COUNTY OF MARIN

OFFICE OF THE
COUNTY ADMINISTRATOR

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

April 26, 2022

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

SUBJECT: Report from the County Administrator regarding General Fund budget projections.

Dear Supervisors:

RECOMMENDATION:

1. Receive report regarding current year General Fund projections
2. Approve next steps in budget process
3. Approve balance sheet adjustments as outlined in the Fiscal Impact section

OVERVIEW

The County has as well-established history of strong fiscal management practices and all three independent bond rating agencies have affirmed Marin County's AAA rating for many years, citing a stable local economy, sound fiscal management and a proactive approach to reducing unfunded liabilities. One of the key principles of long-term financial stability is the practice of matching one-time revenues with one-time expenses and maintaining adequate reserve levels.

As part of the annual budget process, the County Administrator meets with each department to identify expenditure and revenue trends that impact the available year-end General Fund budgetary savings in the current fiscal year. This process includes the requirement to identify at least $20 million in current year budgetary savings to fund next year's ongoing budget. At your Board's discretion, savings of more than $20 million are available for one-time allocations in next year's budget.

After completing our meetings with departments and year-end financial analysis, the Budget Division updates revenue and expenditure trends in the Five-Year General Fund projection. By incorporating current year trends into longer term financial projections, the Five-Year General Fund projection helps inform longer term budget planning efforts.

CURRENT YEAR GENERAL FUND PROJECTION

As a result of greater than anticipated countywide revenues and departments spending at or below their budgeted expenditures, we are projecting a $51.1 million year-end fund balance in FY 2021-22. Of this amount, $20 million will

be used to support next year's ongoing operating budget and $31.1 million will be incorporated as recommended one-time allocations in the FY 2022-24 Proposed Budget.

This year's fund balance projection of $51.1 million is $5.2 million more than the prior year. The year-over-year increase is largely attributable to better-than-expected state revenues for mandated county services such as Proposition 172 Public Safety Sales Tax and 1991 Realignment, as well as increased local revenues from property tax, sales tax and transient occupancy tax. In each of these categories, the revenue growth is attributable to the strong post-pandemic rebound relative to more moderate budget expectations in the FY 2021-22 Adopted Budget. To the extent revenues are ongoing, we have incorporated increased revenue growth in our development of the FY 2022-24 Proposed budget. For example, we have increased our ongoing budget revenue assumptions for property tax, 1991 Realignment and Proposition 172 Public Safety sales tax. We have also increased ongoing revenue assumptions for sales tax and transient occupancy tax within unincorporated areas of the county. We will continue to monitor these trends throughout the coming year to assess the extent to which the post pandemic economic rebound is sustainable over the long-term.

As summarized in the following table and detailed in Attachments A-C, the projected year-end fund balance of $51.1 million is comprised of $12.4 million in net expenditure savings and a savings of $38.7 million in better-than-expected revenues and balance sheet adjustments. The attachments provide a summary by department of the Adopted Budget, the Revised Budget and our projections for year-end results. The Revised Budget is inclusive of previously approved staff reports, cost-covered grants, and monthly budget adjustments. The Revised Budget also incorporates the carryforward of multi-year project balances and prior year contract encumbrances.

Table 1: Projected Variance from FY 2021-22 Adopted Budget

Expenditure Savings	$12.4 million
Revenue Increases & Balance Sheet Adjustments	$38.7 million
Projected Year-End Fund Balance	$51.1 million

Summary of General Fund Revenue Projections

Countywide and department revenue sources were analyzed based on year-to-date receipts and historical trends. Previously approved revisions to the county budget over the prior 9 months have resulted in revenue increases totaling $109.8 million. These increases are largely for cost-covered activities, including grants, reimbursements for countywide emergency response activities, and reimbursements for fire prevention and response. Revenue adjustments also include revised estimates for Proposition 172 Public Safety Sales Tax and 1991 Realignment revenues totaling $11.4 million, and updated countywide revenue estimates of $34.8 million. Countywide

revenues are largely consistent with prior year trends, with excess ERAF, property transfer tax and supplemental property tax revenues being higher than prior years due to increased real estate transactions over the past year. Sales taxes and transient occupancy taxes have also fully recovered and are currently projected to exceed pre-pandemic trends.

