Fiscal Outlook Report

County of Santa Barbara
November 13, 2012

INTRODUCTION

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

1. *Economic Outlook*
2. *Fiscal Issues*
3. *FY 2013-14 Projected Budget Gap*

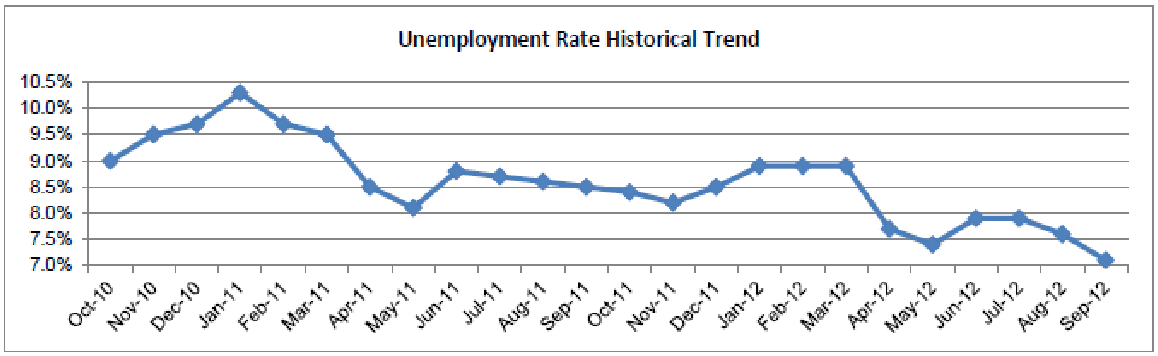
The *Economic Outlook* section describes current economic trends and projections at the federal and local levels. This outlook identifies leading economic indicators that drive the County's primary revenue sources such as property, sales, and transient occupancy taxes. This section serves as context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

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. The issues are summarized in table form and explained in narrative form below the summary tables.

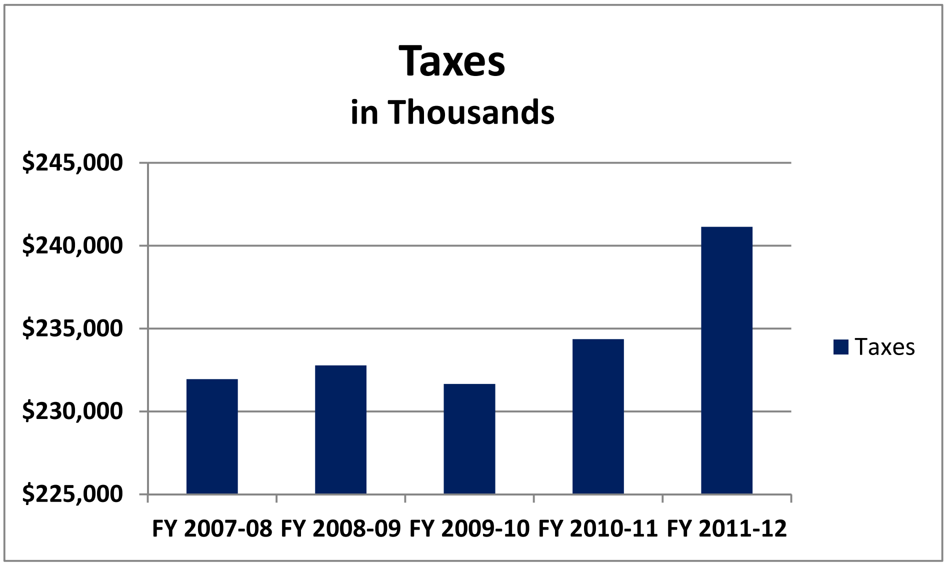
The *FY 2013-14 Projected Budget Gap* section shows the changes in revenue and expenditure assumptions that are expected to occur in the next fiscal year. The FY 2013-14 projected budget gap calculation does not include those fiscal issues that are unlikely to occur in the next fiscal year or already have identified funding sources such as grants or reserve funds. The budget gap calculation also excludes the costs associated with addressing fiscal issues on which the Board of Supervisors has yet to take action.

