COUNTY OF MARIN

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September 22, 2020

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

SUBJECT: First Quarter Budget Update

Dear Supervisors:

RECOMMENDATION:

1. Accept the Administrator's report; and,
2. Approve next steps for the FY 2021-22 budget process

OVERVIEW

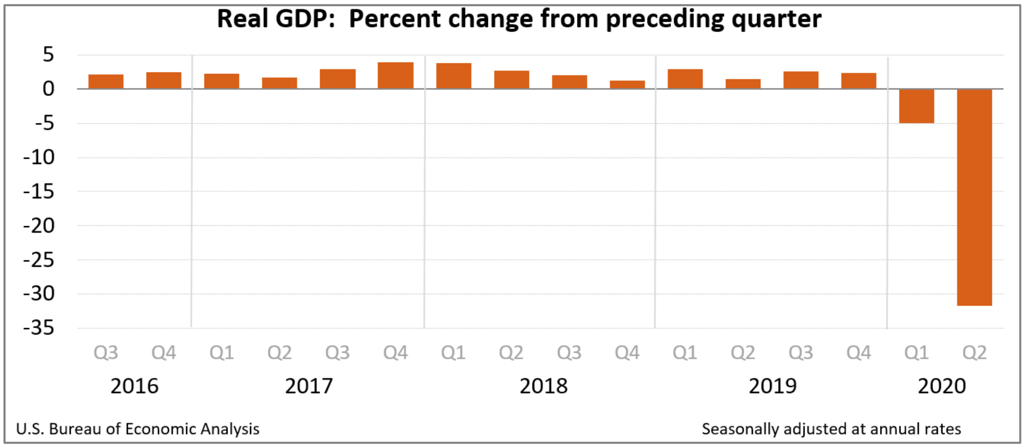
The County has a well-established history of strong fiscal management practices and bond ratings agencies have cited sound fiscal management and a proactive approach to reducing unfunded liabilities as primary reasons for the County's AAA rating. Your Board's adopted Fiscal Policies reflect key long-term financial stability principles such as matching one-time revenues with one-time expenses and maintaining adequate reserve levels.

In June, your Board approved our General Fund budget with the understanding that we would provide quarterly updates and proactively seek budget reductions to balance our budget on an ongoing basis by FY 2020-21. Over the past few months, we have been working with departments to develop budget balancing proposals for your Board's consideration in November and Spring 2021.

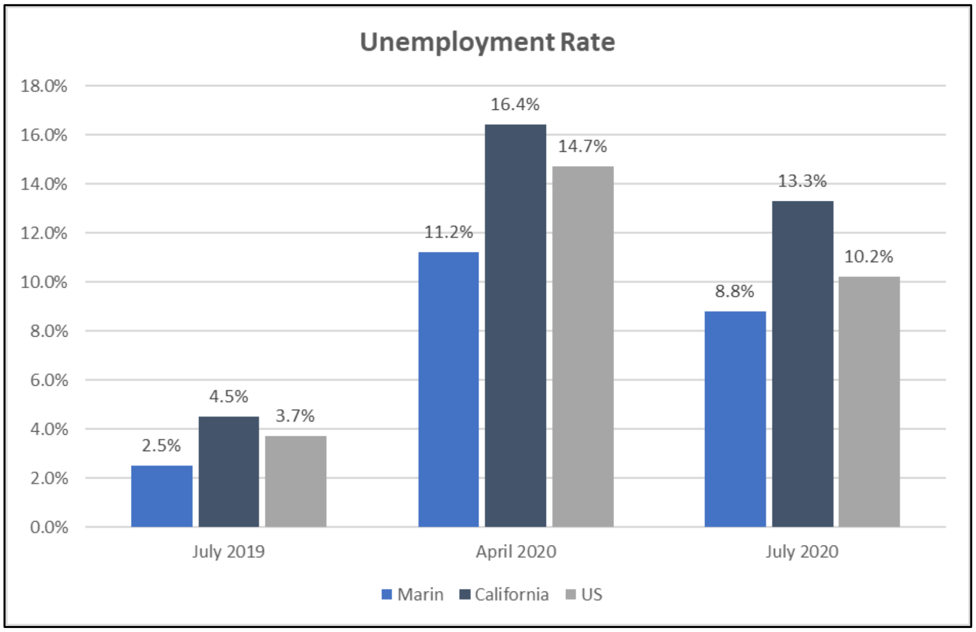
The County's response to COVID-19 has been a significant effort for all County departments, and we are projected to spend over $60 million in response costs by the end of December. While we expect most of the County's emergency response costs to be reimbursed by state and federal revenues, our structural operating budget is projected to have significant shortfalls over the next few years.

