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NAPA COUNTY BOARD OF SUPERVISORS
Board Agenda Letter

TO: Board of Supervisors

FROM: Britt Ferguson for Nancy Watt - County Executive Officer
County Executive Office

REPORT BY: Patti DeWeese, Staff Services Analyst, 253-4197

SUBJECT: Approval of Fiscal Year 2008-09 Budget Policies and Budget Calendar

RECOMMENDATION

County Executive Officer requests approval of:

1. Proposed Budget Policies to guide the preparation and administration of the County's Fiscal Year 2008-2009 Budget; and
2. Proposed Fiscal Year 2008-2009 Budget Calendar.

EXECUTIVE SUMMARY

With the County's FY2008-09 Budget process getting under way, your Board is being asked to review, revise and/or approve the Proposed Budget Policies that will guide staff in preparing and administering the FY2008-09 Budget. Last year, staff provided your Board with a General Fund Five Year Revenue/Expenditure Forecast that projected General Fund revenues, expenditures and fund balance under three different scenarios. Based on these projections, staff concluded that, assuming no major program or personnel cost increases beyond those already known or reasonably anticipated, the General Fund appears to be in structural balance, but it is a somewhat precarious balance. Further, even under the worse case scenario, the County would likely have a number of years to come up with a plan to address any structural imbalance before significant expenditure reductions would be required. The Proposed Budget Policies take this information into account, but also reflect the fact that the County is facing certain fiscal uncertainties in the future. These uncertainties include:

- What the General Fund fund balance will be at the end of this fiscal year;
- A clear understanding of the long-term impact on the General Fund of revenue and expenditure decisions made this year and, in particular, whether last year's General Fund Five Year Forecast remains valid;
- The impact of the State's budget on the County;
- The impact of the downturn in the housing market and the economy generally on the County's property tax, sales tax and Transient Occupancy Tax revenues;
- The impact of the Adult Corrections Master Plan process currently under way as well as any new jail/probation obligations that might be imposed on counties by the State; and

- The impact of the healthcare reform proposals being negotiated by the State Legislature and the Governor.

Given this, key provisions of the Proposed Budget Policies include:

- For General Fund departments (except Health & Human Services), prepare budgets with a goal of funding no more than current staffing levels. Departments are also asked to prepare a Decision Package showing the impact of holding the Net County Cost to the current (FY2007-08 Final Budget) level.
- For non-General Fund departments and Health & Human Services, prepare budgets with a goal of holding the General Fund Contribution or Net County Cost to the current (FY2007-08 Final Budget) level.
- No new or enhanced programs are to be proposed, unless they are funded by dedicated revenues, relate to the planning and implementation of the Adult Correctional System Master Plan or involve the strategic investment of a limited amount of General Fund resources to meet critical needs and in accordance with certain criteria.
- Delete all vacant unfunded positions and all positions that have been vacant for more than 6 months, unless retention of a vacant funded position has been approved by the County Executive Office.
- For departments or budget units with 20 or more allocated positions, budgets should be reduced to reflect historic salary savings.
- Seek enhanced operational efficiency by eliminating, combining or reorganizing programs to reduce expenditures and/or respond to changing needs and priorities.
- Do not backfill reductions in State or federal funding unless there is a legal mandate to do so or the program is a high priority for the Board.
- Place at least 3% of the General Fund's appropriation in Contingency and work toward a goal of building General Reserves equivalent to approximately 5% of General Fund appropriations.
- Fiscal conditions permitting, transfer General Fund resources to the Special Projects Fund in an amount equal to 12.5% of the prior calendar year's actual Transient Occupancy Tax revenue.
- Continue to fully fund the County's Other Post Employment Benefit (OPEB) unfunded liability on a 14 year amortization schedule and allocate the costs to relevant County departments.
- After meeting operating and capital budget needs, the General Fund Contingency and General Reserve requirements and making any required designations, place any remaining discretionary resources in the Accumulated Capital Outlay (ACO) Fund as capital reserves.

Your Board is also being asked to approve a proposed Budget Calendar for FY2008-09. This calendar includes the schedule for preparing the FY2008-09 Budget, as well as the schedule for preparing FY2007-08 Mid-Year and Third Quarter fiscal reviews and the Five Year General Fund Forecast. Key dates include presentation to your Board of the Mid-Year fiscal review on March 11th, your Board's Budget Study Session on April 8th and Budget Hearings on June 9th through 11th.

