COUNTY OF MARIN

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December 10, 2019

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

SUBJECT: Report from the County Administrator on budget planning for FY 2020-22 and updated 5-Year General Fund projection

Dear Supervisors:

RECOMMENDATION:
1. Accept the Administrator's report; and
2. Approve next steps for the FY 2020-22 budget process.

OVERVIEW
We are now beginning our two-year budget development process for FY 2020-22. Budget instructions have been distributed and departments are beginning to update their workplans and operating budgets. We will be updating your Board over the next few months and recommending formal adoption of the budget in June.

Last June, your Board approved a $474 million General Fund budget and a $631 million all funds budget. The General Fund budget included new one-time investments in roads, facilities, affordable housing, emergency preparedness and climate change, as well as new ongoing funding for road infrastructure and facility improvements. The budget also included increased state and regional funding for road infrastructure projects and new local funding for increased fire protection and affordable housing services in West Marin.

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. Since 2013, the County's unfunded retiree liabilities have declined by over $300 million as a result of strong investment earnings and over $100 million in discretionary payments to reduce our unfunded obligations. In addition, your Board created a pension stabilization reserve, which now has a balance of $10 million that can be used to offset volatility in pension rates. A budget stabilization mechanism was also added, in which contributions to the Facility Reserve could be adjusted to mitigate service level reductions when operating shortfalls are projected.

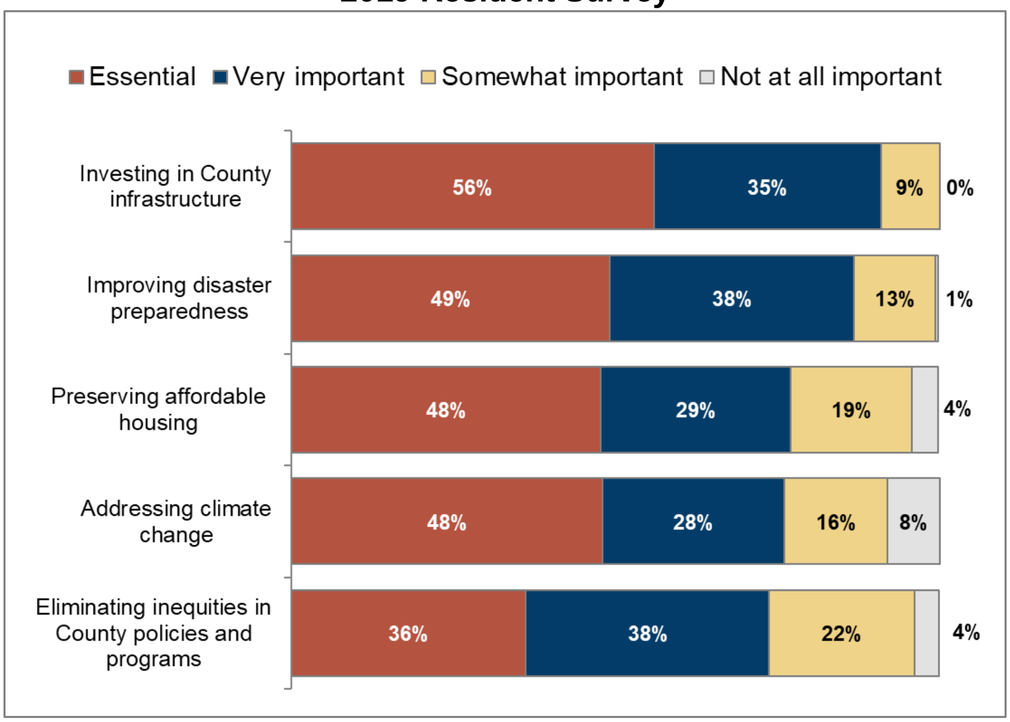
BUDGET PRIORITIES

To be a responsive government, we must continue to collaborate across departments and alongside community partners, understand major trends, adapt to new community needs and plan ahead for future uncertainties. As we prepare for the upcoming budget planning period, your Board has identified several high priorities for the community, including:

- Investing in County infrastructure
- Improving disaster preparedness
- Preserving and creating affordable housing
- Addressing sea level rise and climate change
- Prioritizing racial equity

These priorities will help inform our recommended allocation of ongoing and one-time resources for next year's budget. Last spring, the County conduced a resident survey that affirmed our focus on the current community priorities. As shown below, 75 percent of the community agreed that these were all "essential" or "very important".

