**File #:** 2020-1325, **Version:** 1

**To:** Board of Supervisors
**Department or Agency Name(s):** County Administrator's Office
**Staff Name and Phone Number:** Peter Bruland - (707) 565-2431
**Vote Requirement:** Informational Only
**Supervisorial District(s):** All

**Title:**
Five-Year Projections and Update on Fiscal Year 2021-22 Budget Development

**Recommended Actions:**
Review Five-Year projections for the General Fund and the Departments of Health and Human Services, and receive overview of the Fiscal Year 2021-22 Budget development plan and timeline.

**Executive Summary:**
Consistent with the annually approved county Financial Policies <https://sonomacounty.ca.gov/CAO/Public-Reports/Budget-Reports/Financial-Policies-for-FY-2020-2021/>, Board of Supervisors annually adopts a structurally balanced budget that does not rely on assumptions of year-end savings to finance future years. The development of this budget is a months-long process that begins in the fall of each fiscal year. This culminates with Budget Hearings and the adoption of the budget, which are scheduled for June 2021.

The County Administrator's Office prepares and regularly updates General Fund fiscal projections in order to guide budget development and provide the Board with information on the outlook of the County's discretionary resources and help with long-term planning intended to maintain the County's fiscal health. This year the Departments of Health and Human Services have also prepared fiscal projections in order to provide better information on the future position of these critical agencies.

In sum, the General Fund projections show a deficit of $2.2 million, or 0.4%, for the upcoming new 2021/2022 fiscal year, absent any budget development balancing adjustments. Whereas, Human Services shows a surplus of $2.2 million and Health Services projects a deficit of $1.3 million.

**Discussion:**
**General Economic Situation**

The last year has been a roller-coaster ride for the economy. The early months of the COVID 19 pandemic saw the greatest decreases in employment on record. The following months have seen record job growth results computed from a depressed base, which result in unemployment remaining significantly higher than it was before the epidemic started.

In November, statewide unemployment was at 8.2% (seasonally adjusted), down from a high of 16.4% in May but significantly higher than the 3.9% in November 2019. Furthermore, the labor force has shrunk by almost

600,000 during this period.

Sonoma County has generally fared better than the state as a whole, but has followed a similar trajectory with unemployment going from 2.4% in November 2019 up to 14.5% in April 2020, and falling to 5.5% by November 2020. The Sonoma County labor force decreased by 10,400 from November 2019 to November 2020. Neither the statewide nor Sonoma County numbers yet account for the impact of the latest shutdown order. The effects of unemployment on the broader economy have been somewhat mitigated by Federal support, including enhanced unemployment benefits. These were set to expire, but a new deal reached in congress will provide continued, if reduced, support.

At least in part due to this, economic indicators show a much more mixed picture on spending. According to data published by the California Legislative Analysis Office, overall consumer spending in California remains down, but has rebounded significantly since the early months of the pandemic. This has led to State revenues coming in significantly above the levels projected in the downward adjusted state budget, and has an impact on local revenues, which will be discussed further below. This improvement has not been even, however, and certain industries including restaurants and hospitality remain significantly below pre-COVID levels.

The latest increase in COVID cases and attendant restrictions create greater uncertainty for the coming months, while the approval of multiple vaccines provide hope for a return to some sort of pre-pandemic conditions in the future. While the worst predictions of a new Great Depression now seem unlikely, how quickly, how strongly, and how evenly the economy recovers remains in question.

**General Fund Projections**

The County's resources, like those of other governmental agencies, have not been immune to the roller coaster. Initial projections after the onset of COVID 19 looked dire. Actual returns since that time suggest a less bleak picture, but the revenue impacts of the pandemic remain a source of significant uncertainty and, as of this writing, principal county discretionary revenue streams have not yet returned to pre-pandemic levels. Federal support through the Federal Emergency Management Agency (FEMA) and support passed through the state under the CARES act have so far offset the costs of the County's response, but with no new aid to local governments under the most recent congressional COVID response bill, greater use of discretionary revenue of approximately $600,000, beyond the $20 million set aside by the Board in September is needed for continuing response to the epidemic. These factors lend an even greater degree of uncertainty to projections than is generally the case.

