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November 13, 2012

Marin County Board of Supervisors
3501 Civic Center Drive
San Rafael, CA 94903

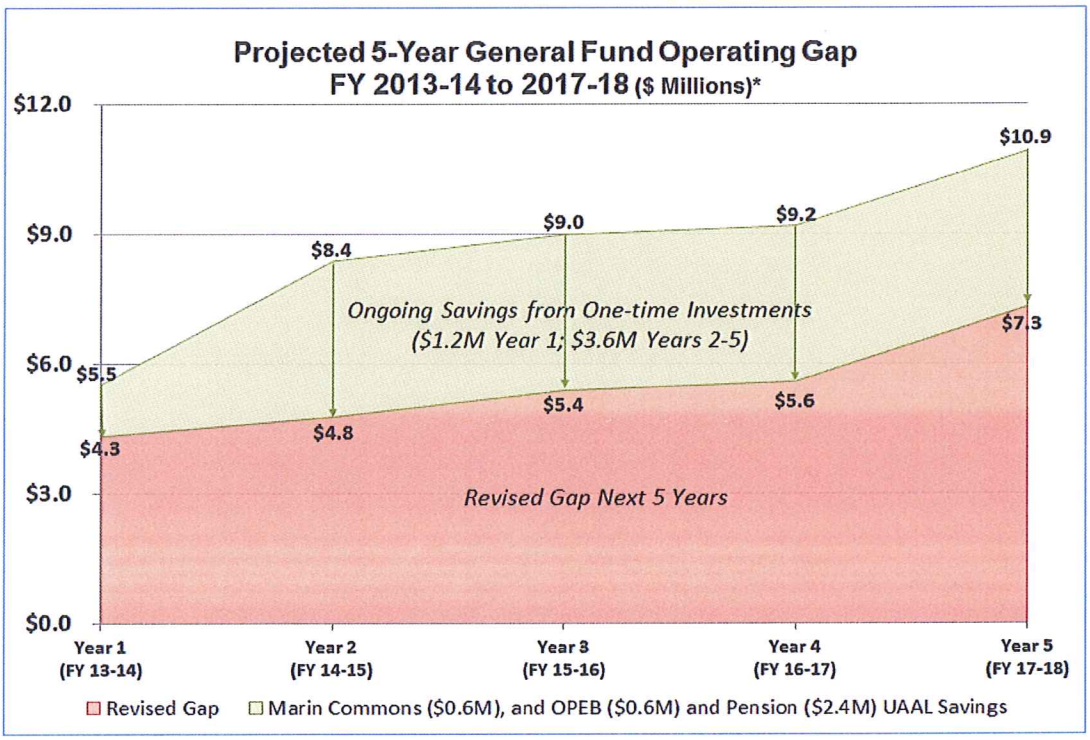
SUBJECT: Report Concerning FY 2013-14 Budget Planning

Dear Board Members:

RECOMMENDATION: Accept report concerning FY 2013-14 budget planning and approve next steps regarding budget instructions

BUDGET OVERVIEW

Our financial outlook is improving, but the risk of State and Federal cuts remain. Because of your Board's past budget actions, the County's financial outlook is improving. We have reduced our annual spending by over $30 million and reduced our workforce by 11% over the past 4 years. Your Board's direction to accelerate payments for our unfunded retiree liabilities will substantially reduce our future costs. As a result, our projected budget gaps below are smaller and we are more structurally balanced than we have been in some time.



**Salary and benefit projections assume known COLA's FY 2013-14 and FY 2014-15 consistent with annual Consumer Price Index (CPI) adjustments per California Dept of Finance forecasts; most bargaining unit agreements expire June, 2015. Approximately 2.0% CPI projections beyond FY 2014-15 are for planning purposes only and do not indicate a commitment or ability to fund. Projections do not include any state or federal budget reductions; do not include statewide pension reform savings; and assume continued slow growth in the economy.*

The chart on the previous page illustrates our updated 5-year General Fund operating budget projections. Projected budget gaps are indicated in red, illustrating relative stability after FY 2013-14, though risks remain. We also present in green estimated savings from paying down our unfunded liabilities and generating new revenue with the prudent investment of one-time reserves; these investments will shift down the County's projected budget gaps by reducing our ongoing costs. Absent your Board's decision to utilize one-time reserves and set-asides to reduce our future year budget gaps, our projected operating deficits would have been $1.2 million greater next year – and $3.6 million greater after FY 2013-14 (or years 2-5 in our forecast).

Increased benefit costs and significantly reduced annual growth in property tax collections have largely contributed to the County's budget gap in recent years – both driven by the economic downturn. Continued slow property tax growth of 1.0%-2.5% annually over the next five years, combined with continued growth in benefit costs as well as new COLA commitments through FY 2014-15, will drive our budget gaps going forward, though at a more moderated pace than in recent years.

