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COUNTY OF MARIN

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December 14, 2021

Marin County Board of Supervisors
3501 Civic Center Drive
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SUBJECT: Second Quarter Budget Update

Dear Supervisors:

RECOMMENDATION:
1. Accept the Administrator's report
2. Approve next steps in the FY 2022-24 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 the at $682 million countywide budget for FY 2021-22 that made significant investments in the community's highest priorities. The adopted budget included new ongoing staff for homelessness, racial equity, and climate change; as well as over $25 million in one-time funding for emergency response, affordable housing, and county infrastructure.

COUNTYWIDE PRIORITIES
Our goal in developing the budget is to present fiscally responsible recommendations that address the community's top priorities. These priorities currently include:
- Improving disaster preparedness
- Building a racially equitable community
- Reducing carbon emissions and adapting to climate change
- Preserving and increasing affordable housing
- Investing in county infrastructure

To be a responsive government, we must build upon the progress we have made, adapt to changing conditions, and continually improve services provided to our residents. The pandemic has increased barriers to medical and housing services for people experiencing homelessness, while at the same time, federal restrictions have limited local jurisdictions' ability to respond to homeless encampments. The County has made it a priority to address this emerging need by enhancing services and leveraging outside funding sources to invest in long-term permanent supportive housing. The recent response follows the County's '*Housing First'* approach to homelessness, which has resulted in permanently housing more than 400 people and over the past four years. Given the current and emerging needs in this area, we are recommending that your Board revise your top priorities to include homelessness as a function of preserving and increasing affordable housing.

FEDERAL RELIEF FUNDS

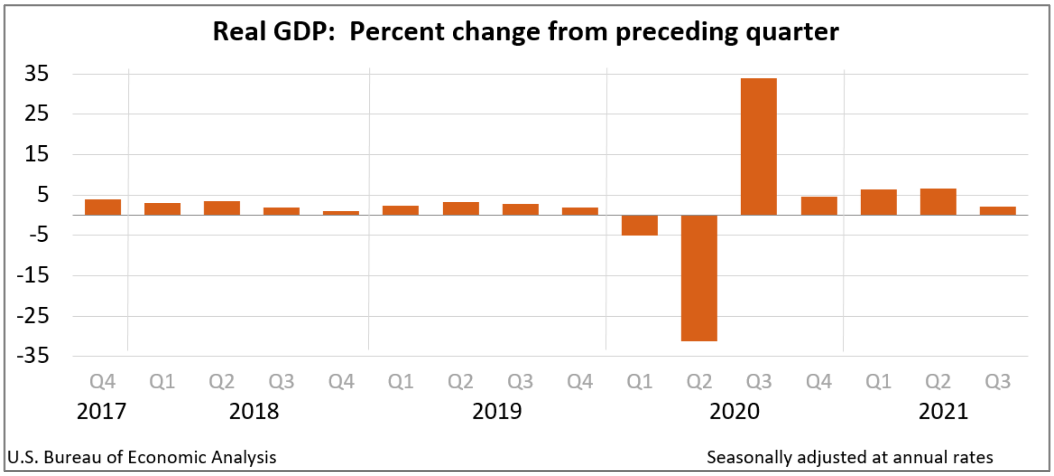
As part of the FY 2021-22 Budget, your Board approved an initial spending plan for the first half of the County's federal stimulus funds, known as the American Rescue Plan Act (ARPA). The $25.1 million spending plan, which includes the repurposed use of reimbursable funds as allowable within the Treasury guidelines, included funding for permanent supportive housing, racial equity initiatives, climate change projects, and enhanced emergency response capacity.

Over the past few months, we have been working to develop specific expenditure proposals for these funds. Today your Board is considering recommendations for $4 million in high priority climate change and sea level rise projects. We have also been developing an expenditure plan for the $5.0 million Homekey 2.0 set-aside, which will be used to support the purchase of the South Eliseo property, and we are working with internal and external working groups to identify spending priorities for the $5.0 million Racial Equity set-aside. In addition, each of Marin's cities and towns have agreed to participate in a $2 million partnership to create 68 new units of housing-focused case management and we are working with the Marin Community Foundation, First Five and the Marin Childcare Council to prioritize childcare and early education investments. Finally, your Board is considering a recommendation to utilize $500,000 from the COVID Response set-aside to create a pilot cost-share program to assist Marin cities and towns with homelessness services.

