic Center) beyond the current infrastructure would cost the County $1,100,000. If a capital expansion funding source were available, General Services/Information and Communications Technology could purchase and depreciate the additional wireless infrastructure ensuring replacement funds for the entire wireless infrastructure in future refresh cycles. Technology equipment generally has a 3 to 4 year life span, and depreciation of $300,000 per year would be collected for replacement.

12. Assessor Property Tax System

The current assessment system used in Santa Barbara County, known as the Assessor Property System (APS), was developed in-house and originally deployed in 1999. The life-cycle of the current system, functional inadequacies, and technological advancement has driven the need for a replacement system. In 2010, the Assessor entered into an agreement with a vendor to develop a new system; however, a few years into the project the vendor filed for chapter 11 bankruptcy, leaving the Assessor in a vulnerable position. To assist in determining the best course of action for the County in pursuit of a “new” system, a Project Owner Manager position has been created to administer the project. Additionally, the Assessor has contracted with a local systems developer to provide technical direction. Currently, the team is working to define system requirements for modernizing the current APS and to design a non-functional prototype. This will allow the Assessor to determine if a satisfactory commercially available system exists or if the County is better off developing the project in-house. If the County decides to modernize its current system in-house, the new APS will be developed by the existing team of programmers in the Department. It is estimated that by the end of Fiscal Year 2015-16, the Assessor will have incurred incremental costs of approximately $0.3 million to define the system requirements and will incur an additional $1.4 million in development costs over the next five year period.

At the end of Fiscal Year 2015-16, the Assessor will have approximately $0.7 million in restricted and committed departmental fund balances available as a potential funding source for the development costs. These fund balances are specifically for the purpose of enhancing the property tax administration program and are appropriate for use by the Assessor for this project. Should the entire fund balances be available for this project, the approximately $0.7 million project cost balance will require a one-time County contribution.

13. Water Shortage and Drought Conditions

Due to the extended drought, Goleta Water has instituted a water surcharge at the Calle Real complex. The water meter currently has a stage 3 drought surcharge of approximately $177k for the next 12 months (starting June 2015). 88% of the surcharge will be charged to the Sheriff's Department and 12% will be charged to the other Calle Real departments.

If the drought continues, we are projecting that the surcharge will increase and water rationing will be instituted as follows:

1. With stage 4 drought conditions, the drought surcharge will be approximately $267k per year. (We could be at stage 4 even if we have some rain)
2. With stage 5 draught conditions, the drought surcharge will be approximately $390k per year. (If the drought continues with little rain, we could be at stage 5 by June, 2016.)

Water reduction measures will continue to be reviewed at the complex in an effort to reduce the surcharge.

14. ADMHS Cost Report Settlement Issues

The County has liability exposure with each fiscal year's cost report until the cost reports are audited by the State. Liabilities can arise from both cost report settlements and audits. In the County's Comprehensive Annual Financial Report (CAFR) ending June 30, 2015, the County estimates a potential liability exposure of up to $7.5 million for outstanding cost report settlements and audits dating back to FY 2007-08. The County has identified sources to pay all these liabilities, but it is unknown what future liabilities the County may be subject to.

The cost settlement process typically spans a 5-10 year period, whereby additional cost settlement liabilities could be assessed until audited. Currently, ADMHS has cost reports that are still subject to the State settlement process for fiscal periods 2011-12 to 2014-15. Cost reports for fiscal periods 2009-10 to 2014-15 are also still subject to State audit.

Based on the State's cost report filing process and long delay in the performance of audits, cost report settlements will continue to occur many years after costs have been incurred and reports submitted. ADMHS has improved its processes in an effort to reduce the magnitude of such settlements. Processes and staff were in place by FY 2009-10 and it is anticipated that settlements for FY 2010-11 and subsequent periods will not be as large as in prior years.