1. ECONOMIC OUTLOOK

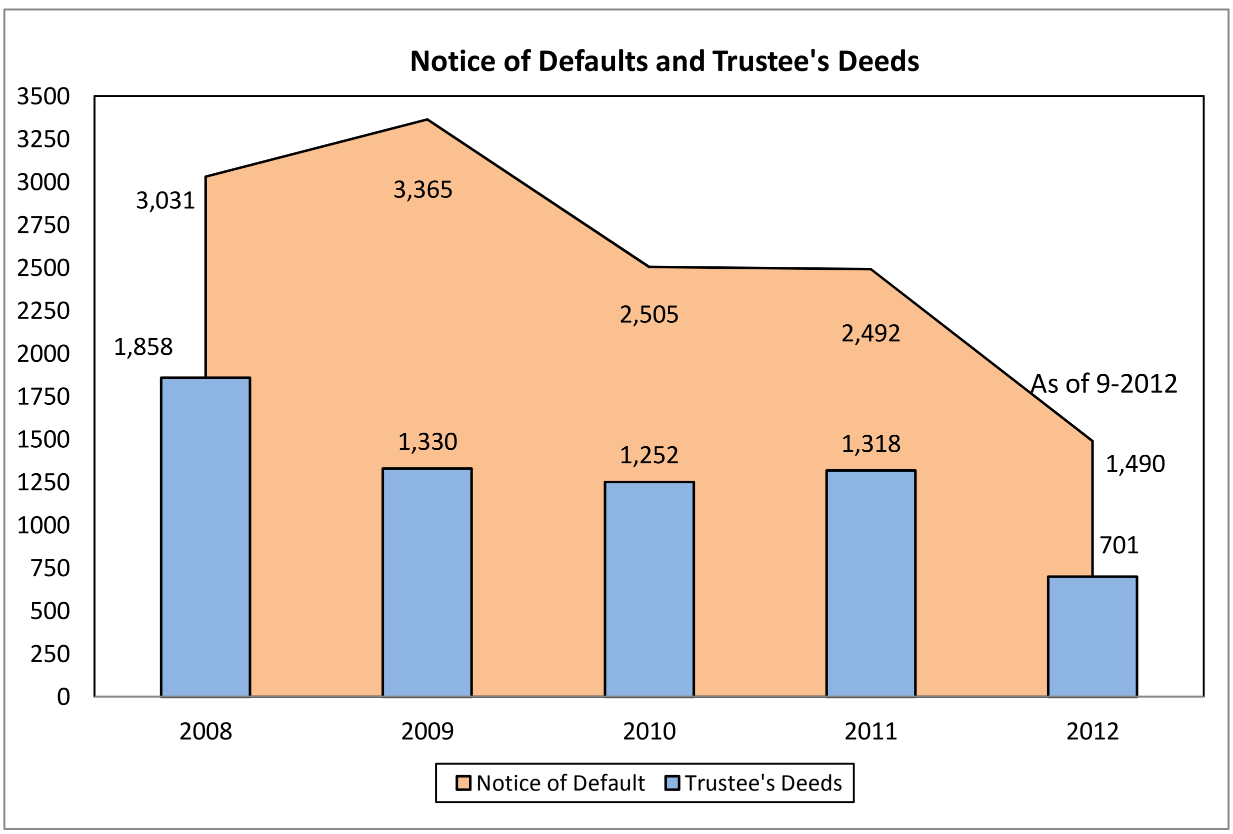
As highlighted in the Auditor Controller's August 29th Financial Highlights report, there have been twelve quarters of positive growth in the gross domestic product (GDP) at the national level and the County economy is starting to show evidence of emerging growth as consumer spending and tourism improved for the second consecutive year. County unemployment rates have continued to drop as September's 7.1% rate was down 1.5% from the previous September's rate of 8.6%. Increases in jobs in the construction, mining and leisure and hospitality sectors point to an increase in economic activity.



In the County, economic growth has increased slightly in FY 2011-12 with lower unemployment and a real estate market that has stabilized and appears to be recovering. The County's major revenues (property taxes, sales taxes, and transient occupancy taxes) had an overall 2.9% increase in FY 2011-12 and are expected to continue to increase slightly in FY 2012-13. Total property tax accounts, the County's largest discretionary revenue source, had an increase of 2.1% in FY 2011-12. Property taxes are estimated to grow by approximately 1.0% in FY 2012-13, well below the average growth rate of 8 percent over the past 30 years. Local sales tax increased by nearly 6% after a three-year decline, and Proposition 172, the statewide public safety ½-cent sales tax, increased 9.4%. Transient occupancy tax increased 8.5%. Despite signs of economic recovery in the County, proposed budgeted expenditures continue to grow at a faster rate than revenues.



The impact of the downturn in the housing market is illustrated by the following chart that shows the changes in the number of notices of defaults on mortgages and the numbers of trustee sales since 2008.



2. FISCAL ISSUES

A. General Fund Discretionary Revenue (in thousands):

Revenue Changes:	Incremental Change ($000's)	
Source	Recommended FY 2013-14	Proposed FY 2014-15
Property Tax Revenues	$ 2,519	$ 4,562
RDA Prop. Tax - Ongoing	2,525	82
Fire - Trans Tax	(884)	(824)
All Other Revenues	(1,710)	810
Impact on Gap	$ 2,451	$ 4,630

Property Taxes:

Santa Barbara will realize growth in Secured Property Taxes; however, the rate of growth is lower than was originally expected during budget preparation and adoption. This was due to the final tax roll for FY 2011-12 coming in lower than anticipated. This variance was communicated to the Board on June 1, 2012, at which time the potential reduction in projected growth to FY 2012-13 was estimated at $1.5 million. The current revised impact on FY 2012-13 is projected to be a negative $.7 million. This revised lower figure is now the starting point for estimating future growth. Secured Property Tax Growth, before consideration of the Fire Tax Transfer is now estimated at:

FY 2011-12 1.15%
FY 2012-13 1.0% (previous estimate 1.6%)
FY 2013-14 2.22%
FY 2014-15 2.62%

Positive leading indicators in property tax accounts are reflected in increased Property Transfer Fees ($.6 million) and Supplemental Property Taxes ($.2 million). Conversely, as property values stabilize and improve; revenues from Delinquent Fees are now declining (-$.6 million). The combined impact of changes in the major property tax accounts is currently projected to be a year over year increase of $2.5 million in FY 2013-14 and $4.6 million in FY 2014-15.

Redevelopment Agency Dissolution

On June 28, 2011, California Governor Brown signed into law ABX1 26 (the "Dissolution Bill") that eliminates all redevelopment agencies (RDA's) effective October 1, 2011. The Bill provides that upon dissolution of an RDA, a "successor agency" may be established to hold the assets until they are distributed to other units of state and local government after the payment of enforceable obligations that were in effect as of the signing of the Bill.

