



COUNTY OF SONOMA

575 ADMINISTRATION
DRIVE, ROOM 102A
SANTA ROSA, CA 95403

SUMMARY REPORT

Agenda Date: 11/28/2023

To: Board of Supervisors

Department or Agency Name(s): County Administrator's Office

Staff Name and Phone Number: Peter Bruland; 565-3086

Vote Requirement: Majority

Supervisorial District(s): All

Title:

Fall Fiscal Update

Recommended Action:

- A. Receive the Fiscal update.
- B. Approve a change to the Fiscal Policies setting the recommended level for the Tax Loss Reserve Fund (Teeter Fund) at 1.5% of the levy.
- C. Provide direction to staff on whether to include funding for fee equalization for Groundwater Sustainability Agencies in the FY 2024-25 Recommended Budget.

Executive Summary:

Each year the County Administrator's Office provides the Board of Supervisors with an updated General Fund Projection and an update on the budget process for the coming year. Consistent with the approved [Financial Policies <https://sonomacounty.ca.gov/administrative-support-and-fiscal-services/county-administrators-office/budget-and-operations/financial-policies>](https://sonomacounty.ca.gov/administrative-support-and-fiscal-services/county-administrators-office/budget-and-operations/financial-policies), the Board of Supervisors annually adopts a structurally balanced budget that does not rely on one-time year-end saving to finance ongoing operational costs. Budget development is a months-long process that begins in the fall of each fiscal year. Budget development culminates with Budget Hearings and the adoption of the budget, which are scheduled for June of 2024.

A key part of this process is a review of available resources for budgeting. Based on the current fiscal forecast, the General Fund is projected to close fiscal year 2023-24 with a fund balance of \$9.8 million, while fiscal year 2024-25 is anticipated to have a deficit of \$0.9 million. This review evaluates the General Fund, the County's discretionary resources and does not include other portions of the budget which are primarily funded with state and federal funds and over which the Board has limited discretion.

As always, there is uncertainty in this forecast both due to factors within the County and broader economic and political factors. These include external and internal factors described later in this item.

In addition to the forecast, this item includes a review of the Fund Balance Directory, which contains a listing of funds governed by the Board, discusses the rules governing these funds, and projects fiscal year 2023-24 year end fund balances. The Fund Balance Directory is normally prepared and included as part of the materials provided during budget hearings, however, during the fiscal year 2023-24 budget hearings the Board requested that the Directory be brought forward again for further review.

While this item is primarily informational staff are looking for two actions: 1.) approval to codify a change to the Tax Loss Reserve Fund (Teeter) Policy that will lower the reserve threshold from 2% to 1.5%, which is still in excess of the state-mandated 1% reserve; and 2.) direction regarding supplemental one-time funding for Groundwater Sustainability Agencies in the fiscal year 2024-25 budget.

Discussion:

Each year the Board of Supervisors adopts a balanced budget, in line with the state constitution. Over the course of the year, staff monitor revenues and expenditures and develop forecasts for current and future fiscal years. The fall fiscal forecast presents a five-year projection of General Fund revenues and expenditures. While the General Fund represents only about one-third of the total County budget, it constitutes the portion over which the Board of Supervisors has the most discretion, as it can be utilized for any general government purpose, whereas most other revenues (including state and federal funds, special district revenues, etc.) can only be utilized for specific purposes.

The fall forecast serves several purposes, including:

- Providing a point-in-time look at where the County’s finances stand in the current fiscal year, drawing attention to any near-term risks and providing an initial picture of what year-end fund balance may be available.
- Providing initial projections for the coming fiscal year that are utilized for development of the upcoming budget.
- Identifying longer-term risks and opportunities that may be available.

General Fund Projections

The five-year General Fund fiscal projections (Attachment 1) offer an illustration of what staff expect general fund sources and uses to come in for the current fiscal year, and for each fiscal year from 2024-25 through 2028-29. Table 1 shows a high-level summary of these projections. The final surplus or deficit for a given year are based on the single-year projections assuming no change in expenditures or revenues. For example, if the projected \$9.8 million surplus in fiscal year 2023-24 were to be utilized for ongoing costs, the projected deficits in fiscal year 2024-25 and beyond would grow. Similarly, if the projected \$13.3 million deficit in fiscal year 2025-26 is addressed in full, the expected deficit in fiscal year 2026-27 would reduce to approximately \$7.3 million. Each year staff will present the board with a balanced budget, including any expenditure reductions necessary for balancing.