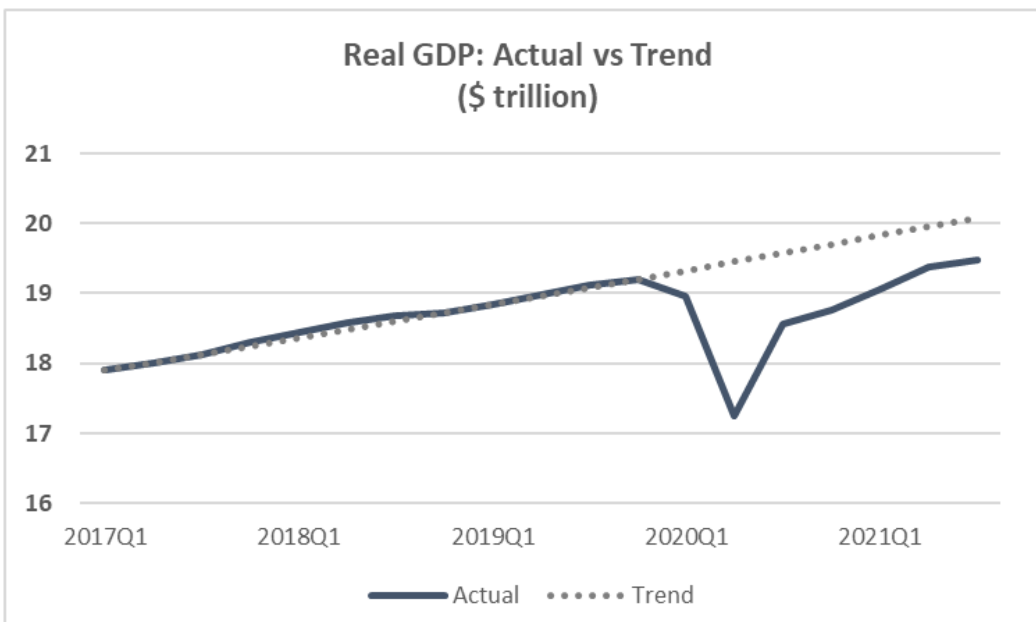
We have also begun working to develop proposals for the second half of the federal funds and will present specific recommendations as part of the March Budget Hearings in 2022. Our initial list of options includes additional funding for permanent supportive housing initiatives and climate change projects, creating a County Service Center in southern Marin, matching funds for capital upgrades for our community healthcare partners, West Marin tourism improvements, and improved broadband infrastructure.

ECONOMIC INDICATORS

COVID-19 caused millions of jobs to be lost and had a significant impact on national economic output as measured by Gross Domestic Product (GDP). Through historic levels of federal intervention and economic stimulus spending, the economy was able to withstand the short-term recession and has now experienced five consecutive quarters of growth as shown below. It is worth noting that the most recent quarter showed an annualized growth rate of 2.1 percent, which lower than the recent pre-pandemic average of 2.5 percent for the third quarter.



While the return to consistent growth has helped stabilize the national economy, we are still behind the pre-pandemic trend line for total economic output as shown in the graph below.



Based on data from the U.S. Bureau of Economic Analysis

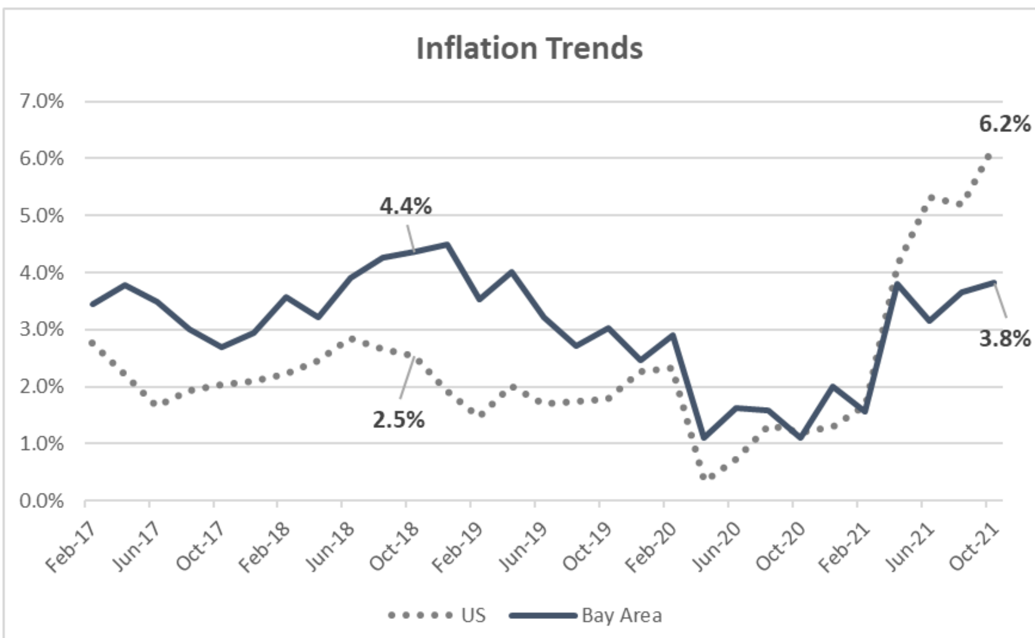
According to the most recent *Survey of Professional Forecasters*, conducted by the Philadelphia Federal Reserve, the outlook for the U.S. economy future has weakened. As shown on the next page, projected GDP growth rates were revised downward and are now expected be 3.9 percent in 2022, compared to the current expectation of 5.5 percent in 2021. The forecasters also indicated a downward revision to growth expectations in the labor market for 2022.