In summary, property tax transfers that previously were distributed to the RDA's will now be used to pay off existing debt of the former RDA's and the balance will be distributed to local government, special districts and schools. It is currently estimated that the County's tax increment from the dissolution will be $4.1 million in FY 2013-14, an increase of $2.5 million from the adopted FY 2012-13 budget and nominally increase to $4.2 million in FY 2014-15. This distribution will increase over time as existing debt of the prior RDA's is paid off. The Fire District also receives a distribution, which is estimated to be approximately $0.75 million in FY 2013-14. These estimates are based on currently known information; however, the effect of dissolution could change significantly based on subsequent actions of the State Controller and the California Department of Finance.

The RDA Dissolution related revenues described above are ongoing sources of revenue. In addition, there will be occasional one-time revenue distributions from the disposal of prior RDA assets. It is currently projected that unbudgeted one-time revenue of $2.0 million from the liquidation of housing cash balances will be received in FY 2012-13.

Property Tax Transfer – Fire District:
Included in the FY 2013-14 projections is the Fire District - Property Tax Transfer, whereby $5.9 million of prior General Fund allocation is now shifted to the Fire Department as part of the approved Fire District Property Tax Allocation. The allocation amount will incrementally increase by 25% of the growth in property tax each year until a full 17% of total countywide property tax is appropriated to the Fire District. The resulting increased property tax allocations to the Fire District are projected to be $0.88 million in FY 2013-14 and an incremental $0.82 million in FY 2014-15.

Other Revenues:
Net Discretionary General Fund Revenues from all other sources is projected to decrease $1.7 million in FY 2013-14 and is primarily the result of the elimination of Payments in Lieu of Taxes (PILT) program, negative $1.6 million.
PILT: The PILT program eligibility is reserved for local governments (usually rural counties) that contain nontaxable federal lands and provide vital government services, such as public safety, housing, social services and transportation. PILT seeks to compensate them for their support and foregoing tax revenue from these federal lands. The US Department of the Interior has announced "This year's PILT program is the last to be funded under the Emergency Economic Stabilization Act of 2008, which enacted a five-year authorization for funding full entitlement levels of the program".

Transient Occupancy Tax (TOT): FY 2013-14 TOT is projected to be down $0.3 million from the FY 2012-13 adopted budget. The current projection for FY 2012-13 TOT is $6.5 million, $0.62 million lower than the adopted budget of $7.1 million. This FY 2012-13 decline is the new baseline for future projections and is reflected in our reduced projections for FY 2013-14 and FY 2014-15.

Sales Taxes: Local Sales Taxes growth is currently projected at a modest $0.2 million (3%) in FY 2013-14 and is based on current trends.

Discretionary General Revenue Summary:				
Source	Adopted FY 2012-13	Current Est. FY 2012-13	Recommended FY 2013-14	Proposed FY 2014-15
Significant Property Taxes	174,902	174,059	177,421	181,983
RDA Dissolution Proceeds - One time	-	2,000	-	-
RDA Prop. Tax - Ongoing	1,555	4,000	4,080	4,162
Fire: Trans Tax	(5,900)	(5,900)	(6,784)	(7,608)
Subtotal Property Taxes	170,557	174,159	174,717	178,537
Cost Allocation Services	7,944	7,944	7,944	7,944
Local Sales Tax	7,096	7,096	7,309	7,601
Transient Occupancy Tax	7,120	6,500	6,825	7,166
Payments in Lieu of Tax	1,625	1,625	-	-
All Other (Franchise,interest, misc State)	8,015	8,222	8,013	8,189
Total Discretionary Revenues	**202,357**	**205,546**	**204,808**	**209,438**

B. Tier 1 Fiscal Issues:

Tier 1 Issues: Expected occurrence within the next two fiscal years				
	Issue	FY 2013-14 Impact (in millions)	FY 2014-15 Additional Impact (in millions)	Onetime or Ongoing
1	Pension Fund Stability	$ 6.7	$ 5.0	Ongoing
2	Expiration of Concession and Other Salary Changes	3.7	0.8	Ongoing
3	Health insurance	2.0	3.3	Ongoing
4	Workers' Compensation	1.9	-	Ongoing
5	Assessor Funding Gap	1.6	0.4	Ongoing
6	New Northern Branch Jail	1.3	1.3	Ongoing
7	Retiree Healthcare	0.7	0.7	Ongoing
	Total	**$ 17.9**	**$ 11.5**	