Table 1: Projected General Fund Sources (revenues) and Uses (expenditures) in Millions of Dollars

Fiscal Year	FY 23-24	FY 24-25	FY 25-26	FY 26-27	FY 27-28	FY 28-29
Total GF Sources	\$685.6	\$653.8	\$667.5	\$683.6	\$700.6	\$718.1
Total GF Uses	\$675.8	\$654.7	\$680.0	\$700.6	\$722.6	\$745.5
Total Surplus (Deficit)*	\$9.8	(\$0.9)	(\$12.5)	(\$17.0)	(\$22.1)	(\$27.4)

*Sources minus uses may not equal total due to rounding.

On June 16, 2023, the Board adopted a balanced budget for fiscal year 2023-24. Currently, the projections

show a \$9.8 million expected surplus, based primarily on increases to revenue projections. In particular, the final 2023 property tax roll provided an additional \$8.3 million in property tax above budget. Of this, 40% or \$3.3 million was allocated to the County Center Modernization Fund (formerly known as the Deferred Maintenance Fund) in alignment with Board policy. The remaining \$5 million will be available to offset cost increases in fiscal year 2024-25 and shows up as a one-time surplus in the fiscal year 2023-24 year-end close estimate. Given the impact of high interest rates on home sales, this level of growth is not expected to continue in the coming years. Those same increased interest rates have, however, led to another major portion of the current year projected surplus. Because returns on the treasury pool are largely linked with interest rates, the County has seen a significant increase in interest earnings, which are projected to be \$3.4 million higher than budgeted. Because these earnings are tied to interest rates set by the federal reserve and have hovered at near-zero for a significant period of time, this should not be viewed as a long-term ongoing revenue source. The remainder of the surplus is made up of several minor adjustments to revenues and expenditures.

For fiscal year 2024-25, the projections are essentially balanced, with a nominal deficit of \$900,000 or 0.1% of budget. Total revenues and expenditures both show significant decreases. This is due to the discontinuance of one-time sources programmed during the fiscal year 2023-24 Budget Hearings. While there may be future one-time expenditures based on available fund balance in the fiscal year 2024-25 budget, these would be balanced by one-time sources and would thus not impact the long-term fiscal picture. The relatively strong position in fiscal years 2023-24 and 2024-25 is the direct result of the Board's decision to maintain sufficient ongoing capacity in the 2022-23 and 2023-24 budgets to support the new labor agreements. Because labor agreements are in place, the forecast has greater certainty in salary and benefits costs, which make up nearly two-thirds of General Fund expenditures, over the next two years. Without knowledge of successor agreements, uncertainty increases beyond that point.

Other portions of the projections are based on assumptions that have a lower degree of certainty. Among them:

- Property tax is projected to slow based on the downturn in sales since interest rates have risen. The model projects growth at 3% for fiscal year 2024-25 and 2025-26, and returning to a more normal rate of 3.5% in 2026-27 and subsequent fiscal years. Each percentage point of property tax growth amounts to approximately \$3.1 million for the General Fund.
- Other tax revenues are also likely to see limited growth, with sales tax expected to increase by 2% and Transient Occupancy Tax, which initially increased following the pandemic but has since slowed, by 2.5%. Supplemental property tax and documentary transfer tax, which are largely driven by sales of properties, are also expected to remain near flat.
- Interest earnings are expected to decline from 2023-24 levels but remain above the recent historical trend.
- Departmental revenues are generally expected to see modest growth.
- Wages and benefits are expected to increase by about 5.6% based on negotiated increases to pay, rising health care costs, and rising pension costs. Pension costs in particular are expected to rise sharply in fiscal year 2024-25 is based on the actuarial report from December 2022, which included significant losses to the pension fund due to market conditions, and due to the sunseting of the 3% employee cost share on Unfunded Actuarial Accrued Liability (UAAL) for approximately 82% of employees by July 1 2024, primarily non-legacy employees who were hired after the Public Employees' Pension Reform Act came into effect on January 1, 2013.

- The current forecast assumes approximately 4.5% savings on labor costs due to vacancies and attrition. While this is in line with actual rates seen during fiscal years 2020-21 and before, it is less than was seen during fiscal years 2021-22 and 2022-23 as these years were unusually high by historical standards, with 2022-23 seeing savings of 11.9% in the General Fund and 14.1% in non-General Fund departments. The Fall Forecast assumes a 4.5% salary savings based on higher compensation as a result of new labor agreements, a loosening labor market coming out of the post-Covid period, and hiring incentives approved by the Board for certain hard-to-fill positions, all of which are expected to return vacancy rates to more normal levels.
- As noted, most one-time expenditures (and associated one-time sources) drop from the budget in fiscal year 2024-25.