2019 Resident Survey



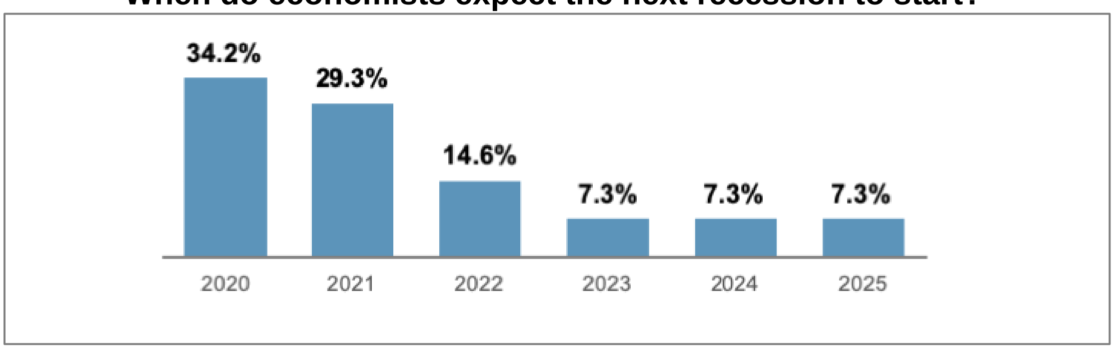
ECONOMIC OUTLOOK: INCREASED LIKELIHOOD OF RECESSION WITHIN THREE YEARS

In July 2019, the U.S. economy broke the record for consecutive months of economic expansion. The previous mark of 120 months was measured from March of 1991 to March of 2001. Most core measures of the national economy remain stable, with record-low unemployment, steady growth in personal income, better than expected investment market returns, and stable GDP data. The same is true for California and particularly the greater Bay Area, where personal income and unemployment consistently rank among the best in the nation.

However, over the last few months many economists are noticing headwinds that may slow economic growth or even cause a recession. In addition to the international trade headlines and the risks of a global economic slowdown, the nation's manufacturing index has declined for four consecutive months, the Federal Reserve has cut interest rates for the first time since 2009, and there was an inverted yield curve in the U.S. Treasury market, which has historically preceded a recession.

For these reasons, many CEO's and economists are warning of an impending recession. A quarterly survey of CEO Confidence recently hit the lowest reading since 2009, with 67% of respondents expecting economic conditions to worsen this year. Similarly, a recent Wall Street Journal poll of leading economists shows that nearly 80% expect a recession to begin in the next three years.

Wall Street Journal Survey:
When do economists expect the next recession to start?