The Five-Year General Fund Fiscal Projections (Attachment A) offer an illustration of where we expect the General Fund sources and uses to come in for each fiscal year between FY 2020-21 and FY 2024-25 under current policies. Table 1 shows a summary of these projections.

**Table 1: Project General Fund Source (revenues) and Uses (expenditures) in Millions of Dollars**

| | FY 20-21 Projected | FY 21-22 Projected | FY 22-23 Projected | FY 23-24 Projected | FY 24-25 Projected |
|---|---|---|---|---|---|
| Total General Fund Sources | $568.4 | $549.5 | $558.0 | $571.3 | $588.1 |

| | | | | | |
|---|---|---|---|---|---|
| Total General Fund Uses | $564.5 | $551.6 | $574.3 | $580.3 | $595.9 |
| Total Surplus (Deficit) | $3.9 | ($2.2) | ($16.3) | ($9.0) | ($7.8) |

On September 11, 2020, the Board of Supervisors adopted a balanced budget, which included reductions to various departments, and carving out $20 million of one-time discretionary resources to address COVID 19 pandemic response given the uncertainty of additional federal/state fiscal support. Since that time, we have seen some revenues, particularly taxes related to property transfers and sales tax, coming in better than the reduced values that were anticipated, which leads to an expected $3.9 million projected surplus for FY 2020-21. This depicted surplus, based on today's information, is the "estimated" General Fund position on 6/30/2021. In other words, the surplus has yet to materialize. In addition, it does not take into account new or increased needs that may have arisen following budget adoption, such as the potential for additional COVID 19 response. In 2021-22, there is a projected deficit of $2.2 million, which is projected to increase to $16.3 million in FY 2022-23 before declining in FY 2023-24 and FY 2024-25 to more moderate, but still negative, levels.

It is important to note that this model does not assume any corrective or balancing measures that will be taken to develop a structurally balanced budget, but rather forecasts current policies, including staffing levels and revenue streams, into the future. State law requires the adoption of a balanced budget, and Board policy dictates that a structurally balanced budget be adopted, where ongoing sources are sufficient to finance ongoing needs. Thus these projections should not be taken to indicate that the County expects to adopt unbalanced budgets in the future, but rather that, under existing conditions, policy changes that either reduce costs or increase revenues will be required such that the budget can be balanced. Staff will prepare the FY 2021-22 Recommended Budget based on projected available funds, which will include either increased revenues (if warranted) or decreased expenditures.

A look at the drivers of future-year projections follows.

While there is a projected $2.2 million deficit in FY 2021-22, general purpose revenues are expected to track in line with the increase in salary and benefits costs associated with the General Fund contribution to departments. This is due to a combination of the belt-tightening that the County has engaged in over the past two years and to the 4-year labor agreement that partially tie cost of living adjustments to inflation, which is currently low. Moderate growth in property taxes and sales tax, and an expected some rebound in transient occupancy tax from its depressed state is enough to match these increases. Instead, the projected deficit is driven by questions about how departmental revenues may be impacted, which means that individual departments may see more or less impact depending on their individual revenue streams. While most departments are not being asked to take cuts, there is not additional available revenue and departments have been instructed not to submit new programs that will require increasing their demand of discretionary General Fund support.

In FY 2022-23, the significant increase in the projected deficit is driven by two factors. First, the Behavioral Health Unit at the Main Adult Detention Facility is projected to begin staffing in that year. While the $45 million estimated capital project is fully funded with SB 863 and Tobacco Securitization funding, the staffing of the unit will require approximately $7 million annually according to early estimates, increasing current General Fund financed baseline operating costs. Second, pension rates, which stayed flat from FY 2019-20 to FY 2020-21 are expected to increase, accounting for much of the remaining increase. This increase is based on the recent trend in which investment returns have failed to match the planned discount rate, leading to a need for additional rate increases to meet the deficit. Should final investment returns meet or exceed the discount rate, this increase may not materialize.

In FY 2023-24 and FY 2024-25, the projected deficit decreases. This decline is tied to the decrease in debt payment levels associated with pension obligation bonds, as the 2003 bond series will be paid off in FY 2022-23. This decrease is partially offset by the decrease to sources due to 3-year PG&E funding that was programmed in the FY 2020-21 adopted budget falling off. Approximately $2.8 million in ongoing costs were funded for three years using this source. The model assumes that the previously PG&E settlement funded costs continue even as the funding for them goes away, leading to an increased deficit.