For fiscal year 2025-26 the projected deficit increases to \$12.5 million. This is driven primarily by an expectation of continued modest growth in taxes (about 3% for property tax and overall), which would not keep pace with expenditure increases. While this offers the best guess of increases at this time, there are two ways that the deficit may fail to materialize even without changes to programs. First, as noted the expectation is that revenue growth will slow. If interest rates are to lower more quickly than expected without significant economic weakening, for example, property sales and development may increase more rapidly, boosting tax revenues. The other place the model assumptions could prove inaccurate is in staffing costs. The model assumes that vacancy rates will return to historically normal levels; if the rates remain closer to the levels seen over the past two years, there will be additional savings. Staff will continue to monitor the future situation and update the Board as part of the budget process. On the other hand, should the state enter a significant recession that would decrease sales tax and other revenue streams, the deficit could become more severe.

External Factors Impacting Projections

The assumptions underlying this model are subject to variation based on many factors. These include economic, political, and natural risks that are largely outside of the County's control. Some of the economic factors being monitored include:

- A. The overall status of the economy remains highly uncertain. While projections of an imminent recession have decreased, there still remains a significant risk. The median projection (the middle projection when projections are arranged from lowest to highest) from the US Federal Open Market Committee (FOMC) is projecting real gross domestic product to rise by 1.5% in 2024, and hold at 1.8% for 2025 and 2026 (source: U.S. Federal Open Market Committee and Federal Reserve Bank of St. Louis, FOMC Summary of Economic Projections for the Growth Rate of Real Gross Domestic Product, Median [GDPC1MD], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/GDPC1MD>, November 8, 2023). While this is above a recession, it is well below the 2.4% average growth seen in the decade before COVID.

Should the economy enter a recession, property tax would be relatively shielded but sales tax could see a sharp decline, which would impact not only the \$26.1 million in general fund sales tax but also more than \$225 million total of Proposition 172 public safety funding, state Realignment funding relied upon by Human, Health and Criminal Justice programs, and special tax funding received by various county departments.

- B. Interest rates remain at the highest level since 2001. During a press conference following the October-

November meeting of the Federal Reserve Board of Directors, Chairman Powell placed a damper on hopes for a quick reduction in rates, noting that the Federal Reserve is still considering whether rates are high enough to curb inflation, not whether they should be reduced. Still, the FOMC projects that rates will reduce slightly by the end of 2024 and continue to decrease gradually beyond that (Source: U.S. Federal Open Market Committee and Federal Reserve Bank of St. Louis, FOMC Summary of Economic Projections for the Fed Funds Rate, Median [FEDTARMD], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/FEDTARMD>, November 8, 2023).

Even the projection for 2026 remains well above the rates seen since prior to the great recession. Interest rates impact the County in several ways. As noted, the County does receive a small amount of revenue from interest on funds in the treasury pool. Any benefit to these funds, however, is small in comparison to the potential negative impact on property tax growth from reduced sales. Even if interest rates remain relatively high, the housing market would likely recover as it adjusts to the “new normal”, however it is uncertain when this might occur.

- C. The Consumer Price Index for the San Francisco Bay area has fallen to 3.4 percent as of August 2023, down from a high of 6.8 percent in June 2022. Still, rates for the area (as well as the nation) remain above the Federal Reserves stated target of 2 percent (source: US Bureau of Labor Statistics: https://www.bls.gov/regions/west/news-release/consumerpriceindex_sanfrancisco.htm). The direct impact of inflation on County costs is more difficult to track and is not highly correlated with consumer-based indexes.

In addition to direct economic factors, there are also other risks. The current divided government has led to constant concerns of whether, and at what level, federal programs will be funded. The County acts as a conduit for many programs such as housing vouchers and CalFresh food assistance that rely on federal funding and provide direct benefits to the community. At the time of writing, the House has passed a short term funding plan, which, if passed by the Senate and signed by the President, will provide additional funding through the current calendar year. Under this bill, appropriations for various federal agencies will expire in a staggered manner beginning in January rather than expiring all at once. At that point the risk of a partial shutdown returns. Should there be a prolonged shutdown, some of these programs will suffer and the County may be pressured to provide emergency assistance utilizing County funds, an action which is not included in this forecast. Actual impacts will depend on the timing and length of a potential shutdown, as well as which portions of the Federal government are impacted. Some potential areas for impact:

- Pass through of aid to local residents, including housing vouchers and CalFresh as well as the Woman-Infant-Children program. The former two programs should be able to operate for approximately one-month in the event of a shutdown in November; the impacts on available funding under the current temporary measure are not clear and will be evaluated prior to the next funding cycle.
- Project reviews and grants that have been awarded but not yet obligated could be delayed. This includes reviews for housing projects such as George’s Hideaway and Elderberry commons, as well as FEMA disaster projects that have not been obligated.
- Most federal employees would not get paid during a shutdown. While there are relatively few federal employees in Sonoma County, a longer shutdown could have a ripple effect through the economy.