1. Pension Fund Stability

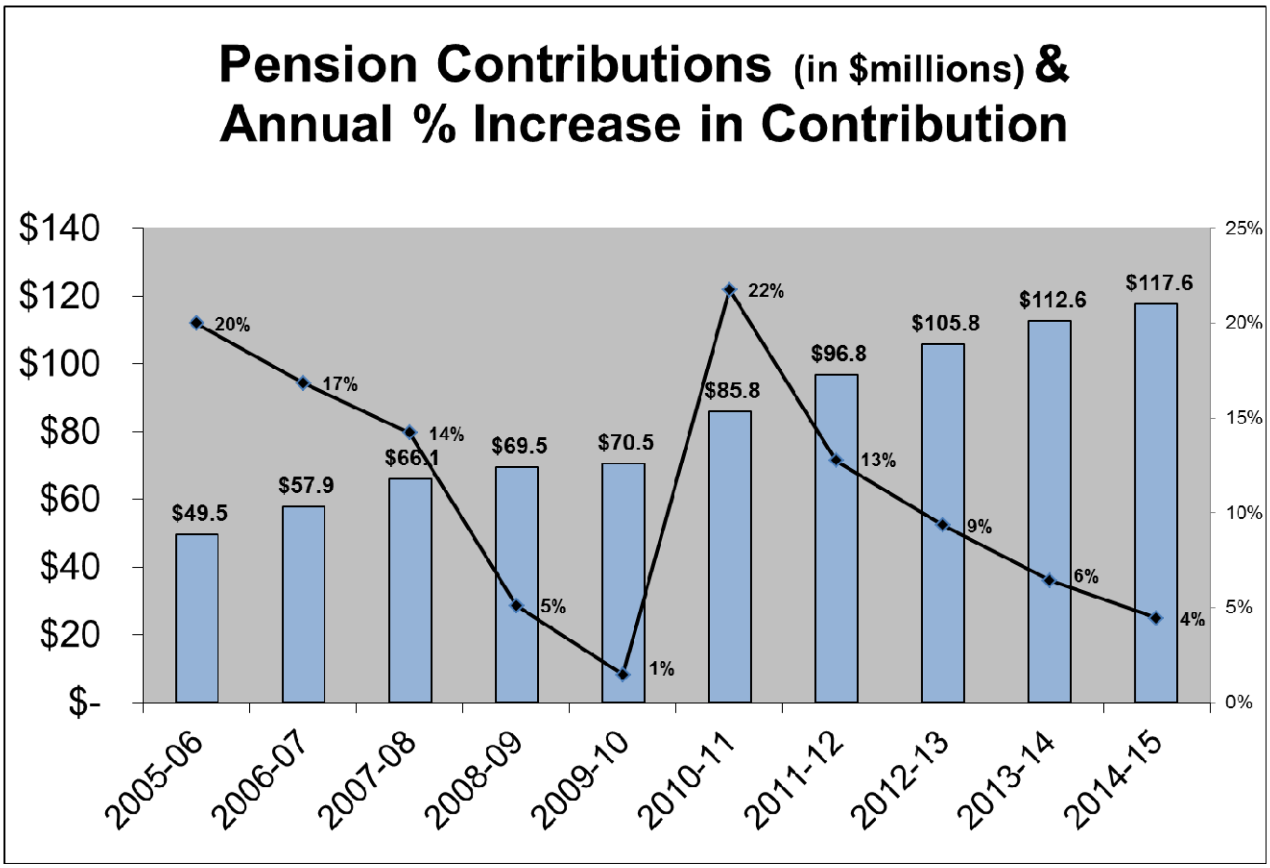
The Santa Barbara County Employees' Retirement System (SBCERS) administers a cost sharing multiple-employer defined benefit pension plan for the County of Santa Barbara. The County's pension costs have steadily increased since the beginning of the decade. Costs are projected to increase further as a result of investment returns underperforming the Board of Retirement adopted long-term assumed rate of return and changes to the principles and estimates used to generate the County's Annually Required Contribution (ARC) to the pension fund. It is anticipated that costs will increase again in FY 2013-14 and while we expect the growth in costs to be moderate, we believe that there is a high probability of continued growth in pension costs over the next five years. The County has made progress towards controlling costs, by negotiating changes to general plan member benefits. Safety plan benefit provisions are still pending collective bargaining negotiations.

Actual investment losses for the Retirement System in FY 2008-09 will be only partially mitigated by investment gains in FY 2009-10 and FY 2010-11, using a five-year smoothing method, and have a high probability to continue to increase employer costs based on the current assumed rate of return of 7.75%. This rate is anticipated to be decreased in the near term and will result in further increases to the rates.

In the October 2012 SBCERS actuarial valuation study, it was determined that the average contribution rates for General Plan members will be 31.7% and Safety members will be 56.8%, resulting in a weighted average contribution rate of 38.3%. The new rates result in a projected cost of $112.6 million for FY 2013-14. The increase over the FY 2012-13 adopted contribution of FY $105.8 million will be $6.7 million.

The Public Employees' Pension Reform Act of 2013 (PEPRA) will impact new employees hired after January 1, 2013 who have no prior reciprocal government employment as it changes several main components of the public employee retirement systems. Retirement provisions of

PEPRA include a 2% at age 62 for non-safety members and 2.7% at age 57 for safety members. Final compensation will be the highest average annual compensation over a three-year period. PEPRA would also require all new members to contribute at least 50 percent of the annual normal cost of their pension benefit. PEPRA establishes a cap on the amount of compensation that can be used to calculate a retirement benefit for all new members of a public retirement system equal initially to the Social Security wage index limit for employees who participate in Social Security or 120% of that limit if they do not participate in Social Security. PEPRA is expected to generate savings; however, the impact is currently unknown and these savings will gradually occur over time as new employees are hired. An actuarial study to determine the appropriate contribution rates for employees hired after January 1, 2013 is underway and is expected to be completed in late December 2012.



The above table displays the increase in retirement contribution costs over time. While the amounts continue to rise, the rate of increase is slowing based on staffing reductions, furloughs, wage freezes, increased employee retirement contributions and the amortization of large losses incurred in 2008 and 2009.

2. Expiration of Concession and Other Salary Changes

Concession agreements with bargaining units during FY 2011-12 included both permanent (e.g., elimination of scheduled pay increases, elimination of benefit allowances) and temporary (e.g., furlough, deferment of scheduled pay increases, and freezes on merit pay increases) components. The temporary concessions are set to expire at the end of FY 2012-13. The impact for FY 2013-14 is estimated to be $3.6 million and $0.8 million for FY 2014-15.