ECONOMIC OUTLOOK

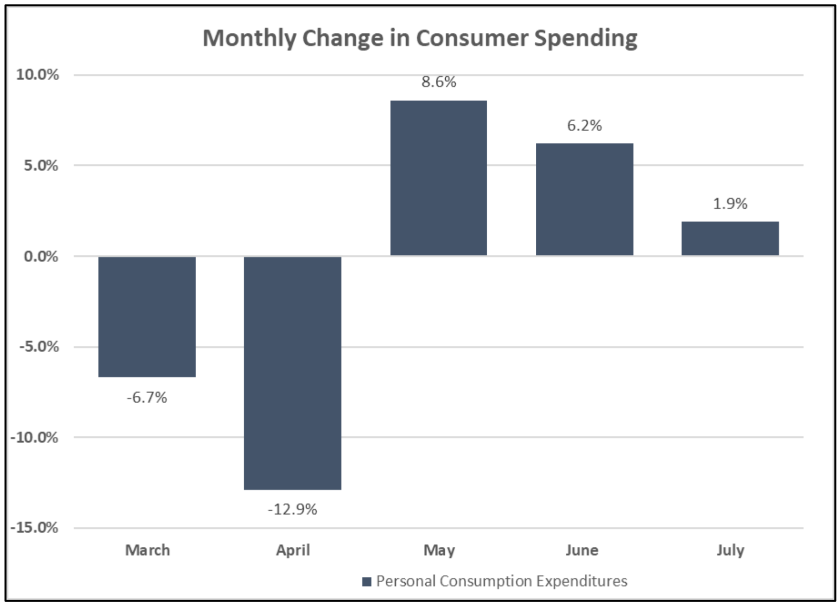
The biggest question impacting our long term budget projection is how long the economy will continue to be adversely impacted by the COVID-19 emergency. COVID-19 has caused millions of jobs to be lost for an unknown length of time, and it is unclear whether the economy will be able to withstand such a significant shock. The data that is currently available has confirmed that the economic damage caused by COVID-19 was of historic proportions, although there are some indications that the economy has already begun to rebound. The graphic below shows that the nation's second quarter GDP declined by 32% compared to the prior quarter, which was the largest quarterly decline on record for the United States.



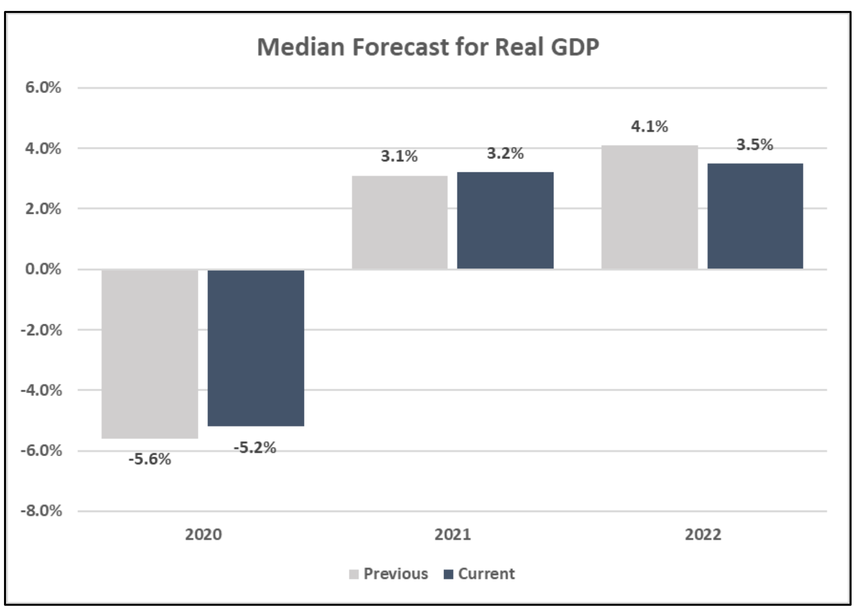
In addition to falling economic output, much of the focus has been on unemployment data, which also reached record levels this spring when over 6 million new unemployment claims were being filed each week. As shown below, unemployment rates spiked in the spring, but there have been improvements in local and national unemployment data since April. As of July, Marin County had 11,700 unemployed residents, which is an improvement from April's figure of 14,400, but still more than triple the amount of unemployed residents in July 2019 when Marin's total was 3,600.

