COUNTY OF MARIN

OFFICE OF THE
# COUNTY ADMINISTRATOR

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December 5, 2017

Marin County Board of Supervisors
3501 Civic Center Drive
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**SUBJECT:** Report from the County Administrator concerning the FY 2018-20 budget process

Dear Supervisors:

**RECOMMENDATION:**

1. Accept the County Administrator's report
2. Approve next steps for the FY 2018-20 budget process

## OVERVIEW

We are now beginning to develop our two-year budget for FY 2018-20. Departments are working on budget reduction options and additional budget instructions will be distributed this month. We will be updating your Board over the next few months and recommending a plan to close our two-year budget gap at the end of March. The final budget will be adopted in June.

Last June, your Board approved a $440 million General Fund budget and a $555 million all funds budget. The General Fund budget included over $10 million in discretionary payments to the county's retiree health trust as well as cost of living salary adjustments and increased County contributions for employee healthcare insurance.

In recent years, all three independent bond rating agencies have affirmed Marin County's AAA rating, citing a strong local economy, sound fiscal management and a proactive approach to reducing unfunded liabilities. Over the past five years, our unfunded retiree liabilities have declined by over $200 million as a result of strong investment earnings and over $90 million in discretionary payments to reduce our unfunded obligations.

## STABLE ECONOMIC OUTLOOK

The California Legislative Analyst Office (LAO) recently released their annual Fiscal Outlook which included a relatively positive short-term outlook for the State budget and continued economic expansion across the country. Although the LAO expects national job growth rates and investment market performance to slow, the overall fiscal environment is expected to be stable and wages are expected to grow in the next year. The key uncertainties noted in the LAO report are related to federal policies; specifically, tax reform, healthcare reform, and international trade.

Other economic forecasts have provided similar guidance. According to a recent presentation by Beacon Economics, the underlying fundamentals of the U.S. economy are stable and California continues to be a driving force for the sustained job market strength and GDP growth. According to their report, the economy is near full employment and the primary limitations on continued expansion in California are labor force supply and new housing units. The Marin Economic Forum recently delivered an economic forecast presentation for the local economy that had similar themes. Dr. Eyler noted that labor force and housing shortages in the Bay Area will continue to hinder economic growth, but the likelihood of a recession before 2020 has significantly declined.

Economic indicators for Marin County remain very positive. In terms of unemployment and personal income measures, the county remains ranked among the top counties in the state. The housing market remains strong, particularly in terms of median sales prices, and sales volume has increased in recent months. There has also been an uptick in Bay Area inflation measures, which are largely correlated to increased housing costs. Marin continues to be one of the healthiest counties in the state, as well as one of the oldest. Total population growth and the number of new housing units in Marin have slowed recently, and both lag behind other counties in the Bay Area.

**BOARD PRIORITIES WILL INFORM FY 2018-20 BUDGET**

To be a responsive government, we must continue to understand major trends, adapt to new community needs, and plan for future uncertainties. The County's 5 Year Business Plan has provided strategic direction and will continue to help empower employees to better serve the community. Your Board has also refined and articulated its guiding principles for a creating a sustainable future in Marin, which include focusing on our environment, economy, equity and education.

As we develop the proposed budget, your Board has identified several high priorities, including:

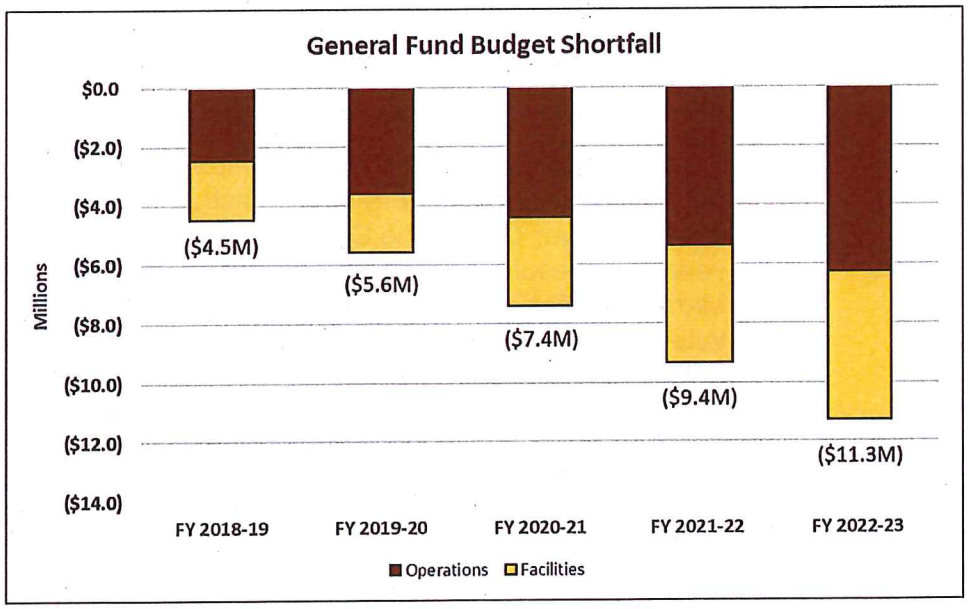
- Enhancing mental health services
- Preserving affordable housing
- Prioritizing racial equity
- Investing in County infrastructure
- Addressing climate change and adapting to sea level rise
- Implementing the 5 Year Business Plan
- Reducing unfunded retiree liabilities