In Sonoma County, we have also learned that the possibility of disaster is never far away in today’s world. This forecast does not assume any new disasters that would require utilization of General Fund resources.

Internal Unknowns

In addition to the uncertainty around external factors, there are a number of items internal to the County that may impact this forecast, but which are not presently known. Among them:

- D. Negotiations are beginning between the In-Home Support Services (IHSS) Public Authority and SEIU regarding a new agreement for IHSS provider salaries. While IHSS providers are not County employees, the County is required to pay a portion of the costs of these agreements under a Maintenance of Effort (MOE) agreement, with federal and state funding the remainder.

Currently the County's MOE share is approximately \$30 million, of which half is paid by the General Fund and half with 1991 Realignment funds. Should new wages and benefits exceed the state participation cap, which is generally \$1.10 per hour above the state minimum wage, the County will be responsible for all additional costs above the cap. This could result in a significant increase in County expenses that are not included in this model.

- E. Several of the recently approved labor agreements include a reopener related to retirement costs. These reopener discussions are slated to begin in the spring of 2024. While there is no guarantee that any adjustments will be made because of these discussions, it is possible that changes could occur that would impact the County's retirement costs.

- F. The County is reviewing the feasibility of the proposed Behavioral Health Housing Unit at the Main Adult Detention Facility. While initially expected to be fully funded with state grant funds, delays have led to significant cost increases that will require additional local funds if the facility is to be built. Additionally, difficulty in filling existing positions in corrections has led to concerns over how the unit would be staffed if built. Sonoma Public Infrastructure is working with the Sheriff's Office and will return with recommendations in 2024.

Currently, the forecast includes staffing and other costs beginning in fiscal year 2025-26, with full staffing in fiscal year 2026-27, totaling approximately \$7.7 million. These costs are partially offset by \$6.6 million in ongoing capacity that has been reserved in the budget for this purpose. If the decision is made to proceed with building the facility, a significant infusion of one-time funding will be needed. Additionally, the costs of staffing the unit will need to be reevaluated, potentially increasing costs to the County.

- G. As noted, one-time funding that was approved by the Board of Supervisors for a limited period are assumed to end in accordance with initial guidance. In general, associated costs are removed from the forecast based on the termination of time-limited programs and positions. If the Board ultimately chooses to extend these programs without an external funding source, additional General Fund cost would be incurred.

An exception is the helicopter program at the Sheriff's Office. Based on prior board direction, staff are working with the Sheriff's Office to bring a long-term strategy for the program to the Board prior to Budget Hearings. Because the program is expected to continue, expenditures are not removed from the forecast.

H. On October 17, 2023 the Board received a report on the status of the Groundwater Sustainability Agencies (GSAs) and staff were directed to return with more information related to potential subsidies. No ongoing subsidies have been built into this model. A discussion on the GSAs for Board direction is included below.

Additional Items

District budget reports

Staff will prepare monthly budget reports for each district that show year-to-date expenditures for district staffing and supplies as well as expenditures associated with District Formation Funds, Hazardous Tree Removal and Community Infrastructure projects. These funds can be spent over the course of multiple fiscal years. The monthly reports through October, 2023 are included in Attachment 2.

Fund Balance Directory

Per Board request during fiscal year 2023-24 Budget Hearings, a review of the Fund Balance Directory is included in this item.

Attachment 3 provides a memo that describes the Fund Balance Directory, as well as the directory itself, which has been updated with fiscal year 23-24 Beginning Balances Available for Budgeting and also displays the fiscal year 23-24 projected balances based on the current budgeted revenues and expenditures.

Generally, the Fund Balance Directory is similar to what was presented during Budget Hearings, but includes these notable updates:

- Community Infrastructure Fund (fund 10138): this fund houses the total funds approved by the Board during fiscal year 22-23 and fiscal year 23-24 for district-specific infrastructure projects. As a result, the balance displayed in this fund is the combined total for all districts. The individual balances available for each district from this fund are included in the monthly district budget reports discussed above and available in Attachment 2.
- Designated Purposes Fund (fund 10155): This fund was established to hold funds designated by Board policy for future year needs. A description of the various items sums held in this fund is available in Attachment 4.