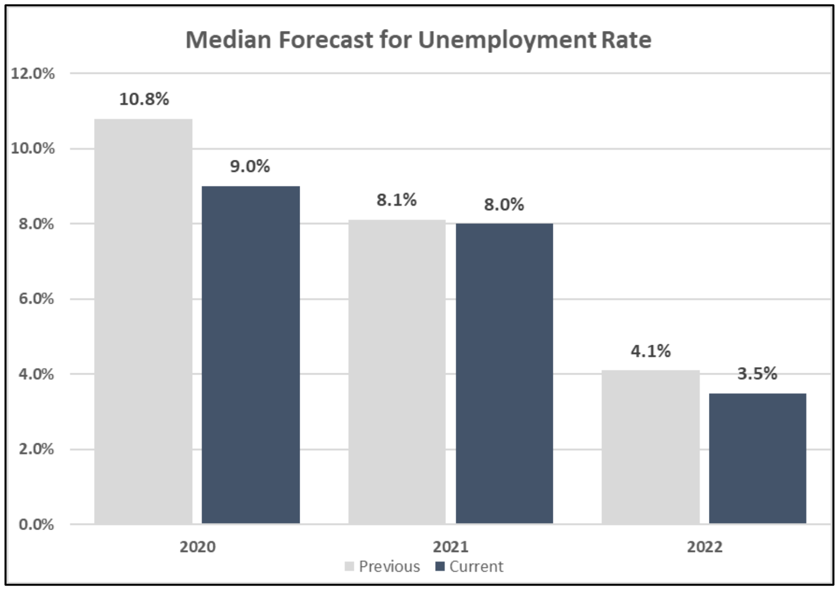


Another key indicator of the nation's economic health is the level of consumer spending, which is measured by the U.S. Bureau of Economic Analysis on a monthly basis. According to their data, consumer spending declined by 6.7 percent in March and by another 12.9 percent in April, but was followed by steady gains in May and June.

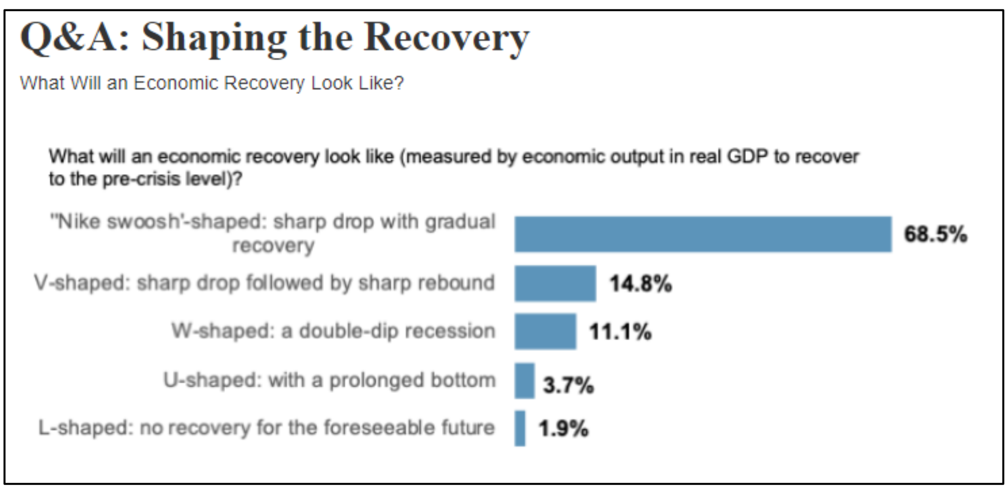


Over the past few months, economists have debated how long the recession may last and what the economic recovery will look like. The Federal Reserve Bank of Philadelphia's third quarter 'Survey of Professional Forecasters' showed upward revisions for GDP and unemployment over the next year. These revisions are an initial indication that economists are starting to see the beginning of a recovery that appears to be happening more quickly than previously expected.





Similarly, a recent poll conducted by the Wall Street Journal shows the consensus expectation is now for a gradual, 'Nike swoosh'-shaped recovery over the next few years. This is in contrast to similar surveys from last spring where about half of respondents projected a 'U-shaped' recovery with a prolonged bottom, and the other half projected a 'V-shaped' recovery with a sharp rebound.