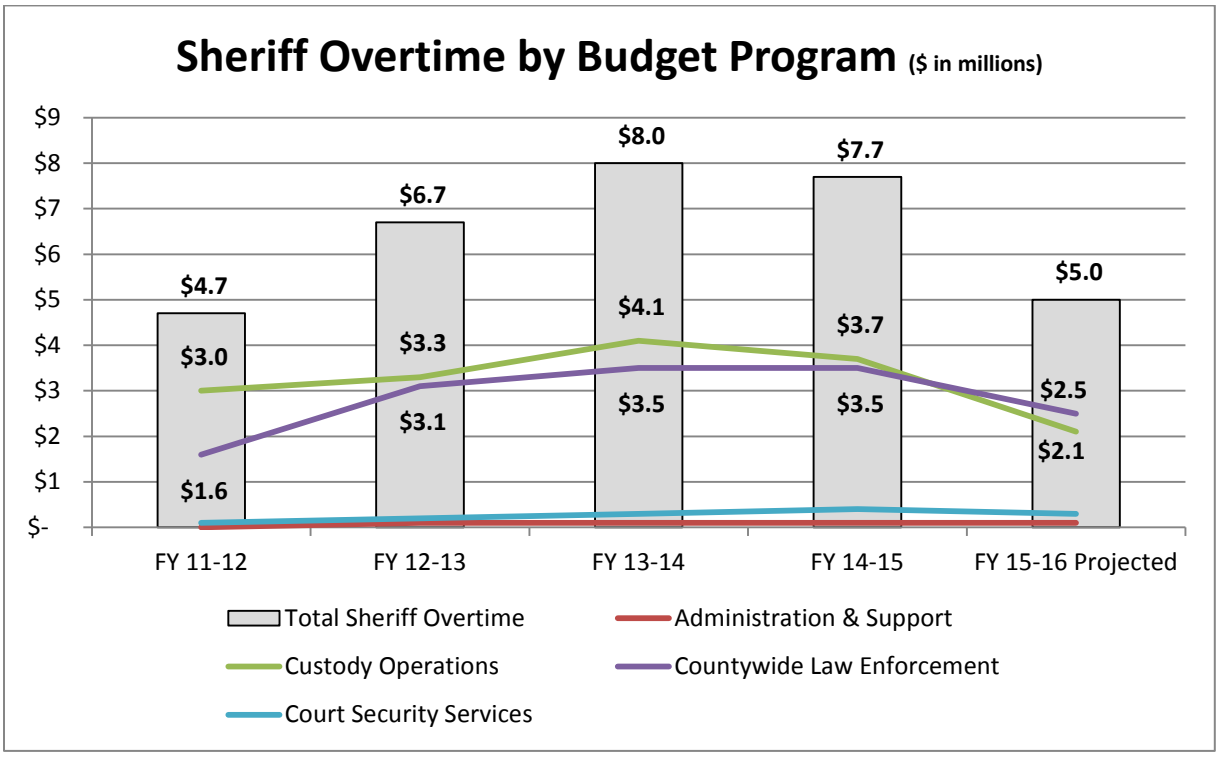
ADMHS also anticipates future audit settlements to decrease, however this depends largely on State audit procedures and application of billing rules.

15. Sheriff Overtime and Staffing Levels

Sheriff staffing levels affect overtime costs for custody and law enforcement operations which necessitate the usage of overtime to backfill 24/7 post positions to account for vacancies and training. This issue negatively impacts the budget as both overtime of existing staff and regular salaries of the new staff are being incurred simultaneously during training periods (6 months training for a Custody Deputy and 9 months for a Deputy).

During FYs 2012-13 and 2013-14 new hires increased significantly to 48 and 52, respectively, and overtime costs increased from $4.7 million in FY 2011-12 to $6.7 million in FY 2012-13 and $8.0 million in FY 2013-14. In 2014, the trend continued, with the Sheriff adding 59 new hires, and overspending the Board Adopted FY 2014-15 budget by approximately $2 million, mostly due to overtime costs of $7.7 million.

The following chart shows annual spending on overtime from FY 2011-12 thru FY 2014-15, both in total and by Budget Program, as well as projected FY 2015-16 spending. The current projection of $5.0 million in overtime for FY 2015-16 is $500 thousand over the $4.5 million budget.



Salary savings due to the vacancies are currently off-setting overtime costs in FY 2015-16, but if the Department fills these vacancies at a faster rate than separations, the savings will diminish, and overtime will also increase as staff is trained. As of October 2015, the Sheriff had only 7

Custody Deputy vacancies, but 18 Sheriff Deputy vacancies, (and 43 vacancies Department-wide). The CEO's Office will continue to work closely with Sheriff staff to monitor overtime usage; additionally, the Sheriff's Office management has taken a more proactive role in managing overtime including biweekly analysis and monthly meetings with cost center managers to review the use of overtime and the underlying causes.