In addition to the previously approved revenue adjustments, we are projecting revenue shortfalls in the Cultural Services department to reflect reduced activities and associated fees at the Marin Center. The revenue shortfall is offset by related expenditure savings within the department.

Summary of General Fund Expenditure Projections
Updated expenditure projections were developed through an analysis of both salary and non-salary spending levels over the first nine months of the fiscal year and all General Fund departments are projected to end the year within their current expenditure budget.

Previously approved expenditure changes total over $199 million. These adjustments consist primarily of the roll forward of prior year grant funds, projects, and contract encumbrances. They also account for new grant-funded programs in Health and Human Services and cost-covered adjustments for out-of-county fire response.

Overall, the General Fund is projected to end the year with $12.4 million in expenditure savings as shown in Attachment C. The majority of countywide expenditure savings are typically attributable to salary savings, and this year's net salary savings projection of $9.5 million is representative of a continued trend of increased turnover among county staff and an increasingly competitive labor market.

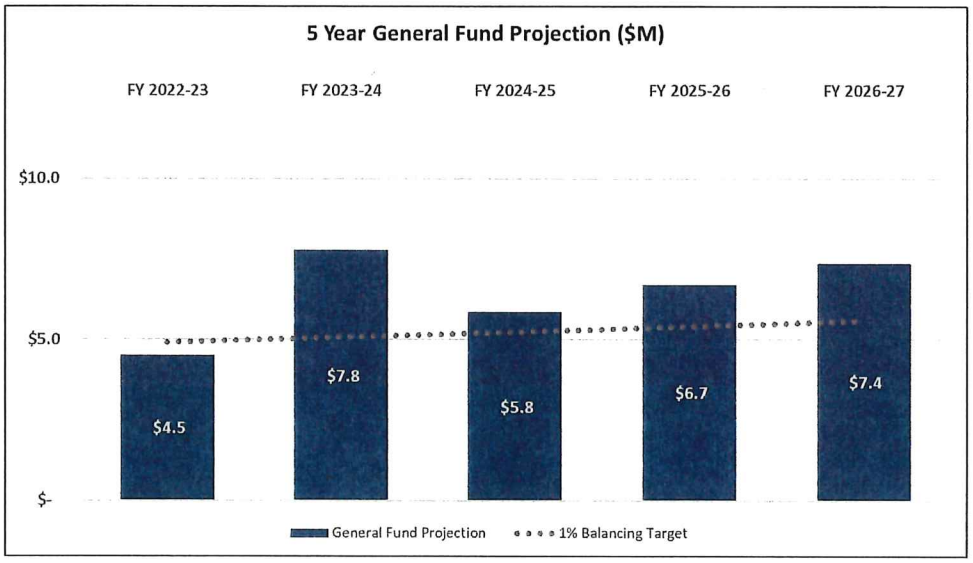
Balance Sheet Adjustments
In addition to the roll forward of prior year fund balances for grants, projects, and contracts, we are recommending $9 million in adjustments to committed and assigned fund balances consistent with your Board's current Fiscal Policies. This amount is comprised of a $5 million addition to the Facility Reserve (Fiscal Policy #19), which is used as a budget stabilization mechanism with the goal of saving $50 million by 2025 for deferred maintenance needs, and a $4 million addition to the Economic Uncertainty Reserve (Fiscal Policy #16) to maintain our goal of a 10 percent reserve target for unanticipated economic downturns or natural disasters.

FIVE YEAR GENERAL FUND PROJECTION
The General Fund accounts for nearly $500 million in ongoing expenditures, which is approximately 75 percent of the countywide all funds expenditure total and includes the majority of our discretionary spending initiatives.

In January, staff presented a Five-Year General Fund projection that was balanced for the two-year planning period and had minor shortfalls beginning

in FY 2025-26. Since that time, we have continued to experience growth in many core revenue streams, including property taxes, sales taxes, and statewide allocations for mandated health and safety services. The post-COVID economic recovery drove most of our largest revenue sources above pre-pandemic trendlines and we can now incorporate a majority of the gains as ongoing sources for longer term planning purposes.