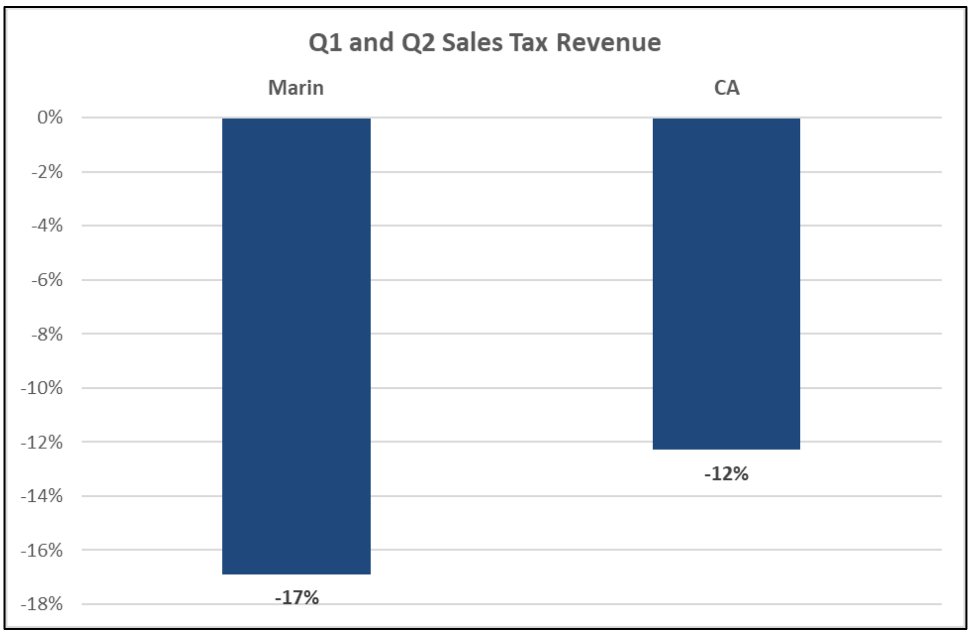
STATE BUDGET IMPACTS

Nearly 40 percent of Marin County's revenue comes from state and federal sources, with two key state revenue streams that are based on statewide sales tax revenues. One of these revenues, 1991 Realignment, provides funding for mandated public health, social services and behavioral health services. The other, Proposition 172 Public Safety Sales Tax, provides funding for mandated services provided by the District Attorney, Public Defender, the Probation Department, Marin County Fire, and the Marin

County Sheriff's Office. Taken together, these two sources comprise over $50 million, or ten percent of Marin County's budget.

As part of the FY 2020-21 State Budget, all counties received state allocations of CARES stimulus funds and also received a one-time supplement of realignment revenue. While these one-time funds will allow Marin to continue responding to the public health emergency, the ongoing impacts to the state budget remain unknown.

As shown on the next page, statewide sales tax in the first two quarters of 2020 declined nearly 12 percent compared to the prior year, and countywide sales tax in Marin declined by 17 percent in the same period. The data below reflects revenues received through June 2020, and therefore it does not capture revenue trends in recent months.



PROPERTY TAX

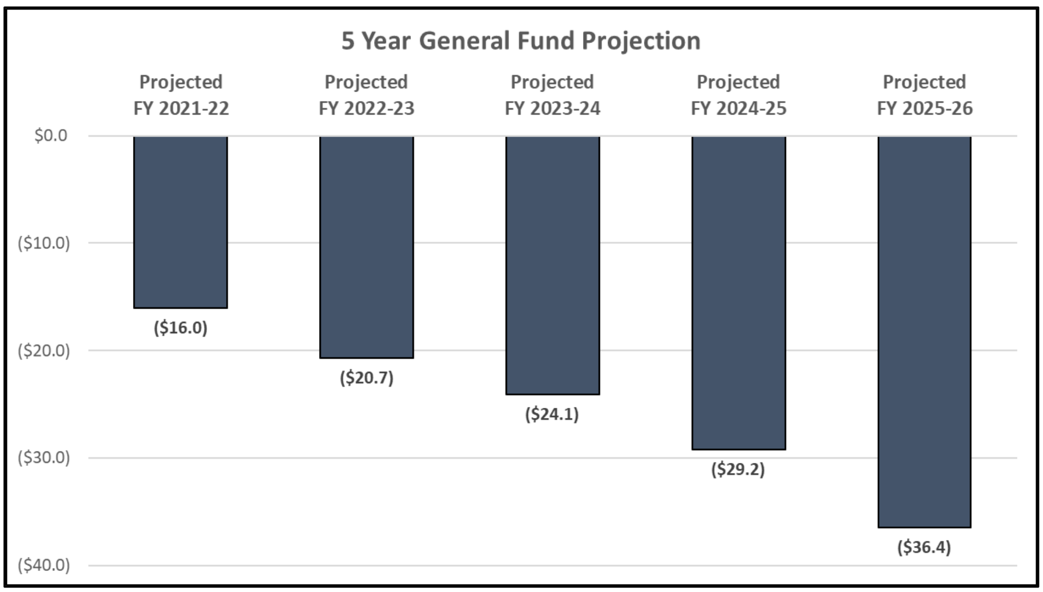
The largest source of discretionary revenue for county governments is local property tax. In Marin, secured property taxes comprise about 40 percent of the General Fund budget. In June 2020, the Marin County Assessor reported that the annual growth in assessed value was 4.5 percent for FY 2020-21. This assessment was lower than the budget forecast of 5.0 percent, and was also lower than the Bay Area average, which was 6.7 percent. It is worth noting that these assessment growth rates are based on valuations as of January 1st, 2020, and therefore do not include the impacts of COVID-19.