FISCAL IMPACT

Is there a Fiscal Impact? No

ENVIRONMENTAL IMPACT

ENVIRONMENTAL DETERMINATION: The proposed action is not a project as defined by 14 California Code of Regulations 15378 (State CEQA Guidelines) and therefore CEQA is not applicable.

BACKGROUND AND DISCUSSION

Staff will soon begin the process of preparing the County's FY2008-09 Proposed Budget. One of the first steps in that process is to seek direction from your Board on Budget Policies that will guide staff in preparing and administering the Budget. To that end, the attached "Proposed FY2008-09 Budget Policies" are recommended for your review, possible modification and approval.

Over the last few years, your Board has controlled spending, and prudently set aside significant reserves and designations, to help ensure that funding for County programs can be sustained at an appropriate level. Nevertheless, the County is facing a number of uncertainties with regard to this fiscal year, next fiscal year and the fiscal years immediately following. Those uncertainties include:

- We do not know how much General Fund fund balance will be available at the end of this fiscal year. That fund balance will serve as an important resource for financing FY2008-09 expenditures and/or building appropriate reserves. We will be starting the FY2007-08 Mid-Year fiscal review process in January and will be able to provide your Board with a status report by mid March. However, past experience has shown that the Mid-Year fiscal review is not as accurate at estimating the ending fund balance as the Third Quarter review, which will not be available until May.
- The longer-term fiscal condition of the General Fund will need to be projected, since expenditure decisions made in FY2008-09 will have an impact on future years' budgets. As your Board knows, a General Fund Five Year Revenue/Expenditure Forecast, prepared in April of last year, projected revenues, expenditures and ending fund balance under three different scenarios. Based on these projections, staff concluded that, assuming no major program or personnel cost increases beyond those already known or reasonably anticipated, the General Fund appears to be in structural balance, but it is a somewhat precarious balance. A fairly small increase in Net County Cost or decrease in discretionary revenues could push the General Fund into structural imbalance, requiring expenditure reductions or revenue increases to balance the budget in future years. At the same time, given the relatively robust nature of the General Fund's fund balance, staff concluded that, even under the worse case scenario, the County would have a number of years to come up with a plan to address any structural imbalance before significant expenditure reductions are required. Taken together, this suggested that it would be prudent to invest a limited amount of General Fund resources in new staff or programs, if the investments are strategically targeted to address the Board's key priorities. However, new issues have arisen or information has become available since last year's Five Year Forecast (some of which is discussed below). Following the completion of the FY2007-08 Mid-Year fiscal review in March, staff will prepare a new General Fund Five Year Forecast, which will provide your Board with updated projections of the General Fund's fiscal condition.
- The impact on the County of the State's budget situation is not entirely clear, but it is clear that the State's fiscal condition has significantly deteriorated compared to this time last year. In November, the Legislative Analyst's Office (LAO) released a report that estimated the State will end the current fiscal year with a $1.9 billion deficit and, with no policy changes, the State will end the FY2008-09 fiscal year with an additional $8 billion deficit. This cumulative $10 billion shortfall will need to be addressed, either through expenditure reductions or revenue increases, in this fiscal year and FY2008-09. In addition, the LAO is projecting a State budget deficit of $8 billion in FY2009-10 and then the annual operating deficit will decrease to approximately $3 billion a year. As in past periods when the State has faced fiscal difficulties, and notwithstanding the protections provided local governments by Proposition 1A, it is likely that there will be efforts by the Governor and Legislature to reduce State funding to counties and.or to shift costs from the State to local governments generally. We will have some idea of what the impact of the State budget on the County might be after the Governor issues his FY2008-09 Proposed Budget and an even better idea after he issues his May Revise.
- The bursting of the so-called "housing bubble" that has occurred nationally, and the related constriction in the credit markets, is also impacting Napa County and will likely result in a decrease in the rate of growth in County property tax revenues, which account for over 70% of the County's discretionary revenues. Over the

last 10 years, the County's property tax revenues have increased by an average of about 10% a year. For FY2007-08 it appears that property tax collections will probably meet budget projections. However, for future years the County Assessor is advising that the rate of County-wide assessed value growth will likely decrease - to around 4% in 2008 - and may decline even further in the following years, as occurred from 1994 through 1997.