Our updated Five-Year General Fund projection now indicates a slight surplus in each of the next five years. It is worth noting that the FY 2021-22 Proposed General Fund budget was $490.9 million and therefore the surplus shown below is slightly above 1 percent of total expenditures. We consider the budget to be balanced when it is within 1 percent of the overall General Fund expenditure budget, as indicated by the dotted line in the chart below.



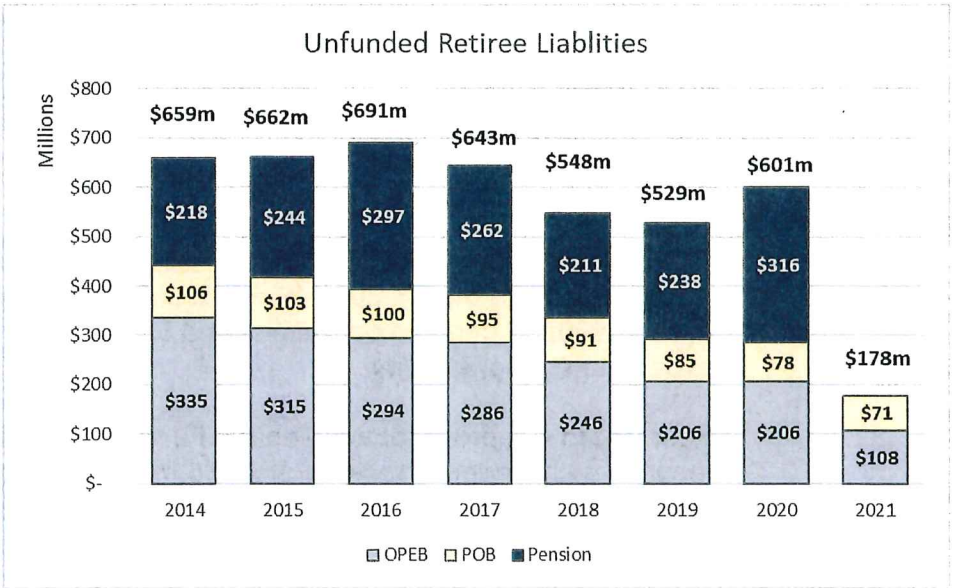
The longer-term outlook is heavily dependent on several key assumptions. For revenues, we are now projecting that countywide assessed value, which determines property tax revenues, will grow at 6.5 percent in FY 2022-23 and will average 5.4 percent over the subsequent four years. Sales taxes have fully recovered at the local level, and we are projecting that sales tax revenues in FY 2022-23 will be approximately 20 percent higher than what was received in FY 2020-21. Similarly, state allocations of 1991 Realignment and Proposition 172 sales tax are based on statewide sales tax revenues and are expected to grow by approximately 15 percent compared to FY 2020-21 actuals. We are mindful that recent property tax growth may be extraordinary due to historically low mortgage rates, implementation of Proposition 19, and a surge in demand following the pandemic. While we are expecting growth in these areas to slow in the coming years, the new ongoing baseline contributes to a significant improvement for our longer-term revenue projections.

Personnel costs are the largest category of General Fund expenditures, accounting for nearly two thirds of the ongoing budget. Consistent with our currently approved bargaining agreements, cost of living adjustments for County staff are expected to be 2.5 percent annually over the next two years. For planning purposes, we are assuming wage-related increases to be 3.0 percent annually thereafter. Similarly, for planning purposes, county contributions for employee health insurance are consistent with existing labor agreements and are assumed to increase by up to five percent annually for employees with dependents.

As indicated in January, required pension costs will decline considerably due to last year's extraordinary investment earnings. The current projection assumes that savings from investment market earnings will be dedicated to paying down other retiree liabilities as discussed in further detail below.

Other assumptions include the addition of $5 million in new ongoing spending for high priority County programs, including a countywide sea level rise unit, enhanced public communications staffing, a reorganization of the Office of Emergency Services (OES), increased annual support for permanent housing support services, and expanded staffing for services in Southern Marin.

