OFFICE OF THE
COUNTY ADMINISTRATOR

COUNTY OF MARIN

Matthew H. Hymel
COUNTY ADMINISTRATOR

Daniel Eilerman
ASSISTANT COUNTY ADMINISTRATOR

Angela Nicholson
ASSISTANT COUNTY ADMINISTRATOR

Marin County Civic Center
3501 Civic Center Drive
Suite 325
San Rafael, CA 94903
415 473 6358 T
415 473 4104 F
CRS Dial 711
www.marincounty.org/cao

January 31, 2017

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

SUBJECT: Budget Update and Five Year General Fund Projection

Dear Supervisors:

RECOMMENDATION: Receive budget update and accept recommendation to establish a hiring review process.

SUMMARY

Your Board approved a two-year budget in June 2016 that was balanced for FY 2016-17 and FY 2017-18. Long-term projections pointed toward budget shortfalls beginning in FY 2018-19 resulting from a slowdown in the growth rate of County property tax revenues and increased personnel costs. Since June, financial forecasts have reinforced the expectation of budget shortfalls beginning in 2018. To proactively address our projected shortfall, we are recommending a hiring review process to ensure our baseline budget is addressing new and emerging needs and we are developing contingency plans to balance future shortfalls.

ECONOMIC SLOWDOWN REFLECTED IN GOVERNOR'S BUDGET

The United States is in its eighth year of economic expansion, which makes it the fourth longest expansion on record. While most national economic indicators remain stable, the consensus among leading economic forecasters is that an economic downturn is likely to occur by 2019. There are significant risks and uncertainties in the longer term outlook which have been exacerbated by potential changes in federal fiscal and policy priorities resulting from the 2016 election.

On January 24th, 2017 staff provided your Board with an overview of the Governor's Proposed Budget. While many of the details will remain unknown until later this spring, it is clear that the state budget outlook has been downgraded, primarily as a result of declining tax revenues. The Governor's proposal did not include the fiscal impact of federal funding changes; however it is important to note that the state is heavily reliant on federal funds associated with the Affordable Care Act (ACA). The most significant fiscal impact to county finances will come from changes to the In-Home Supportive Services (IHSS) program, which provides essential services to elderly residents and those with disabilities. Early estimates indicate that Marin County could lose at least $2.5 million in state funds for this program.

COUNTY BUDGET OUTLOOK

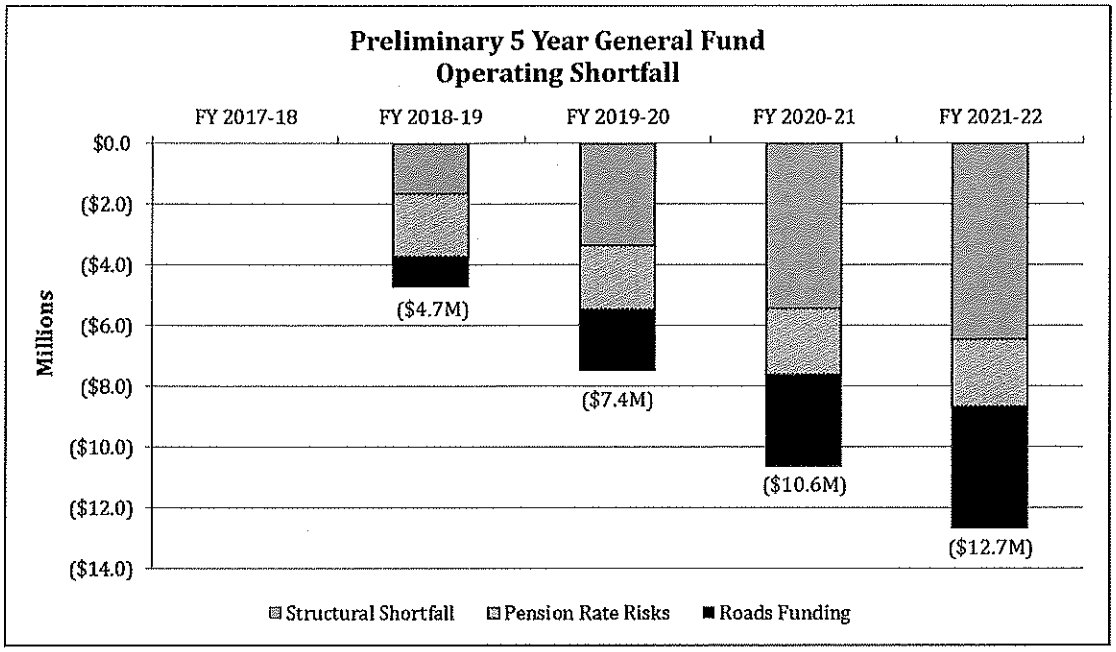
Many of the County's economic indicators remain strong, with unemployment levels among the lowest in the state, and household incomes among the highest. However, the County's largest source of discretionary revenue comes from local property tax. And while Marin's median housing prices regularly exceed $1 million, the County's share of property tax revenue is largely restricted by Proposition 13, which limits annual growth in the assessment values that determine the County's revenue base. After years of near-zero growth in assessed values during the Great Recession, County property tax revenues experienced steady gains that topped out at 7% in 2015. However, over the past two years there has been a slowing in the growth rate of assessed values. Longer term forecasts now indicate an annual growth rate of approximately 5% for the foreseeable future.