- Nationally and statewide overall economic conditions have worsened considerably compared to a year ago, driven in part by the severe decline in the housing market mentioned above. Most economists are not predicting a recession at this time, but are predicting a significant slowing of growth. At this point, it appears that the Bay Area is faring better than some other parts of the state and the County's sales and transient occupancy tax (TOT) revenues remain relatively robust. Nevertheless, a general economic decline could negatively impact County sales and TOT revenues which, together, account for almost 20% of the County's discretionary revenues.
- Another future cost impact is implementation of the County's Adult Correctional System Master Plan. In November, the Board approved Phase I of that plan, which calls for implementing evidence-based practices designed to reduce recidivism, the creation of a Community Corrections Services Center and major changes to the mix of beds in the jail, which could require new construction. Phase II of the planning process, which is just getting under way, will provide detailed cost estimates, but it is clear that there will be significant costs. In addition, a Federal Court three-judge panel is currently considering a request to reduce the state prison system's population. Depending on what this panel does and how the state reacts, it could result forcing counties to keep certain state prisoners at the local level, which could result in increased operating and capital costs for the County.
- The Governor and legislature are currently grappling with the issue of healthcare reform. At this point it is not clear what approach, if any, may be adopted, but the proposal currently under consideration would relieve the counties of certain indigent healthcare obligations and require that counties "contribute" approximately $1 billion toward the healthcare reform program, most likely by redirecting certain Realignment revenues that now go to the counties. Unfortunately, the current proposal would not relieve the counties of their Welfare and Institutions Code Section 17000 obligation to provide indigent healthcare and it is not clear precisely what healthcare obligations would remain with the counties, what the cost of those obligations are and whether the amount that would be "contributed" to the plan by the counties fairly reflects the cost of the services the counties would no longer have to provide.

Given the above, the Proposed Budget Policies include the following key provisions:

- For General Fund departments (except Health & Human Services), prepare budgets with a goal of funding no more than current staffing levels. Departments are also asked to prepare a Decision Package showing the budget impact of holding the Net County Cost to the current (FY2007-08 Final Budget) level. Based on what we know about the current fiscal situation, it makes sense to budget conservatively, but not to require staffing reductions that might otherwise be necessary to fund salary and benefit cost increases approved this year. The Decision Packages would be used on a case by case basis if additional fiscal information suggests that expenditure reductions are necessary. Your Board has directed staff to prepare a Strategic Financial Plan for the County. Once prepared and approved by your Board, that plan will provide long term direction for funding levels for different departments and programs.
- For non-General Fund departments and Health & Human Services, prepare budgets with a goal of holding the General Fund Contribution or Net County Cost to the current (FY2007-08 Final Budget) level. If necessary, Health & Human Services can prepare a Decision Package that shows the impact of increasing Net County Cost for critical programs to maintain current staffing. Depending on specific circumstances and based on the most recent fiscal information available, the Decision Package will be considered by the County Executive Officer. These are departments that are typically funded with State and/or federal revenue or other dedicated resources and it is prudent to size the programs to fit the available revenues. There may be exceptions to this in Health & Human Services if holding to the current Net County Cost results in unacceptable impacts to critical programs (and one likely exception would be the need to cover the cost of

allocating OPEB costs to departments as described below).