Recommended Fiscal Policy for Unfunded Retiree Liabilities
In 2013, your Board approved an Other Post-Employment Benefits (OPEB) policy to pay down retiree healthcare liabilities over a 30-year period. We recently received an updated actuarial report regarding our unfunded healthcare liabilities which showed that the County is approximately 60 percent funded, a significant improvement from the 36 percent funded status in the 2019 actuarial valuation. Similar to our pension liabilities, the improvement in our retiree healthcare funding status is largely the result of better-than-expected investment earnings in 2021.



Overall, the County's unfunded retiree liabilities declined by over $400 million last year and the County's pension plan is now fully funded. The remaining unfunded retiree liabilities include $71 million in pension obligation bonds (POB) and $108 million in retiree healthcare liabilities. The reduction of nearly $100 million in unfunded retiree healthcare liabilities also resulted in lower required annual contributions under the current amortization plan. In consultation with our actuary, it was determined that the County could accelerate the retiree healthcare funding schedule from the current 21-year period to a 15-year period while still staying below the actuarially determined contribution (ADC) that was established in 2019.

We know that investment markets are inherently volatile, and the gains of 2021 are likely to be short-lived as the historic levels of federal stimulus begin to expire. While it is too early to draw conclusive comparisons to dot-com boom of the early 2000's or the housing bubble of the mid-2000's, recent survey data from the Philadelphia Federal Reserve and Wall Street Journal show that economists are seeing increasing risks of a recession within the next year due to persisting inflation, increasing interest rates, supply chain disruptions, labor shortages, and geopolitical instability.

Given the likelihood of future investment market losses, and acknowledging that the County still faces over $175 million in unfunded retiree liabilities, we are recommending your Board adopt the following policies as budget stabilization strategies:

1. Modify the amortization schedule for paying down unfunded retiree healthcare liabilities from the current 21-year period to a 15-year period.
2. Beginning in FY 2022-23, if the General Fund is balanced, allocate annual savings from reduced pension payment requirements to the Retiree Healthcare Trust Fund (OPEB). This policy will remain in effect for five years, or until the OPEB Trust is 85 percent funded.

If all current funding assumptions are met, these policy recommendations will set aside approximately $15 million over the next two years to further reduce unfunded retiree liabilities.

FISCAL IMPACT

The projected savings of $51.1 million identified in this report will be incorporated into the FY 2022-24 Proposed Budget, with $20 million being used to support ongoing operations and $31.1 million available for one-time expenditure programming.

Your Board's approval of the General Fund balance sheet adjustments will result in a contingency reserve of $49.5 million, which is ten percent of budgeted expenditures, as well as a balance of $22 million in the Facility Improvement Reserve as shown in the following table.

Recommended Balance Sheet Adjustments in the General Fund (1000)

Account Title	Current Balance	Recommended Adjustment	Resulting Balance
320555 – Committed Economic Uncertainty	$45,500,000	$4,000,000	$49,500,000
330312 – Assigned Facility Improvements	$17,017,500	$5,000,000	$22,017,500

NEXT STEPS FOR FY 2022-24 BUDGET PROCESS

Given the historic volatility that we have experienced during the COVID-19 pandemic, we have committed to providing budget updates throughout the fiscal year. Over the next few months as we work to prepare our presentation of the FY 2022-24 Proposed Budget in June, we will be working to finalize the remaining budget follow-up items:

- Return to your Board to present initial recommendations for roads, capital improvements, and long-term facility investment strategies
- Develop and finalize one-time expenditure recommendations for both $25 million in federal COVID relief funds and $31 million current year surplus funds
- Incorporate new fiscal policies in the FY 2022-24 Proposed Budget to further pay down unfunded retiree healthcare obligations
- Include approximately $5 million in new ongoing expenditures for high priority programs in the FY 2022-24 Proposed Budget
- Set Public Hearings for June to review the FY 2022-24 Proposed Budget

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

Sincerely,

Bret Uppendahl
Budget Manager

Reviewed by,

Matthew H. Hymel
County Administrator