Survey of Professional Forecasters

	Previous	Current	Change
GDP Growth 2021	6.1%	5.5%	-0.6%
GDP Growth 2022	4.4%	3.9%	-0.5%
Payroll 2021	309.4	325.8	+16.4
Payroll 2022	456.3	439.7	-16.6
Inflation Rate 2021	4.9%	5.8%	+0.9%
Inflation Rate 2022	2.4%	2.7%	+0.3%

Source: Philadelphia Federal Reserve (November 2021)

INFLATION HAS INCREASED IN THE SHORT TERM
In addition to monitoring economic output, there has been a recent focus on inflation. The Philadelphia Federal Reserve's forecast indicates significant revisions to nearly all measures of inflation (CPI) in 2022, increasing from 2.4 percent to 2.7 percent, however, longer term expectations have remained largely unchanged at about 2.4 percent for 2023.



Source: Bureau of Labor Statistics

The chart above shows both US and Bay Area inflation trends. The recent spike of over 6 percent in national inflation figures has garnered attention, however, inflation in the Bay Area was only 3.8 percent in October, which is actually lower than October 2018 and only slightly above the pre-pandemic average. In fact, similar to recent GDP trends, price levels in the Bay Area are actually lower than the pre-pandemic trendline would have indicated. This is largely due to the historically low inflation rates seen throughout the first year of the pandemic, where there was an extended period of low inflation, averaging around 1.5 percent from April 2020 to February 2021. Nonetheless, inflation can have significant impacts on the economy as well as the County's financial outlook. We will continue to monitor inflation projections and will update your Board in the Spring of 2022.

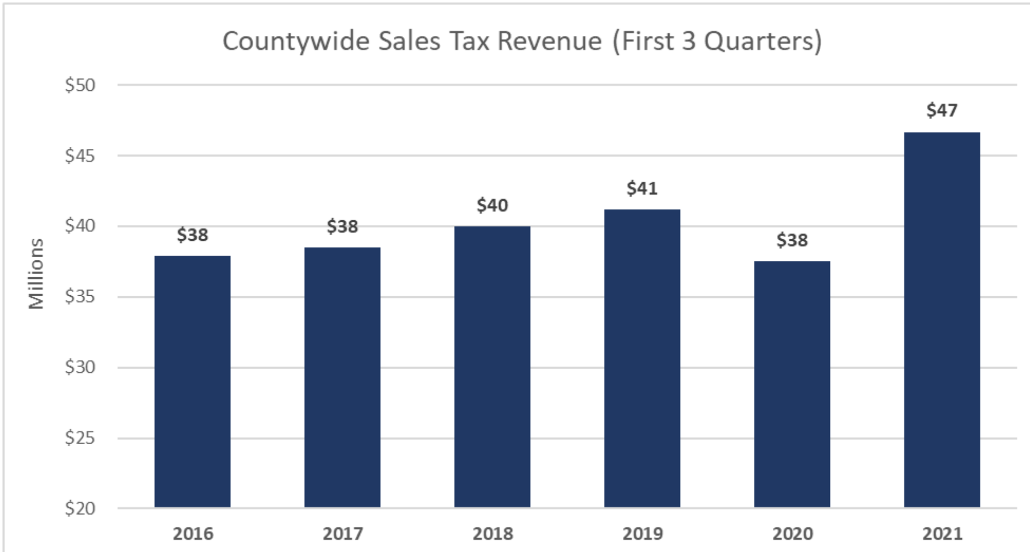
PROPERTY AND SALES TAX REVENUES

Property tax is the largest source of discretionary revenue for county governments and accounts for about 40 percent of Marin County's General Fund budget. In June 2021, the Marin County Assessor reported that the annual growth in assessed value was four percent for FY 2021-22, which was consistent with the budget forecast. While it is still too early in the calendar year to draw definitive conclusions regarding future growth rates, recent real estate sales trends (as shown below) are over 30% higher than pre-pandemic averages which supports an upward revision to next year's property tax revenue growth projections.