Expiration of Concession Agreements		
Bargaining Unit	FY 2013-14 Increase	FY 2014-15 Increase
Firefighters Local 2046	$ (0.6)	$ 0.8
SEIU Local 620	3.0	
Engineers & Technicians Association	0.3	
Deputy Sheriffs Association	0.8	
Sheriffs Managers Association	0.2	
SEIU Local 721	(0.3)	
All Other Bargaining Units	0.2	
Total	**$ 3.6**	**$ 0.8**

3. Health Insurance

Health insurance premiums continue to rise throughout the State. The primary driver of the increase is the rising cost of health care, as well as new regulatory requirements that increased to age twenty-six the eligibility for children to obtain health coverage through their parent's plan and the requirement for the health plan to cover specific types of care. As a result of ongoing efforts to improve employee health and keep rates low, the County's calendar year 2012 loss ratio (the difference between the cost of medical care and the amount of premiums paid to insurance plans) dropped to 90% from 159%. This was the primary contributor to the 2013 renewal rate of a relatively modest 4% increase. The federal Patient Protection and Affordable Care Act (ACA), goes into effect in January 2014 and therefore projecting future rates becomes more difficult. Based on the uncertainty surrounding the new ACA, CSAC-Excess Insurance Authority (EIA), a risk sharing pool of California public agencies, currently recommends a rate increase of 15.0%, in calendar year 2014, resulting in a $2 million increase using these blended rates (4% and 15%). This will result in a total estimated FY 2013-14 health insurance budget of $28.4 million. The projected increase for calendar year 2015 is expected to be a similar 15% increase over calendar year 2014. This will result in to a total estimated health insurance FY 2013-14 budget of $31.7 million.

4. Workers' Compensation

Last year, the Workers' Compensation (WC) fund had an unfunded liability of $4.2 million for claims incurred prior to 07/01/10 (tail claims). In an effort to stabilize the rates, it was determined to amortize this deficit over seven years at approximately $0.6 million per year. Amortization began in FY 2012-13. The current actuarial report for WC tail claims identified an increase in the expected ultimate liability of $4.0 million, bringing the total actuarial unfunded liability, after other minor adjustments, to $7.8 million at 06/30/12. To minimize the ongoing increase in rates, a one-time, FY 2012-13 mid-year adjustment of $1.5 million will be assessed to the departments, bringing the total WC FY 2012-13 cost to $13.2 million (adopted budget of $11.7 million + $1.5 million). Departments will be able to utilize health care benefit savings to fund the majority of this one-time assessment. The remainder of the unfunded liability will be recovered primarily through the six year amortization, which will now increase to $0.94 million per year. This will result in a total estimated WC FY 2013-14 budget of $13.6 million.

Risk Management has analyzed the claims data and found that the frequency of claims has been trending downward but the severity (cost per claim) of cases has been increasing. A plan to stem this negative trend in the severity of WC cases has been developed, and is now being executed. Progress on this plan will be communicated to the Risk Management Evaluation Team (RMET) on a quarterly basis.

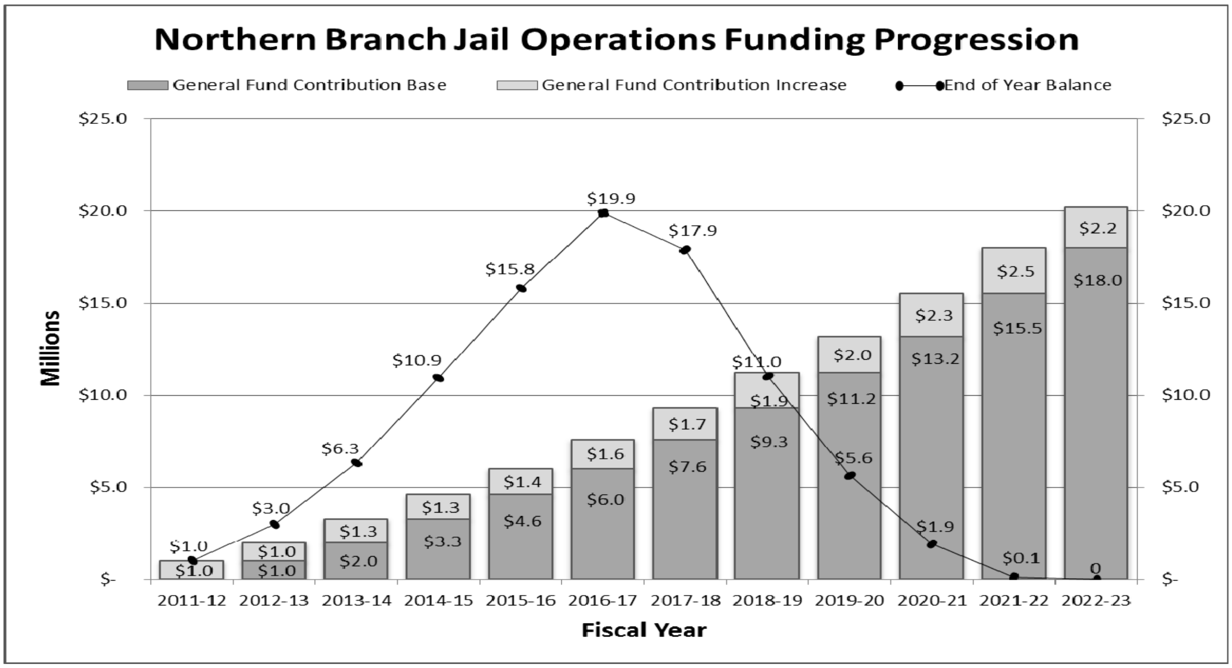
5. Assessor Funding Gap

The County is able to recover Property Tax Administration Fees, which represent a portion of its costs attributable to assessing, collecting, and allocating property tax revenues. Currently the percentage of recoverable costs from cities and special districts is roughly 25 percent of the net cost of property tax administration. The total amount of fees has decreased over recent years with the Assessor portion decreasing from $2.8 million in FY2010-11 to an estimated $1.7 million in FY 2013-14. Additionally, due to declining and/or flat housing prices, Supplemental Administration Fees have declined by $167,000 during this same period.