While it is too early in the calendar year to draw conclusions regarding future growth rates, we will continue to refine our ongoing projections as more data becomes available. However, one of the leading indicators is the total number of sales transactions that occur within the county. The chart below shows that the total number of home sales in Marin between January 1st and July 31st dropped by over 17 percent in 2020.

Year	Single Family Home Sales*	% Change
2017	1,847	+7.1%
2018	1,738	-5.9%
2019	1,816	+4.5%
2020	1,499	-17.5%

**Sales volume between January and July*

5 YEAR BUDGET PROJECTION: $16 MILLION SHORTFALL NEXT YEAR
Each year we update the General Fund 5-Year projection to help inform budget planning. As shown in the graphic below, the General Fund is currently facing increasing operating shortfalls in each of the next five years, with shortfalls in the next two years projected to be $16.0 million and $20.7 million.



In the short term, the primary cause of our projected shortfalls is declining sales tax revenues, particularly the statewide sales tax allocations that fund mandated health and safety services. Over the longer term, we are expecting to see a slowing of our property tax revenue growth and increased pension costs resulting from investment market returns below the seven percent target in the next two years.

The projections are based on current service levels, meaning they do not reflect budget reductions in any General Fund departments. We are also assuming that the overall economy will largely recover by 2024, particularly as it relates to local and statewide sales taxes. The figures above do not incorporate additional federal stimulus funds for California counties, nor do they reflect costs for the County's emergency response. Finally, the projections assume 3 percent annual cost of living adjustments (COLAs) consistent with current labor agreements. However, future labor agreements are subject to future negotiations and our ability to achieve a balanced budget.

At this early stage in the budget planning process, there are several uncertainties that can substantially impact budget projections. First, we do not know whether we will continue to receive FEMA funding beyond December for our emergency response efforts, and nor do we know whether counties will receive additional federal or state stimulus funds. Second, we do not know whether the economy will be able to rebound sufficiently or whether we will face a double-dip recession in the coming years. Retiree liabilities will also remain an ongoing uncertainty, as the County will incur additional annual costs for pensions if investment returns fall short of the seven percent annual target or if long-term earnings assumptions are lowered. Finally, the County's property tax revenues may be negatively impacted if housing sales volume remains below recent trends or if the commercial real estate sector is unable to recover when the economy is re-opened. Property tax revenues may also be impacted if the Proposition 13 inflation factor, which is a statewide measure based on October to October CPI, ends up being less than the two percent annual limit.

EMERGENCY RESPONSE UPDATE

Since the COVID-19 emergency began in March, our number one priority has been to effectively respond to the emergency by allocating new funds and redeploying existing resources. We are projected to spend an average of over $6 million a month through the end of the calendar year on our COVID-19 response. The extent of federal and state funding to support our emergency response in 2021 remains uncertain.

Our emergency response spending includes the following:

- EOC operations (call center, Alternate Care Site)
- Emergency Isolation Housing (motels)
- COVID-19 Testing and Contract Tracing
- Emergency Assistance to small businesses, low-income renters and COVID+ low-income workers
- Emergency food and meal distribution
- Redeployment existing staff to Disaster Service Worker (DSW) roles

Overall, we project over $30 million in increased appropriations above our baseline budget that will be funded by General Fund reserves, grants, FEMA and/or CARES funds. We are also projected to spend a similar amount by redeploying existing staffing from their regular duties to support our COVID-19 emergency response effort. In short, we are spending far more than our $26.5 million CARES allocation to respond to this event. We are working closely with the State to ensure that our activities are FEMA reimbursable so the General Fund is not required to pay more than the local matching requirement of 6.25 percent. We will continue to update your Board on a regular basis.

NEXT STEPS

Our next steps to bring the County budget back into balance will be to recommend a first round of General Fund budget reductions in November 2020. The first round of reductions will only include vacant positions and will not involve layoffs. We will return to your Board in the Spring to close the remaining FY 2021-22 budget gap.

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

Sincerely,

Bret Uppendahl
Budget Manager

Reviewed by,

Matthew H. Hymel
County Administrator