**Health and Human Services Projections**

While the General Fund represents the portion of the County budget over which the Board of Supervisors has the most discretion, the General Fund makes up less than one third of the total $1.9 Billion budget for entities governed by the Board of Supervisors/Directors. A significant portion of the remainder falls in the two largest County departments, the Departments of Health and Human Services, which make up 25% of the County's total budget. These agencies primarily sit outside the General Fund. While each receives a General Fund contribution, they are primarily funded through a variety of State and Federal programs. The County's adopted fiscal policies state that local funding will not be used to make up for reductions in State and Federal funding. Nonetheless, given the importance of social services to our community, at times the Board of Supervisors has decided to use discretionary resources to support critical services in these agencies that might otherwise be cut. As such, it is important to understand their fiscal outlook to have a fuller picture of the County's position. Health and Human departments' staff developed forecasts for today's update, which are discussed below.

Revenue & expense projections for the Human Services Department (HSD) over the next 5 years starting with this current FY 2020-2021 will be initially flat with tentative growth in the latter 2 years. Revenues in particular will be driven primarily by the Realignment revenue funds 1991 and 2011.

- Both 1991 and 2011 Realignment funds are based on state sales tax and Vehicle License Fees, which at the time these projections were made were facing significant challenges from a COVID-19 pandemic economy per the LAO analyses.
- A smaller-than expected $900 billion Federal stimulus package negotiated by Congress in late December 2020 provided no relief to the many state and local governments reeling from the pandemic economy. Local governments incurred significant debt to deal with COVID-19 mitigation in the absence of Federal relief efforts leading up to the passage of the bill on 12/27/20.

Expenses are projected to be flat as well, notwithstanding the assumed 3% Cost-of-Living Adjustment calculated into payroll costs for the next 5 years.

- In the Family, Youth & Children division, service levels can be maintained for Child Welfare Services even as efficiencies are implemented (e.g., underutilized contracts are decreased or terminated).
- In the Adult & Aging division, services will be maintained for senior clientele in line with flat funding sources.
- In the Economic Assistance division, demand for CalFresh and Medi-Cal services will increase due to the pandemic economy, which will be funded with state allocations expected to keep up with demand.

- In the Employment & Training division, falling caseloads for employment services will be offset by increased demand for housing and homelessness programs, and associated funding is expected to follow the need.

Given current projections, there are NO expected cuts to HSD programs or services in the next 5 years.

Health Services revenue Forecast assumptions include flat revenues for Realignment in Fiscal Year 2021-22 with growth coming in Fiscal Years 2022-23 through 2023-24. Federal and State awards are projected flat, Medi-Cal Federal Financial Participation includes an estimated 3% inflator as reimbursements are based upon costs that include an inflator. One-time discretionary funding provided by the Board of Supervisors has been removed of approx. $3 million for Peer and Family, Adult Full Service Partnership, and Animal Services, the department will bring these reductions as an add-back request during the budget hearings in June 2021.

Expenditure Forecast assumptions include an average of 3% inflator annually for Salaries and Benefits along with Services and Supplies.

Based upon the above assumptions and early forecast model the departments' expenditures trend to increase approximately 2.7% annually outpacing the revenues trend increase of 2.4% annually in future years.

**Fiscal Year 2021-22 Budget Development**

The FY 2020-21 Budget was adopted on September 11, 2020, and development of the FY 2021-22 began nearly as soon as it was completed. The key change for FY 2021-22 from the prior year is a return to the normal budget cycle. Due to COVID 19, the County approved a Recommended Budget in June and did not adopt the final budget until September, as is allowed under state law. For this budget cycle, we will be returning to adopting the budget in June.

Several key milestones have already been met, including the distribution of the preliminary General Fund Contributions to departments, which went out on December 1, 2020. These contributions were able to match FY 2020-21 levels and adjust for increase in expected wages and benefits costs included in General Fund programs' budgets. As such, we are not expecting General Fund departments to require significant reductions to meet their budgets, a thankful reprieve after recent years. While there should be fewer proposed reductions, there is not additional funding available for new needs and departments have been instructed not to submit requests for new programs that with augment their demand of discretionary General Fund support. A brief summary of upcoming key dates appears in Table 2 below.