To mitigate the impact on service levels created by the funding gap, the Assessor has budgeted $1.1 million of one-time funding in their FY 2012-13 Budget. A $1.6 million gap is projected for FY 2013-14. Without additional funding it will be difficult for the Assessor to complete the assessment workload, likely negatively impacting the amount of property taxes generated. To partially mitigate the FY 2013-14 funding gap, a projected departmental fund balance of approximately $0.3 million may be available.

6. New Northern Branch Jail

Presently, the County is under a stipulated order to reduce jail overcrowding. The project scope is for a 376 bed jail facility, of which 32 beds are for medical and mental health. The facility will be built on a portion of the 50 acre property located at Black and Betteravia Roads just outside the City of Santa Maria. The construction cost of the project is estimated to be approximately $96.1 million and the annual operating cost is estimated at $17.3 million at the start of operations in FY 2017-18. Operating costs for the new jail are being accumulated through a General Fund North County Jail Operating Fund. The County developed a funding plan to set aside incrementally increasing amounts of General Fund to accommodate the estimated annual operational funding needs of the new jail. The table below demonstrates the incremental General Fund Contribution, the base General Fund Contribution and the ending Fund Balance of the New Jail Operating Fund.



Annual operating costs for the Northern Branch Jail, including debt service, are shown below:

2011-12 $ 0	2012-13 $ 0	2013-14 $ 0	2014-15 $ 0
2015-16 $ 1.1M	2016-17 $ 3.5M	2017-18 $11.4M	2018-19 $18.2M
2019-20 $18.7M	2020-21 $19.2M	2021-22 $19.8M	2022-23 $20.3M

In 2012, the County was awarded conditional funding from the State in the amount of $80 million for new jail construction, leaving a one-time capital cost to the County of approximately $9.7 million. The $9.7 million is estimated to be incurred over a 3-4 year period and could be financed through issuance of debt, the use of current County cash reserves, or a combination of both. In September 2012, the Board of Supervisors conceptually accepted the $80 million state grant and directed staff to return with the appropriate documentation to move forward with the project.

7. Retiree Healthcare

The Retirement System administers the County's cost sharing multiple-employer defined benefit post-employment healthcare plan (OPEB Plan). The OPEB Plan provides medical benefits to eligible retired County employees and their eligible dependents. The County currently determines the contribution rate to the Retirement System to fund the retiree medical program. The County has adopted an initial 3% employer contribution rate of covered payroll. This contribution is intended to cover annual premium costs of the plan. It is estimated that the County contribution will remain at $8.7 million in FY 2013-14 in order to keep up with the current "Pay-as-you-Go" funding method.

The "Pay as you Go" method of financing requires contributions to the plan that are generally made at the same time and amount as benefit payments and expenses become due. While providing near-term budgetary relief, the policy trade-offs of funding on a "Pay as you Go" basis create the following significant fiscal issues:

- The County is required to recognize a liability for the retiree medical program in its financial statements;
- The County is not being reimbursed for the full cost of administering State and federally funded programs; and
- The County is not able to take advantage of more favorable actuarial assumptions that would lower the expense of the program over time.

The result of the County's "Pay as you Go" funding approach is that the County's total unfunded liability for retiree medical benefits was $172.1 million at the end of FY 2011-12. It is recommended and reflected in this report that the contribution rate be increased by 0.25% per year, or $0.7 million, annually in order to gradually increase funding and reduce this liability.

C. Tier 2 Fiscal Issues:

Tier 2 Issues: Probable occurrence within the next two fiscal years				
	Issue	FY 2013-14 Impact (in millions)	FY 2014-15 Additional Impact (in millions)	Onetime or Ongoing
8	Social Services Mandate Match	$ 4.2	Unknown	Ongoing
9	Property Tax Administration Fee	4.1	0.5	Onetime + $0.5M Ongoing
10	Mental Health and Partner Agencies Medi-Cal Billing Exposure	2.8	-	Onetime
11	Mental Health Services Act	2.5	Unknown	Ongoing
12	Deferred Maintenance Backlog	2.0	2.0	Ongoing
13	Public Health Declining Revenue	2.0	1.5	Ongoing
14	2005 Emergency Storm Damage Repair - Second FEMA Appeal – Audit Report	1.1	-	Onetime
15	Fire Department Increased Salary/Benefit Costs	-	1.6	Ongoing
16	ADMHS Cost Report Settlement Issues	Unknown	Unknown	Onetime
17	Health Care Reform Act (ADMHS, DSS, PH)	Unknown	Unknown	Ongoing
	Total	**$ 18.7**	**$ 5.6**	

8. Social Services Mandate Match

The Department of Social Services (DSS) continues to experience caseload growth in many programs as a result of the recessionary economy. Compounding the issue is the State's "Cost of Doing Business" funding cap. Contributions for increases in administration and overhead expenses have been frozen by the State at 2001 levels. In past years, DSS has used fund balances to close gaps between expenditures and revenues. However, DSS anticipates that most, if not all, discretionary fund balances will be depleted in FY 2012-13, leaving an estimated funding shortfall of $4.2 million in FY 2013-14. Based on the difficulty in determining this figure, the amount has been included as a Tier 2 item as previous estimates have not materialized.

The FY 2012-13 adopted budget includes a local match of $24.0 million. This local match provides the required matching monies to fund DSS's mandatory programs including Child Welfare Services, Adult Services, Foster Care, Adoptions, CalWORKs and CalFresh. The $24.0 million local match is made up of County General Fund Contribution, Realignment Revenue, Miscellaneous Revenue and about $4.7 million of DSS' Special Revenue funds to meet the required match.