These priorities will help inform our upcoming budget process and recommendations for one-time spending. These priorities have also led to significant improvements in County services over the past few years, including:

- Restructuring mental health service delivery programs
- Adopting Housing First approach and expanding homeless outreach and support programs
- Opting into Deep Green Energy
- Installing energy efficient lighting and solar panels at County facilities
- Completing a countywide sea-level rise risk assessment
- Improving unincorporated road pavement condition index (PCI) scores from 49 to 65 over 10 years
- Investing in improved technology
- Reducing unfunded retiree liabilities by over $200 million over 5 years

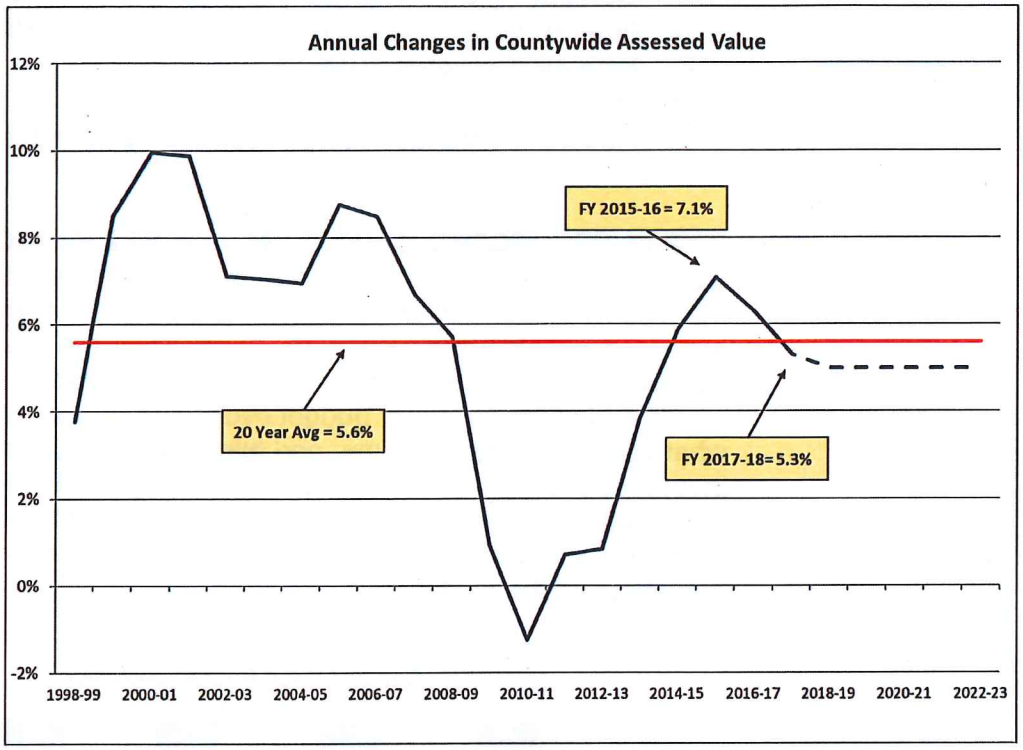
## 2 YEAR PROJECTED BUDGET GAP OF $5.6 MILLION

Due to the slowing of local revenue sources and increasing personnel costs, the County of Marin is projected to experience a General Fund budget shortfall beginning in FY 2018-19. As shown in the chart below, the shortfall is initially expected to be $4.5 million and is projected to increase to $5.6 million by the end of the two-year budget cycle. The budget shortfall is smaller than what was projected last June, and this is largely due to better than expected investment returns for the County's pension portfolio. However, the shortfall represents 1.3 percent of the General Fund budget and without significant changes in local revenues or personnel costs, the shortfall will continue to grow beyond the next two years.