FEMA Reimbursement update

To date, the County has spent \$123 million on disasters which is expected to be reimbursed by FEMA/Cal-OES. \$32 million is due to the Roads fund to fund repair work, \$1 million is due to Parks for repair projects associated with the 2023 storms, and \$90 million is due to the General Fund - \$80 million of which is associated with COVID-19.

These costs have been temporarily covered through a mix of General Fund sources and other funds. In fiscal year 2021-22, the Kincade Settlement Fund provided \$20 million as a temporary bridge for reimbursement delays; repayment of the Kincade Settlement Fund is being tracked and will occur as FEMA reimbursements are received and overall Disaster Funds are balanced.

As is true for all municipalities, reimbursements are exceedingly slow. The Disaster Finance Team in the Auditor-Controller-Treasure-Tax Collector's Office works regularly with FEMA and Cal-OES on the reimbursement process.

Policy Update

Per direction received at the fiscal year 2023-24 Budget Hearings, the minimum fund balance for the Tax Loss Reserve Fund (Teeter Fund) is being changed from 2% to 1.5%. This will keep the level above the legal minimum of 1%. Because the direction was received late in budget hearings, it was not included in the adopted policies and is being adjusted here. A redline version of the updated Financial Policy can be found in Attachment 5.

Groundwater Sustainability Agencies

On October 17, 2023, the Board received an update on the status of Groundwater Sustainability Agencies (GSAs) in Sonoma County. The GSAs were formed in 2017 in order to implement the Sustainable Groundwater Management Act (SGMA) which requires that local agencies throughout California manage groundwater in certain key basins in order to ensure that groundwater is available for future human and environmental uses. During the 2022-23 Budget Hearings, the Board approved \$1.5 million over two years to ensure that rates paid by groundwater users in the unincorporated areas of the two smaller basins (Petaluma Valley and Sonoma Valley) were in line with those paid in the Santa Rosa Plain.

The three GSAs are beginning the process of updating fees as they prepare their budgets for fiscal year 2024-25, and need to know if the County subsidy will continue in fiscal year 2024-25 or they will need to begin the process of notifying groundwater users that there will be substantial fee increases. Attachment 6 includes responses from the GSA staff to questions posed by the Board during the October meeting. Staff are seeking direction as to whether the Board wishes to continue funding for the GSAs. If directed, staff will include approximately \$1 million to continue rate standardization in the 2024-25 Recommended budget. If the Board does not wish to provide this support, the GSAs will go forward with public outreach regarding fee increases. Regardless of the Board's decision, the GSAs will be undertaking revised fee studies this winter which will inform future rates. Given that it has been two years since fees were adjusted and there has been significant inflation in this time, it is anticipated that rates will increase. Any subsidy would be designed to match the revised rate in the Santa Rosa Plain.

Strategic Plan:

N/A

Racial Equity:

Was this item identified as an opportunity to apply the Racial Equity Toolkit?

No

Prior Board Actions:

Agenda Date: 11/28/2023

October 24, 2023 - Approval of the First Quarter Consolidated Budget Adjustments to the Fiscal Year 2023-24 Budget

October 17, 2023 - Update on implementation of the Sustainable Groundwater Management Act in Sonoma County

June 16, 2023 - Adoption of the Fiscal Year 2023-24 Budget

FISCAL SUMMARY

Expenditures	FY23-24 Adopted	FY24-25 Projected	FY25-26 Projected
Budgeted Expenses			
Additional Appropriation Requested			
Total Expenditures			
Funding Sources			
General Fund/WA GF			
State/Federal			
Fees/Other			
Use of Fund Balance			
General Fund Contingencies			
Total Sources			

Narrative Explanation of Fiscal Impacts:

There is no immediate fiscal impact to this item. Should direction be given to provide funding for Groundwater Sustainability Agencies to standardize rates across basins, approximately \$1.1 million will be included in the fiscal year 2024-25 recommended budget for this purpose.

Staffing Impacts:

Position Title (Payroll Classification)	Monthly Salary Range (A-I Step)	Additions (Number)	Deletions (Number)

Narrative Explanation of Staffing Impacts (If Required):

N/A

Attachments:

Attachment 1 - General Fund Forecast

Attachment 2 - District Budgets

Attachment 3 - Fund Balance Directory

Attachment 4 - Designated Purpose Fund Balance Details

Attachment 5- Update to Financial Policies

Attachment 6 - Groundwater Sustainability Agencies' response to Board Questions

Agenda Date: 11/28/2023

Related Items "On File" with the Clerk of the Board:

None.