Source: Marin County Assessor's website

Sales tax is another key input to the County budget, although it has less impact on the General Fund and more impact on the County's special revenue funds. The General Fund only receives revenue for taxable sales in unincorporated areas, which amounts to less than one percent of the overall General Fund budget. However, countywide sales tax, which includes all taxable sales in cities and towns as well as the unincorporated areas, has a direct impact on Parks Measure A revenues and Transportation Authority of Marin (TAM) allocations. Countywide taxable sales also factor into statewide allocations of Proposition 172 Public Safety Sales tax and 1991 Realignment, both of which are allocated by the State to support mandated health and safety functions within the County.

The chart below shows sales tax revenues generated countywide in the first three quarters of the calendar year from 2016 to 2021. The pandemic resulted in a decline of nearly ten percent in 2020, but the recent economic recovery has resulted in a significant rebound in local taxable sales, and we are now above our pre-pandemic trendline in this revenue source.



Source: CA Department of Tax and Fee Administration

PENSION COSTS AND REMAINING UNFUNDED LIABILITIES

Pension costs, which account for nearly 10 percent of the County's expense budget, are largely driven by investment market performance. The Marin County Employee Retirement Agency (MCERA) recently announced that the investment returns exceeded 30 percent for the year ending June 30, 2021. While the final impacts of the investment returns will not be known until MCERA adopts its annual actuarial report in early 2022, it is likely that the County be nearly 100 percent funded and required contributions for unfunded liabilities will be significantly reduced. It is worth noting that under current MCERA policy, the 2021 investment return will be phased in over the next five years.

Summary of Recent Pension Returns

Year	Actual Return	Assumed Return	Funded Status
2016	2.1%	7.25%	84.1%
2017	11.9%	7.25%	86.8%
2018	9.7%	7.00%	89.8%
2019	5.5%	7.00%	89.0%
2020	3.5%	7.00%	86.2%
2021	32.15%*	6.75%	TBD*

**Pending final actuarial report*

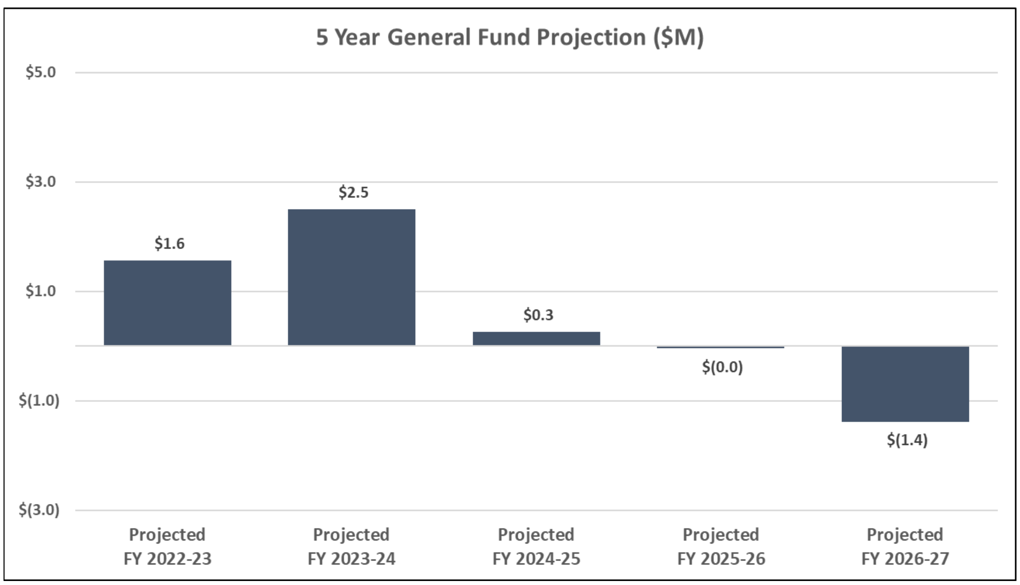
As shown above, annual investment returns are inherently volatile. Despite recent reductions to the assumed return percentage, it is likely that future returns will fall short of the target rate which will increase the County's required contributions for unfunded pension liabilities. While we are hopeful that the County's unfunded pension liabilities will remain near-zero, we also acknowledge that there is still approximately $250 million in other unfunded County retiree liabilities including such as retiree healthcare benefits and required payments for the 2003 pension obligation bond.

