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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 2007-08 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 2007-2008 Budget; and
2. Proposed Fiscal Year 2007-2008 Budget Calendar.

EXECUTIVE SUMMARY

With the County's FY2007-08 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 FY2007-08 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 addressing the County's unfunded Other Post Employment Benefits (OPEB) unfunded liability; and
- 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.

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 (FY2006-07 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 (FY2006-07 Final Budget) level.
- No new or enhanced programs are to be proposed, unless they are funded by dedicated revenues 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.
- Cancel the existing $4.14 million OPEB designation and use that money to make first year payment to PERS to begin funding the County's OPEB unfunded liability.
- 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 FY2007-08. This calendar includes the schedule for preparing the FY2007-08 Budget, as well as the schedule for preparing FY2006-07 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 13th, your Board's Budget Study Session on April 10th and Budget Hearings on June 18th through 20th.

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 FY2007-08 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 FY2007-08 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 FY2007-08 expenditures and/or building appropriate reserves. We are just starting the FY2006-07 Mid-Year fiscal review process 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 FY2007-08 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 enhance operational efficiency, effectiveness or accountability in selected areas. 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 FY2006-07 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. Like last year, the information available at this point suggests that the State's fiscal situation is relatively good, at least compared to the prior four years, but the State still faces a structural deficit. In a November 2006 report, the Legislative Analyst's Office (LAO) indicated that, while the State's General Fund is projected to end this fiscal year with $3.1 billion in reserve, in each of the subsequent two fiscal years expenditures will exceed revenues by over $5 billion. In the fiscal years after 2008-09, the LAO projects that the State's operating shortfalls will decline, but will still exceed $1.2 billion in FY2011-12. These operating shortfalls will need to be addressed either through revenue increases or expenditure reductions. Further, notwithstanding the protections provided local governments by Proposition 1A, counties continue to be at risk for efforts by the Governor and/or legislature to shift costs from the State to local governments. We will have some idea of what the impact of the State budget on the County might be after the Governor issues his FY2007-08 Proposed Budget and an even better idea after he issues his May Revise.

- One of the potential future cost impacts the County faces is addressing our Other Post Employment Benefits (OPEB) unfunded liability. As the Board is aware, a recent actuarial study commissioned by the

County, determined that the County's OPEB unfunded liability is between $37 and $51 million. Staff is currently evaluating options for funding that unfunded liability, but the annual cost of fully funding that liability could range as high as an additional $3 to $5 million.

- Another potential future cost impact is the possible need for additional jail beds and/or probation services. As the Board knows, staff have been working on developing an Adult Corrections Master Plan that would identify the long-term need for jail beds and probation programs. More recently, various State actions suggest that counties may be required to assume significant additional jail/probation obligations. For example, the Governor has proposed placing offenders sentence to a year or less of custody in county jails rather than State prison (currently, offenders sentenced to more than one year of custody are sent to State prisons). And, although the Governor has proposed providing some State money for local jail construction, he has not proposed providing any additional funds for jail operating costs. In addition, with the passage by the voters of "Jessica's Law," that strengthens penalties and supervision requirements for certain sex offenders, it is possible that County probation departments will face a significant increase in responsibility and costs.

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 (FY2006-07 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 (FY2006-07 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.

- Do not propose any new or enhanced programs, unless they are funded by dedicated revenues 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; and organizational development and Board-community relations), whether the request is well justified, whether the request addresses needs that have long gone unmet and how critical the need is. This policy recognizes that, though it is somewhat precarious, the General Fund is likely in structural balance so there is an opportunity to invest in some critical unmet needs. 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 FY2006-07 budget process, except that organizational development and Board-community relations is substituted for internal services infrastructure. This change recognizes that a number of internal services infrastructure enhancements were approved in FY2006-07 and that staff will be proposing major organizational development and Board-community relations initiatives, designed to address critical issues the County is facing.

- 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 FY2006-07 Final Budget included $5 million in the General Fund Contingency, which represents approximately 3% of General Fund appropriations. The FY2006-07 Final Budget included General Reserves of approximately $8.84 million, which represents approximately 4.6% 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.

- Cancel the $4.14 million OPEB designation and use that money to make a first year payment to PERS to begin funding the County's OPEB unfunded liability. Depending on decisions made regarding amortization of the County's unfunded liability, if necessary make additional payments to PERS.

- After meeting FY2007-08 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 additional jail beds and a new County Administration Building.

- Continue to include quantitative performance indicators in the Recommended Budget document.

Also attached is the proposed FY2007-08 Budget Calendar. This calendar sets out the schedule for preparing the FY2007-08 Budget as well as the schedule for the FY2006-07 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 13th, holding a Budget Study Session on April 10th and holding budget hearings June 18th through 20th.

SUPPORTING DOCUMENTS

A . FY2007-08 Proposed Budget Policies

B . FY2007-08 Proposed Budget Schedule

CEO Recommendation: Approve

Reviewed By: Maiko Klieman