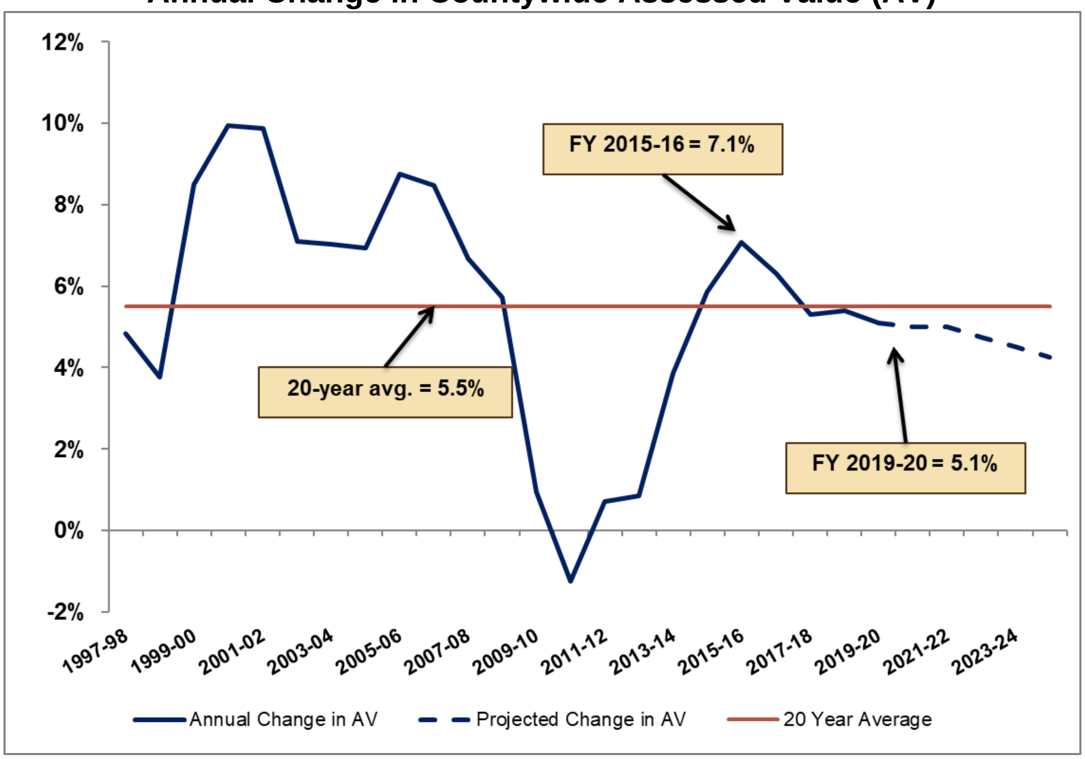
Early reports from the California Legislative Analyst's Office (LAO) indicate that despite increased risks to this year's economic outlook, the State budget has a current surplus of $7 billion and is well-positioned to withstand an economic slowdown. This is largely due to the strong economy that has enabled the State to build significant 'rainy day' reserve from revenues received from statewide income and sales taxes.

According to the LAO's 2020-2021 Fiscal Outlook Report, even with a typical postwar recession, the State budget is expected have sufficient reserves to remain in surplus through FY 2023-24. Although County budgets have different funding sources than the State, the economic forecast is a positive sign for the County of Marin and means that our State funding sources are likely to be stable for at least the next two years.

PROPERTY TAX REVENUE CONTINUES SLOWING TREND

Although home sales in Marin have been strong in 2019 and median housing prices are at record highs, the County's property tax revenue continues to be moderated by a combination of factors, including Proposition 13, a relatively small commercial sector, and minimal new development. As the chart below illustrates, annual growth in assessed value (AV) has fallen over the past four years and is expected to continue declining over the next five years. With over 40 percent of General Fund revenues coming from local property tax, the annual change in assessed value is a key indicator of the County's ability to fund new discretionary services.

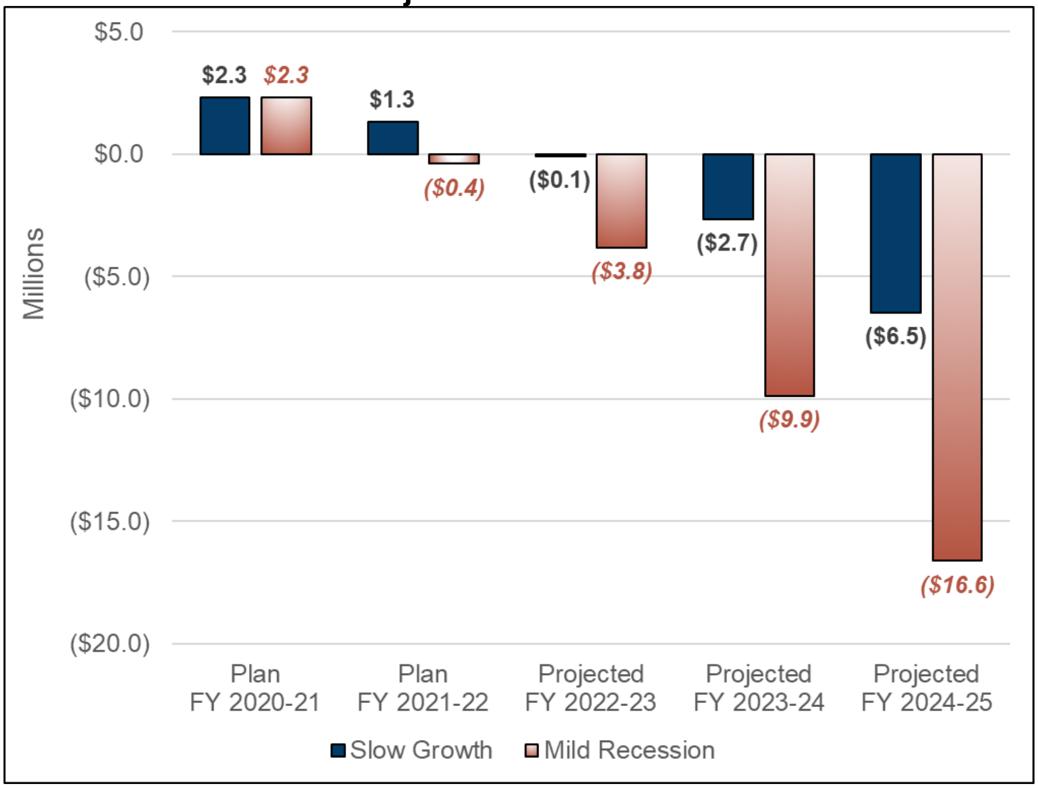
Annual Change in Countywide Assessed Value (AV)