9. Property Tax Administration Fee

Forty-seven cities in Los Angeles County brought a lawsuit against the County of Los Angeles regarding the calculation of Property Tax Administration Fees (PTAF). The legal issue in dispute is whether counties can include "flip" and "swap" revenues in the calculation of administrative costs that counties recover from cities. The Court of Appeal of the State of California issued a decision in favor of the cities; however, the County of Los Angeles appealed to and was granted review by the California Supreme Court.

The pending decision from the Court will be significant for the County of Santa Barbara because there are similar claims against this County. The potential annual negative financial impact to the County related to the outcome of this case is approximately $0.5 million. The one-time amount of PTAF exposure for FY 06-07 through FY 2013-14 is approximately $4.1 million plus any possible interest.

10. Mental Health and Partner Agencies Medi-Cal Billing Exposure

Santa Barbara County received federal and State funding to implement a “system of care” known as the Multi-agency Integrated System of Care (MISC). The initiative served ADMHS child and adolescent clients with mental health needs who were also clients of the Santa Barbara County Departments of Probation, Public Health or Social Services. The grant program ended in 1999, but the Santa Barbara County program continued using Medi-Cal as a funding source.

A State Department of Mental Health (DMH) audit made a finding that the portion of costs billed under the Medi-Cal program by the Departments of Probation, Public Health and Social Services were disallowed. The remaining audit years for which the County faces a MISC liability are FY 2006-07 through December 2008. While the State audits for these years are not yet completed, if these costs are again disallowed, the County will once again appeal these findings. Staff has estimated a total potential liability of $4.7M for these remaining years. The $4.7M estimated liability is currently reserved; $1.9 million is budgeted to be paid in FY 2012-13, leaving a balance of $2.8 million to be paid in FY 2013-14. However, the contingent liability amounts are subject to the State’s final audit and could change.

11. Mental Health Services Act (MHSA)

ADMHS began drawing down MHSA funds (Proposition 63) in FY 2011-12, when its annual Community Services and Support (CSS) allocation dropped significantly (from $10.5 million in FY 2009-10 to $8.6 million in FY 2011-12). ADMHS’ adopted budget for FY 2012-13 anticipates continued use of these funds. At the end of FY 2012-13, the MHSA reserve balance is projected to be $3.1 million.

In FY 2013-14, without program changes, the MHSA Fund Balance will be fully expended, leaving MHSA with an estimated FY 2013-14 deficit of $2.5 million. For FY 2014-15, the total MHSA funding shortfall is uncertain, in part due to the Affordable Care Act (Healthcare Reform).

12. Deferred Maintenance Backlog

The current unfunded backlog for the County of Santa Barbara is estimated at $291.5 million. This includes: Public Works Transportation Division, estimated at just over $250 million; General Services Department, estimated at $30 million for County facilities; and the Community Services Department, with estimated deferred maintenance for County Parks of $11.5 million. The unfunded backlog for County facilities and infrastructure are projected to continue to grow. The CEO's office is revising its Capital Improvement Program to include a section on "Ongoing County-wide Maintenance Needs" which will be the basis for developing a long term plan to address the growing countywide increase in unmet maintenance needs. An amount of $2.0 million per year was added to this report to highlight the fact that funding is needed but a full analysis is needed before a specific funding plan can be proposed.

13. Public Health Declining Revenue

Counties are mandated by the State to provide healthcare to residents who are indigent or have limited ability to pay for health care services. To meet this mandate Public Health operates nine clinics and contracts with other health care providers to service approximately 32,000 patients annually. The Department has been impacted by declining revenue sources for the indigent patients, the declining number of patient visits, and an increasingly unfavorable "payer mix" (percentage of patients with various reimbursement sources versus those without any funding sources). The Public Health Department projects that this issue could result in a reduction in Medi-Cal clinical revenue of approximately $2 million for FY 2013-14 and approximately $1.5 million in FY 2014-15.

In order to address the impacts, the department is implementing a number of internal actions in order to mitigate this potential ongoing loss of revenue and watching several uncertainties that could impact revenues, such as health care reform and State budget reductions. Options to address this could include scaling back primary care clinical services but due to the potential need for greater clinic capacity if the Affordable Care Act (ACA) is implemented in January 2014, this would be problematic.

If the negative trends continue without appropriate mitigating actions, such as increased funding or the reduction of certain services provided, the Department's special revenue fund balance may be depleted as early as FY 2015-16, resulting in the need for a significant contraction of clinic services.

14. 2005 Emergency Storm Damage Repair

The amount in dispute at this time is $1.7 million. The majority of the findings ($1.2 million) related to purchasing procedures by Roads Division used during the storm. An additional finding ($0.5 million) related to the amount of work Flood Control Division provided after the storm period.

Public Works has requested re-obligation of $1.1 million in road repairs supported by additional documentation. The amount related to Flood Control work was not disputed as no additional information could be provided. The Department will utilize existing fund balance to pay for the undisputed reimbursements. If the appeal is unsuccessful, the repayment would be made from a combination of existing fund balance and a realignment of ongoing departmental funding.

15. Fire Department Increased Salary/Benefit Costs

Increasing salary and benefit costs of 6.9% in FY 2013-14 are associated with previously negotiated wage increases and rising retirement costs. For FY 2012-13, the property tax transfer is $5.9 million which will be in lieu of the General Fund Contribution to the Fire District. The transfer will increase incrementally every year (25% of total General Fund growth) until the Fire District's share of property taxes is 17%. The Fire District also anticipates receiving $0.75 million in un-budgeted Redevelopment Agency dissolution tax increment for FY 2013-14 (see discussion in General Fund Discretionary Revenue section). These revenue increases will partially offset rising costs but are not projected to close the funding gap until FY 2016-17. The Fire District's fund balance will offset the projected FY 2013-14 operating deficit of $1.6 million. The anticipated operating deficit of $1.8M in FY 2014-15 will deplete the estimated remaining fund balance of $0.2 million in FY 2014-15 leaving a $1.6M gap.