Over the next few months, we will work with MCERA and our retiree healthcare actuary to refine the longer-term cost estimates and payment options. As part of the FY 2022-24 proposed budget, we will also recommend a fiscal policy that dedicates savings resulting from reduced unfunded pension liabilities toward paying down unfunded retiree healthcare benefits.

FIVE YEAR GENERAL FUND PROJECTION

The General Fund accounts for nearly $500 million in ongoing expenditures, which is approximately 75 percent of the countywide expenditure total and includes the majority of unrestricted and discretionary spending initiatives.

The graph below shows that the General Fund is projected to be balanced for the next three years as a result of improved local revenues and decreasing costs for unfunded pension liabilities.



The longer-term outlook is heavily dependent on a number of key assumptions. On the revenue side, we have increased growth assumptions for property tax and sales tax. We are projecting that countywide assessed value, which determines property tax revenues, will grow at 4.5 percent in FY 2022-23 and will average approximately 4.0 percent over the subsequent four years. Similarly, we are projecting that sales tax revenues will grow by approximately 4.25 percent in FY 2022-23, followed by growth rates averaging 3.5 percent thereafter.

Personnel costs are the largest category of General Fund expenditures, accounting for nearly two thirds of the ongoing budget. We are assuming that cost of living adjustments will be 2.5 percent annually over the in the next two years and will be 3.0 percent annually thereafter. As discussed above, recent investment earnings will reduce required payments for unfunded pension liabilities, and we are assuming that the resulting savings will be dedicated toward unfunded retiree health liabilities beginning in FY 2023-24. The recent addition of nearly 30 FTE in grant-funded staff for Health and Human Services and Marin County Fire are expected to be largely cost-covered upon the expiration of the current grants. Finally, we are incorporating an assumption that ongoing discretionary expenditures will increase by $3-5 million, or approximately one percent of the current budget, to address high priority emerging needs beginning in FY 2022-23.

FUTURE RISKS REMAIN

Although many economic indicators have been strong over the past several months, there remain uncertainties that can substantially impact budget projections. First, we do not know whether the pandemic will continue to produce outbreaks and/or variants and we are expecting FEMA funding to expire before the end of the fiscal year. Second, we do not know whether the economy and investment markets will be able to sustain the recent rebound on an ongoing basis, which could lead to increased pension costs in future years. Finally, we will carefully monitor inflation data and will provide additional updates to your Board in March.

NEXT STEPS

In order to maintain a balanced budget while also adapting to emerging community needs, we are recommending the following guidelines for the upcoming two-year budget cycle. First, we are directing all departments to apply a racial equity lens to current baseline budgets and budget change proposals. Second, we are directing departments to submit two-year budget workplans highlighting initiatives that will be completed within existing baseline budgets. Third, we are recommending that all one-time and cost-covered budget change proposals be evaluated consistent with your Board's top countywide priorities. In addition, all budget change proposals, including capital and technology projects, must adhere to funding restrictions and must have a feasible implementation timeline. To the extent that limited ongoing service enhancements are considered, we will base our recommendations on proposals that address top countywide priorities and emerging community needs. Finally, we will recommend new fiscal policies that incorporate contingency plans to mitigate future risks associated with investment earnings, inflation and ongoing pandemic impacts.

Our next steps in the budget process are to finalize recommended spending proposals for federal stimulus funds and to meet with departments to prioritize one-time and ongoing expenditure proposals for your Board's consideration in the March Budget Hearings. Upon receiving input from the community and your Board, we will submit the Proposed FY 2022-24 Budget for your Board's consideration in June 2022.

EQUITY IMPACT

The County of Marin strives to be an anti-racist, multicultural organization committed to accountability, transformational change, and community engagement. The Office of Equity's vision is to dismantle inequities and modify systems inherited through centuries of racial, social, and political injustice.

We will continue to work with your Board and County Departments to ensure that the budget allocation process is informed by a racial equity lens that evaluates the potential impacts on unserved and underserved populations within our community.

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

Sincerely,

Bret Uppendahl
Budget Manager

Reviewed by,

Matthew H. Hymel
County Administrator