- Do not propose any new or enhanced programs, unless they are funded by dedicated revenues, are related to preparing and implementing the Adult Correctional System Master Plan or involve the strategic investment of a limited amount of General Fund resources in accordance with certain criteria. Those criteria include, among other things, whether the investment will target high priority areas (accountability and compliance; critical public health and safety needs), whether the request is well justified, how critical the need is, and whether the proposal addresses a critical liability issue for the County. These investments would only be made to the extent sufficient resources are available, based on the updated General Fund Five Year Forecast. The proposed criteria generally reflect the factors approved by the Board as part of the FY2007-08 budget process, except that organizational development and Board-community relations has been eliminated. This change recognizes that a number of organizational development and Board-community relations initiatives were funded in FY2007-08 and the potential deterioration in the fiscal prospects means that investments should be limited to dealing with issues that involve potential significant liability to the County. The proposed commitment to continuing with the Adult Correctional System Master Plan process reflects the fact that there are potentially significant liability issues related to the County's jail situation and there are long lead times for implementing many of the plan's components and it does not make sense to proceed in fits and starts.
- Delete from the Department Allocation List all vacant unfunded positions and vacant funded positions that have been vacant for more than 6 months, unless the County Executive Office has approved retaining a vacant unfunded position.
- To the extent permitted by law, all revenues not previously earmarked for a particular purpose by the Board are to be treated as discretionary revenues rather than tied to a particular program, thus providing the Board with as much flexibility as possible in terms of use of resources.
- Seek operational efficiencies by eliminating, combining or reorganizing programs to reduce expenditures and/or respond to changing needs and priorities. In general, the goal is to make sure that programs are still serving an important need or Board priority and, if so, that services are provided as cost-effectively as possible.
- If funding is reduced for programs that are primarily a non-General Fund responsibility, there will be no increase in General Fund Contribution unless that is legally mandated or the program is a high priority for the Board.
- For departments or budget units with 20 or more allocated positions, Departments should submit a budget that includes a reduction in salary and benefit costs to reflect a vacancy factor based on historic vacancy rates for that program, adjusted to reflect current circumstances. This policy, given the goal of funding current staffing levels in the General Fund, will help to ensure that Net County Cost is not over-budgeted.
- Place at least 3% of the General Fund's appropriation into Contingency and work toward a goal of building General Reserves equivalent to approximately 5% of General Fund appropriations. The Contingency would be utilized to cover the impact of unanticipated cost increases or revenue decreases during the fiscal year. With regard to the General Reserves, the idea would be to add to the reserves when resources are available until the 5% level is reached. Then, in times of fiscal difficulty, the Reserves can be utilized to help phase into needed reductions in expenditures. Cities and counties typically maintain contingencies in the area of 3 to 5% of appropriations. The FY2007-08 Final Budget included $5.6 million in the General Fund Contingency, which represents approximately 3% of General Fund appropriations. The FY2007-08 Final Budget included General Reserves of approximately $9.26 million, which represents approximately 4.5% of appropriations. The amount of General Reserves appropriate for a local government can vary considerably depending on specific circumstances, with goals in the range of 5 to 10% appropriations being common. Reserves are typically used for two purposes: to provide funds that can be used in future years to balance the budget (reserves cannot be spent in the current fiscal year) and to aid in cash flow, so that short term borrowing against anticipated revenue is not needed. In Napa County's case, we not only have General Reserves, but also Fund Balance Designations which are typically earmarked for a specific purpose. Thus staff believes that a prudent Reserve of 3% and a goal over time of 5% would be adequate.
- Fiscal conditions permitting, transfer General Fund resources to the Special Projects Fund in an amount

equal to 12.5% of the prior calendar year's actual Transient Occupancy Tax (TOT) revenue received by the County. Money in the Special Projects Fund will be used to fund programs or services related to parks and open space, visitor management and arts and culture.

- Continue to fully fund the County's OPEB liability on a 14 year amortization schedule by transferring funds to an irrevocable trust. Allocate the FY2008-09 OPEB costs to the relevant County departments based on a State-approved allocation formula. In the current (FY2007-08) fiscal year, the County's OPEB contribution is budgeted in one General Fund budget unit. This policy would provide that the cost of the contribution (approximately $6 million in FY2008-09) would be allocated to all appropriate County departments for two primary reasons: (1) it more accurately reflects the cost of the programs and treats OPEB the same way the County treats other benefit costs, like PERS and employee health insurance; and (2) in certain areas allows departments to claim the cost against federal and state revenue sources and include the cost in fees for service.
- After meeting FY2008-09 operating and capital budget needs, the General Fund Contingency and General Reserve requirements and making any required designations, place any remaining discretionary resources in the Accumulated Capital Outlay (ACO) Fund to be retained as capital reserves. This is being recommended due to the number of significant new capital projects on the horizon including the potential construction of jail beds and a new County Administration Building.
- Include quantitative performance measures and narrative information about the those performance measures consistent with the recommendations described at the Board's Performance Measure Work Session.

Also attached is the proposed FY2008-09 Budget Calendar. This calendar sets out the schedule for preparing the FY2008-09 Budget as well as the schedule for the FY2007-08 Mid-Year and Third Quarter reviews and the General Fund Five Year Forecast. As you can see, the schedule calls for your Board receiving a Mid-Year fiscal review on March 11th, holding a Budget Study Session on April 8th and holding budget hearings on June 9th through 11th.

SUPPORTING DOCUMENTS

A . Proposed FY2008-09 Budget Policies

B . FY 2008-2009 Budget Calendar

CEO Recommendation: Approve

Reviewed By: Maiko Klieman