**Table 2: Budget Calendar**

| Task Description | Date Completed |
|---|---|
| FY 21-22 Budget Planning & Outlook Report (Regular Item) | 01/05/21 |
| Q2 CBA (Consent Item) | 03/23/21 |
| Fee Hearings (Regular Item) | 03/23/21 |
| **Community & Board Budget Requests Submission Deadline** | **04/07/21** |
| 3 Day Budget Workshop Presentations (Regular Item) | 4/26/2021 to 4/28/21 |

| | |
|---|---|
| **Board Inquiry Requests Deadline** | **04/30/21** |
| Publish Recommended Budget Online | 05/14/21 |
| Conduct Budget Hearings | 6/15/2021 to 6/25/2021 |

Staff will return to the Board in March to present the Consolidated Fee Hearing, where operational cost increased or service improvement supported changes to fees and charges for FY 2021-22 will be presented for Board adoption.

The Community & Board Budget Requests was put in place in the FY 2019-20 budget development cycle in order to document, review, and track community funding requests not included in applicable departments' recommended budget, as well as individual Board Member funding requests. The Board established a form to allow staff to capture and analyze requests. See attached Community Based Organization Submission Form.

In FY 2021-22 the process will include a step where the community entity requesting funding must first secure endorsement from at least two Board of Supervisors members before the request is accepted by department staff for review and analysis, in line with direction given by the Board of Supervisors during the FY 2020-21 process. Individual Board Member funding requests do not need a second Board member endorsement. All Board of Supervisors' endorsed requests and associated department staff review will be included in the Board's Budget Hearings materials for consideration.

The budget development process includes two key avenues for the Board and the public to receive information from departments in advance of budget hearings. The first is the three-day Budget Workshops, which will be held from April 26 through April 28, 2021. These workshops will include an update of the Fiscal Forecast, a general overview of the budget, and presentations by each department highlighting their Recommended Budgets. Board members will be able to ask questions and the public will be able to comment at this time.

The second avenue is the Board Inquiry Request (BIR) Form. This was also begun during the FY 2019-20 budget cycle to ensure that departments have time to fully answer significant questions in advance of budget hearings and that Board members and the public have access to these questions in advance of budget deliberations. The deadline for Board member submission of BIR forms is April 30, 2021, following the Budget Workshops. This deadline is needed to ensure that staff have time to provide answers to questions and to compile these questions and responses as part of the materials that will be available to the Board and the public in advance of the Budget Hearings.

The Budget Hearings are scheduled to begin on June 15, 2021 and tentatively scheduled to end on June 25; however, as in prior years, they are likely to conclude on Friday, June 18 unless significant additional deliberation is necessary. Because the Board will have department/agency heads presentations during the April workshops, departmental presentations during Budget Hearings will not be included. Therefore, providing for a focused reviewed of the Recommended Budget and Board members deliberations to consider changes and/or adjustments.

**Prior Board Actions:**

September 11, 2020 - Adoption of the Fiscal Year 2020-21 budget.

**FISCAL SUMMARY**

| **Expenditures** | **FY 20-21 Adopted** | **FY21-22 Projected** | **FY 22-23 Projected** |
|---|---|---|---|
| Budgeted Expenses | | | |
| Additional Appropriation Requested | | | |
| **Total Expenditures** | | | |
| **Funding Sources** | | | |
| General Fund/WA GF | | | |
| State/Federal | | | |
| Fees/Other | | | |
| Use of Fund Balance | | | |
| Contingencies | | | |
| **Total Sources** | | | |

**Narrative Explanation of Fiscal Impacts:**

N/A.

| **Staffing Impacts:** | | | |
|---|---|---|---|
| **Position Title (Payro** | **Monthly Salary Range (A - I Step)** | **Additions (number)** | **Deletions (number)** |
| | | | |
| | | | |
| | | | |

**Narrative Explanation of Staffing Impacts (If Required):**

N/A

**Attachments:**

Attachment A: General Fund Fiscal Projections
Attachment B: Department of Human Services Fiscal Projections
Attachment C: Department of Health Services Fiscal Projections
Attachment D: Community and Board Budget Request Form

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

N/A