Personnel costs account for over 60% of the County's expenditure budget. In recent years, pension costs have steadily increased, largely resulting from investment returns that have not met long term expectations. Your Board has been proactive in paying down unfunded liabilities, and the Marin County Employee Retirement Agency (MCERA) Board has already lowered the expected long-term investment target to 7.25%. It is likely that the MCERA Board will consider another reduction in the long term investment target next fall, which would impact County finances beginning in 2018.

Road infrastructure is also a significant expense for the County. While the County receives gas tax revenue to support road improvements, these revenues have declined in recent years, resulting in an increased reliance on General Fund contributions to maintain and improve the roadway system in unincorporated areas. In order to fully fund the annual infrastructure and maintenance requirements, our goal would be to increase annual General Fund contributions by at least $5 million over the next five years.

FIVE YEAR GENERAL FUND PROJECTION

As seen in the following graphic, the County is currently projecting a balanced General Fund budget for FY 2017-18 and budgetary shortfalls beginning in FY 2018-19. The shortfalls are comprised of a structural imbalance stemming from slowing property tax growth and increasing personnel costs, as well as an anticipated increase in pension costs and a phased-in General Fund contribution for ongoing road infrastructure investments. If no corrective actions are taken, the County will face a budgetary shortfall of nearly $13 million by FY 2021-22, which would represent approximately 4% of the total General Fund budget.



It is important to note that the figures above are based on a moderate economic slowdown and do not assume any changes to federal or state revenues. With approximately 40% of the County's budget funded by state and federal sources, the ongoing risk to County service levels is significant. Your Board has set aside $4.8 million in a one-time reserve fund to help adjust to revisions in state or federal funding policies. These one-time funds would be used to provide time for departments to adjust their spending plans to stay within their current budgeted net county costs.

It is also worth noting that the figures above assume current service levels across the County. Although actual negotiated labor agreements may differ, for planning purposes we have reflected a CPI-based increase in personnel costs after current labor contracts expire.

BUDGET STRATEGY TO PREPARE FOR THE DOWNTURN

Marin County has a proven history of prudent fiscal management. This was reinforced in 2015 when all of the major ratings agencies reaffirmed the highest possible credit rating for County debt. The Great Recession of 2009 required a significant long term restructuring of the County's budget, and over the course of five years, the County reduced ongoing expenditures by over $30 million and reduced the workforce by over 10 percent. In addition to reducing ongoing expenditures your Board also established a dedicated trust and funding plan for retiree healthcare liabilities, contributed over $90 million in discretionary payments toward reducing the County's unfunded liabilities, and substantially increased our General Fund support for improving road conditions in unincorporated areas.

Throughout the recent economic recovery, your Board made targeted investments toward the County's highest priorities and developed a 5 Year

Business Plan to focus County resources on becoming a more responsive government for the benefit of the community. As we prepare for the impending economic downturn, it is imperative that we continue to evaluate ongoing operations and reprioritize existing resources accordingly. The goal will not be to simply reduce service levels, but to make strategic adjustments that ultimately improve critical services and enable the County to respond to emerging issues within our community.

Your Board's stated priorities are:

- Investing in County road infrastructure
- Reducing unfunded retiree obligations
- Preserving affordable housing
- Enhancing mental health and homeless services
- Addressing traffic congestion and climate change
- Implementing the 5 Year Business Plan

Although the structural shortfall is not expected to begin until 2018, we are recommending that your Board approve a hiring review process to ensure that all County recruitment decisions are made with a clear understanding of the long term strategic objectives. This will include an evaluation of funding sources, staffing levels and attrition trends. We are not recommending across-the-board reductions at this time; however, the County Administrator will be working with departments over the next few months to identify potential reduction scenarios and long-term structural changes that would be incorporated in the next two-year budget. Staff will also continue to evaluate federal and state funding policies, and will return to your Board in April with an updated fiscal outlook.

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

Sincerely,

Bret Uppendahl
Budget Manager

Reviewed by,

Matthew H. Hymel
County Administrator