Investment of One-Time Sources Results in Ongoing Savings
As outlined above, we are recommending the investment of one-time reserves and set-asides to save ongoing costs in a countywide effort to reduce our future year operating gaps. These include the following investments:

- Paying down our Other Post-Employment Benefits (OPEB) unfunded liability by approximately $14 million this fiscal year will reduce the County's annual required contribution by an estimated $0.6 million effective FY 2013-14.
- Paying down approximately $32 million of our unfunded pension liability this year will reduce the County's required pension contribution by an additional $2.4 million effective FY 2014-15.
- Finally, utilizing one-time reserves to facilitate new ongoing revenues to the County from private lessees at the new Marin Commons facility will generate an additional $0.6 million to the County.

Recalling that our initial 5-year LTR projection for FY 2009-10 indicated a roughly $50M deficit over five years, and largely did not assume COLA adjustments, our future year gaps are clearly getting smaller. While there is still work to do, the County has done much in the last four years to adapt to the economic downturn with disciplined leadership from your Board and the cooperation and inventiveness of department heads and their staff. The good news is that our financial outlook is improving, though risks remain.

Risk of State and Federal Cuts Remain
Not included in our multi-year projections are the yet unknown impacts of future State and Federal revenue reductions. Many of the County's safety net services are largely supported by State and Federal funds. Continued State budget difficulty is likely to result in additional funding reductions, even with passage last week of the Governor's Proposition 30 revenue ballot measure.

Because more than 30% of County services are funded by the State, additional budget cuts are likely to result in a reduced level of safety net and other services that

the County is able to provide to residents. The County simply does not have the capacity to backfill the portfolio of programs currently funded by, and often performed on behalf of, the State. It has also become clear that significant Federal reductions are likely in coming years as pressure builds to address the nation's growing debt burden.

While it is still early, we anticipate a projected State budget deficit likely in excess of $5 billion for FY 2013-14. Many of the same programs that have been threatened for the past 4-5 years will likely again face threat of reduction or elimination. The Governor may also propose another phase of realigned programs to counties for FY 2013-14. We maintain approximately $5 million in one-time State Budget reserves to help us establish a glide path in the event the County suffers significant cuts to critical State or Federally-funded programs without sufficient time to transition to a lower level of service.

FIVE KEY STRATEGIES TOWARD A BALANCED BUDGET

With a projected General Fund operating gap in the next fiscal year of $4.3 million – or about 1% of our operating budget – and a projected 5-year cumulative deficit of $7.3 million inclusive of CPI-level COLA assumptions, we are recommending several strategies in the coming budget process to maintain our momentum toward fiscal sustainability. Five key strategies to reduce our budget gap for FY 2013-14 include the following:

I. **Investments to pay down our unfunded retiree liabilities with $46 million in one-time reserves and set-asides**, which will reduce our ongoing budget $3.0 million annually by FY 2014-15

As a separate item on your Board's current agenda, we are recommending the investment of $32.2 million of these one-time reserves and set-asides to pay down the County's current $370 million unfunded pension liability. We will return to your Board in January with a recommendation to invest the remaining $13.8 million in the County's new Other Post-Employment Benefits Trust once we have concluded our request for proposals (RFP) evaluation of potential trust providers.

Our 5-year General Fund operating budget projections assume an overall savings of $3.0 million annually beginning FY 2014-15 as a result of paying down these unfunded retiree liabilities. This is a significant reason that the FY 2014-15 budget gap (the second year in our five-year forecast) has been reduced to $4.8 million relative to our spring, 2012 forecast of $9.6 million. Paying down our unfunded retiree liabilities with these one-time reserves and set-asides will reduce the County's annual required contribution in future years, mitigating the extent of budget reductions required to balance our budget while also protecting benefits that employees plan on for their retirement.

II. **New ongoing revenue to the County from private lessees at the new Marin Commons facility**, which will generate $0.6 million in new revenue next year

In November of 2011, when your Board authorized the purchase of 1600 Los Gamos Drive for the Emergency Operations Facility ("EOF") Project, staff outlined project funding sources. The project budget included dedicating

existing lease revenues and issuing a private financing so the existing revenues could be used to fund capital improvements to the facility. To save financing costs and reduce future budget shortfalls, we are now instead recommending the use of one-time reserves to cover these costs and dedicate these future lease revenues to help close future General Fund budget shortfalls, starting with the projected FY 2013-14 budget gap.

This approach saves County costs of working with a financial advisor and bond counsel for a placement of funds through a private borrowing mechanism, as well as interest costs. As a result, the use of $3.9 million in one-time reserves for this purpose, recommended as a separate item on your Board's current agenda, is anticipated to save an additional $0.6 million annually as the General Fund would begin receiving these revenues effective this fiscal year.