Property tax growth is slowing in Marin. These revenues represent over 30% of the General Fund revenue and are the source for nearly all discretionary spending for the County. Although median sales prices remain near record high levels, the majority of Marin County assessed property values are limited by Proposition 13 to an annual growth of two percent.

As shown in the figure below, annual growth in property tax has declined from 7.1% in FY 2015-16 to 5.3% in FY 2017-18. In collaboration with the County Assessor, we are expecting annual growth in property tax revenue to remain near 5% over the next five years.




The two most significant expenditure items for the County budget are personnel costs and countywide infrastructure rehabilitation. Personnel costs represent over 60% of the County budget, and have grown over the past 5 years as a result of increased pension and workers' compensation costs. The Marin County Employee Retirement Association (MCERA) board recently voted to reduce the annual investment return assumption from 7.25% to 7.00%. This decision is expected to cost the County approximately $4 million annually once fully implemented. However, much of the increased cost will be offset by better than expected investment returns in FY 2016-17 as well as revised mortality and demographic assumptions. The final fiscal impact of the reduced investment return and demographic assumptions will be determined by the MCERA actuary over the next few months.

Over the past few years, your Board has dedicated over $20 million in one-time funds and $2 million in increased ongoing discretionary funds for road infrastructure improvements. These funding allocations have helped increase unincorporated road pavement condition index (PCI) scores from 49 in 2010 to 65 in 2017. In addition, increased state gas taxes were approved last year as part of Senate Bill 1 (SB1), and these revenues will further supplement the County's investment in road infrastructure. However, deferred maintenance at County buildings, libraries, and parks have resulted in over $150 million in unfunded repairs and upgrades. In order to address the growing deferred maintenance at County facilities, we are recommending increased ongoing infrastructure investments over the next five years.

The projected General Fund shortfalls incorporate several key assumptions, including:

- Continued regional economic stability
- Annual property tax growth of 5 percent
- Updated department fee schedules
- Continued growth in state and federal revenues
- Cost of living adjustments for all employees

**$9 MILLION IN REDUCTION OPTIONS CONSIDERED TO CLOSE GAP**

To close the two-year budget gap of $5.6 million, we have requested that all General Fund departments submit 5% Net County Cost (NCC) reduction proposals by mid-December. Over the next few months we will review approximately $9 million in Countywide proposals and recommend a plan to close the $5.6 million budget gap at your Board's budget workshops in late March.

The criteria and principles that will guide our recommendations for the FY 2018-20 budget are:

- We will engage employees in setting priorities and determining reduction options
- All General Fund departments will participate in closing the gap by at least 1% of NCC
- Reductions above 1% will be based on a review of programmatic impacts
- Countywide goals such as equity and sustainability will be considered in review and prioritization of budget reductions
- We seek to minimize impacts on current employees and make reductions through attrition to the extent possible
- We will adjust fee schedules to keep pace with inflation
- We will allocate one-time funds toward high priority needs

## PERFORMANCE MANAGEMENT

Performance management continues to be a priority in the organization. It should not be an exercise, but instead a meaningful way to drive change for departments and the organization. In order to ensure that the County's performance management program is valuable, we have convened a stakeholder group to provide recommendations on ways to improve the program. The stakeholder group includes Board Members, Department Heads, Assistant Department Heads, employees from throughout the organization, and community members.

Based upon the stakeholders' recommendations, in 2018 we will ask departments to update their performance plans to include at least one initiative that was derived from meaningful employee engagement that includes at least two metrics that establish whether or not the initiative is helping the department to improve performance. Additionally, departments will have the opportunity to eliminate or revise initiatives and metrics in their current plan. Since the performance planning process is still being evaluated by the stakeholder group, the performance plan for this year will only cover FY 2018-19. Departments will provide your Board an overview of their performance plans and new performance metrics at the March budget workshops.

## NEXT STEPS

We are planning a workshop in early February to provide a budget update and discuss long-term facility and capital needs. General Fund departments will submit 5% NCC reduction proposals to the County Administrator by December 15th, and we will present our proposed plan to close the two-year budget gap at our March budget workshop. Departments will also present their updated performance plans at the March workshop. In June, we will ask your Board to consider the Proposed FY 2018-20 Budget for approval.

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

Sincerely,

Bret Uppendahl
Budget Manager

Reviewed by,

Matthew H. Hymel
County Administrator