16. ADMHS Cost Report Settlement Issues

The County has liability exposure with each fiscal year's cost report that is submitted to the State, until the cost reports are audited by the State. In the County's Comprehensive Annual Financial Report (CAFR) ending June 30, 2012, the County's accrued liability related to mental health cost reports through FY 2008-09 is approximately $3.2 million. These funds have been set aside in the committed fund balance-Audit Exceptions and are budgeted to be paid in FY 2012-13.

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 2009-10 and subsequent periods will not be as large as in prior years. In the FY 2013-15 Recommended Budget Policies, additional funding of the audit exception reserve was recommended to provide funding for such future State settlements and we will be including a re-allocation of existing or newly available funds to establish an amount for such future needs. This will be viewed as a one-time allocation of funds rather than ongoing.

17. Health Care Reform Act

The federal Patient Protection and Affordable Care Act (ACA), also referred to as Health Care Reform, was signed into law on March 23, 2010 and established comprehensive health insurance reforms that will roll out over several years with most changes taking place by 2014.

The major element of the ACA is the expansion of health coverage to individuals who were previously uninsured, including the expansion of Medicaid, the federal health insurance for people with low incomes. The Medicaid expansion, which will take effect on January 1, 2014, will impact the Alcohol, Drug and Mental Health Services (ADMHS), Department of Social Services and the Public Health Departments, all of which provide enrollment, health services and substance abuse services to Medicaid, Medi-Cal and indigent beneficiaries.

The ACA presents many opportunities and challenges for these three County departments. These changes include the possibility of an increase in demand for services, and increased expenditures to provide for services. All three departments anticipate higher revenues correlated with the demand, as federal funds will cover 100% of costs for the first three years, and 90% thereafter. However, sources of revenue to cover the future costs of providing services and funding for other program not related to the ACA are uncertain at this time.

Alcohol Drug and Mental Health: The Department estimates 1,500 to 1,900 newly eligible clients for the Alcohol and Drug Programs (ADP). Estimates for newly eligible Medi-Cal Mental Health clients are between 1,100 to 1,400. A significant share of costs for Medi-Cal covered residents under the expansion will now be covered through an increase in federal funds to ADMHS; however these increases may result in reductions to existing revenues, such as realignment, MHSA and other funding sources currently being used to cover the uninsured.

Department of Social Services (DSS): It is estimated that Santa Barbara County has approximately 35,000 uninsured residents (22,000 current clients and 13,000 potential new); of which some are currently under the County Medically Indigent Adult (MIA) program (no Medi-Cal) and some are in the Healthy Families program. These non Medi-Cal clients as well as other uninsured will be entering the system under the Medi-Cal expansion program. The Department expects they will continue to receive the same 100% funding for eligibility services as we currently receive under Medi-Cal.

Public Health Department: (PHD) Many of the patients currently seen by PHD as uninsured and MIA will have a reimbursement source if the health insurance mandate and Medicaid expansion components of the Affordable Care Act are implemented. Newly covered individuals, currently estimated at 1,100 may now seek care at PHD Health Care Centers. This would generate significant new revenue for the PHD. There is concern that the State will reduce or eliminate current funding for programs for the uninsured residents because the previously uninsured clients are now covered by ACA.

3. FY 2013-14 PROJECTED BUDGET GAP

FY 2013-14 Projected Budget Gap		
GAP SUMMARY:		**Total Gap**
Revenue Changes	**$**	**8.1**
Expenditure Changes		**(17.9)**
Use of One Time		**(2.6)**
Projected Budget Gap	**$**	**(12.4)**
Detail of Revenue Changes		
State/fed reimbursement for S & B increases	$	5.7
State Redevelopment Agency Dissolution		2.5
Property Tax Revenues		2.5
Fire District Property Tax Transfer		(0.9)
All Other Revenues		(1.7)
	$	8.1
Detail of Expenditure Changes		
Pension Fund Stability	$	6.7
Expiration: Concessions & Salary Changes		3.7
Health insurance		2.0
Workers' Compensation		1.9
Assessor Funding Gap		1.6
New Northern Branch Jail		1.3
Retiree Healthcare		0.7
	$	17.9

Final Comments:

The projected FY 2013-14 gap of $12.4 million is $2.8 million less than last year's gap of $15.2 million. This is significant in that the FY 2012-13 gap had a net positive impact of concession savings of $8.9 million that does not recur in FY 2013-14. As budgets are developed, it's important to recall that the following funding sources will help address departmental funding needs:

- $7.6 million of FY 2011-12 savings now added to the Strategic Reserve
- $5.1 million of FY 2011-12 concession savings has been set aside in a committed fund balance to help address FY 2013-14 or future funding needs.

- The FY 2012-13 beginning balances of Proposition 172, Public Safety and Local Safety Realignment committed fund balances of $5.6 million are available for certain departments and will help to address various funding needs in FY 2012-13 and future years.
- Concession savings for the Sheriff and Fire Departments of approximately $4 million from FY 2011-12 were left in these departments to address their current (FY 2012-13) and future funding needs.
- $2.1 million earmarked for facilities maintenance is available and could be used to address the deferred maintenance backlog (item #12) once the projects have been prioritized.

All of the above factors will be taken into account in developing the FY 2013-14 and FY 2014-15 recommended and proposed budgets.