MARIN COUNTY BUDGET IS BALANCED FOR NEXT TWO YEARS

As part of the two-year budget process, we have updated the 5-Year General Fund projection with two scenarios as shown on the following page. Under both scenarios, it is assumed that the County will maintain current service levels, provide cost of living adjustments (COLA's) for County employees and our community partners, and update department fee schedules where applicable. It is also assumed that annual investments in road infrastructure will increase to achieve our long-term goal of $8 million per year, and we will allocate up to $1 million for ongoing high priority initiatives.

5 Year General Fund Projection: Slow Growth vs Mild Recession



In the ‘Slow Growth’ scenario, we are assuming that property tax growth will slow gradually to four percent by 2025, pension costs will increase by two percent over the next five years, state and federal revenues have moderate growth, and other local revenues such as sales tax will grow by one to two percent per year. This set of assumptions results in a balanced budget for two years, a slight deficit in 2023, and a $6.5 million deficit in FY 2024-25. This deficit would represent approximately 1.5 percent of the General Fund budget, which could be addressed through a combination of budget stabilization strategies that would not require reductions in service levels.

However, the “Mild Recession” scenario results in much larger ongoing deficits beginning in 2023 that would require more significant budget reduction measures. Under this scenario, we assume that annual property tax growth slows to 3.5 percent by 2024, pension costs increase four percent over the five years, state and federal revenues are flat, and sales tax revenues decline by one to two percent in 2024.

At this time, we are recommending the ‘Slow Growth’ scenario, and as such, we are not recommending any additional ongoing spending commitments due to the likelihood of an economic slowdown within the next three years. Although we are not currently recommending using the ‘Mild Recession’ scenario, it is important to note how quickly the County budget can become unbalanced if property tax or personnel costs deviate from their current growth levels.

RECOMMENDED BUDGET STRATEGIES

Due to the limited new ongoing funding, we are not recommending any ongoing department budget change proposals (BCP's) without a corresponding offset in net county costs, and we are recommending that your Board consider one-time allocations to the extent to which temporary surpluses are projected over the next two-year period. As such, the recommended goals for the FY 2020-22 budget are to:

- Maintain current services
- Allocate one-time and limited ongoing funds toward high priority programs
- Update department fee schedules to keep pace with inflation
- Establish working groups to develop recommendations for baseline services and one-time investments related to Emergency Preparedness, Climate Change and Equity
- Submit two-year budget workplans
- Update baseline budgets for cost-covered, contractual and/or mandatory obligations
- Complete all Marin Compass Steps

NEXT STEPS

Staff in the County Administrator's Office will continue to refine ongoing revenue and expenditure projections throughout the winter and spring. We will meet with each department in January and February, and will present revised General Fund projections, Compass updates and department workplans at the March Budget Workshops. In June, we will ask your Board to consider the recommended FY 2020-22 two-year 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