III. **A 5th phase of our Voluntary Separation Incentive Program (VSIP)** to accelerate attrition and facilitate departmental restructuring

In October, your Board authorized a new phase of VSIP Countywide to incent additional attrition as a component of the FY 2013-14 budget process. Similar to the last VSIP program, this will be the last VSIP opportunity for at least the next two years.

This 5th phase of VSIP opened Countywide November 5, 2012 with the application period closing Monday, December 3, 2012. Departments are encouraged to consider VSIP applications within their departments as potential 5% NCC reduction options. In recognition that departments have been reducing their budgets for the past several years, potentially making it more difficult to reduce a full position, the VSIP program was modified to allow departments to utilize the VSIP as long as the reduction achieves an ongoing savings of at least 50% of the value of the separating employee's position. This modification to the program guidelines provides more flexibility in ensuring a successful program, as well as better enabling reorganization or restructuring opportunities for departments.

This 5th phase of the VSIP program is timed to provide certainty about VSIP attrition prior to your Board's March, 2013 budget workshops. This allows departments to review VSIP applications prior to development of their 5% net county cost reduction options for FY 2013-14.

IV. **Long-term restructuring policy options,** of which up to 28 remain from last year's restructuring process

Last year's budget planning and long-term restructuring (LTR) process included an assessment of each department's future services and programs, and development of a department strategic plan vision for the next 5 years. Looking ahead to FY 2013-14 and later, we will continue working with departments to consider the viability of up to 28 remaining long-term restructuring policy options as additional options for departments to meet their 5% NCC reduction targets.

V. **New 5% Net County Cost (NCC) reduction options from departments**

Departments are requested to prepare potential reduction options by February 4th as part of the FY 2013-14 budget process. As in prior years, cost-covered departments will be excluded unless they wish to participate since they do not rely on net county costs to fund their programs. Because we are not recommending an across-the-board approach to budget reductions, we anticipate an average of approximately 3% NCC reductions to departments. These 5% NCC reduction scenarios should generate approximately $7 million overall in options to address our projected $4.3 million operating gap next year, which again could also include VSIP or long-term restructuring policy options which can be implemented next year.

We plan to work with departments and the Board to prioritize these reduction options in February and March, ultimately working to recommend a subset that best reflects our priorities and values with a sustainable operating budget in mind. Vacant or non-salary reduction options would be recommended for Board adoption during the March budget workshops (with reductions effective July 1st). In addition, a list of contingency options may be presented to the Board in March for consideration to ultimately close any remainder of the budget gap not resolved with the strategies outlined above as part of Final Budget consideration in June.

Department Credit toward Future Budget Reductions
Departments may consider any combination of VSIP, LTR and/or other ongoing departmental net county cost reduction options as they submit their 5% NCC reduction scenarios at the beginning of February. We once again recommend that departments exceeding their 5% NCC reduction target with ongoing reductions for FY 2013-14 receive credit toward future budget reductions on a dollar-for-dollar basis.

CONSIDERATION OF POLICIES TO ADDRESS UNFUNDED PENSION AND ROAD MAINTENANCE
Going forward, we are also considering new budget policies or strategies to ensure increased funding toward the County's unfunded liabilities in pension and road maintenance. Based on Board policy or direction, potential policy options for your consideration include the following:

- **Dedication of PEPRA Savings to Increase Pension Funding Ratio**
  To further your Board's policy direction to accelerate payments toward our unfunded pension liability, staff is asking your Board to consider a policy to dedicate all Public Employees' Pension Reform Act of 2013 (PEPRA) savings toward further paying down the County's unfunded pension liability for the next five years. We anticipate returning to your Board in December with an estimate from our Actuary of the PEPRA savings.

  For reference, the County's current funding ratio is 74.2% as of MCERA's June 30, 2011 valuation. We anticipate that your Board's direction to pay down $32 million of our current unfunded liability this fiscal year would improve our funded ratio to approximately 76.4% (all else remaining the same).

- **Dedication of 50% of Year-end Fund Balance to Road Maintenance**
  Given the County's unfunded roads maintenance liability, the County could also consider a policy to allocate 50% of any year-end fund balance in excess of $20 million to address deferred road maintenance. These investments in County roads maintenance would help achieve the Board's goal of improving our Pavement Condition Index (PCI) from its current 54 level over the next five years.

  We anticipate that such a policy could result in a $15-$25 million additional contribution to roads maintenance over the next five years, at which time your Board could reevaluate the policy.

At this time, we recommend that your Board authorize staff to issue budget instructions for FY 2013-14 to departments by month's end including the key strategies outlined in this staff report to close our projected operating gap next year.

Please let me know if you have any questions or concerns.

Respectfully submitted,

Daniel Eilerman
Deputy County Administrator

Reviewed by:

Matthew H. Hymel
County Administrator