FY2016-17 Recommended Budget
ECONOMIC AND FISCAL CONTEXT

Economic conditions nationally and locally have generally been improving over the last four to five years – though that improvement has not always been consistent or robust.

In April, the national unemployment rate stood at 5%, down from 5.4% a year ago. The unemployment rate has been decreasing steadily since October of 2009, when it reached 10%, though it has hovered at around 5% for the last 7 months. The last time the national unemployment rate was at or below 5% was in 2007. Although the unemployment rate has been declining for a number of years, average wages were not increasing until recently, when we have begun to see a small rise in both workforce participation rates and average wages.

Housing has been one of the national economy's strongest growth sectors over the past few years, and it appears that growth in this sector will continue but at a somewhat slower pace. The U.S. Department of Commerce reported that housing starts in April climbed 6.6% to an annual number of 1.17 million, but permits for new construction, a sign of future demand, are running 5.3% below year-ago levels. In 2015, home prices rose 4%, following a 6.4% rise in 2014. In January, Kiplinger projected that home price growth in 2016 would be an even more moderate 3% nationally.

Overall, the U.S Gross Domestic Product (GDP) increased at an annualized average rate of 0.5% in the first quarter of 2016. This is the slowest pace in two years, and is likely due largely to weak global financial conditions and the plunge in oil prices. Many economists believe that the rate of economic growth will improve in future quarters, but will trend slightly lower than last year. For example, the most recent report from the Federal Reserve Open Market Committee reflects a median 2016 GDP growth forecast of 2.2%, compared to actual growth rates of 2.4% in 2014 and 2015.

Although the available data suggests that the economy will continue to grow in 2016 and 2017, albeit perhaps at a slightly reduced rate, some economists and others have suggested that there are potential risk factors that could throw economic growth off track. Some of these risk factors were noted by the Governor in his May Budget Revise, including:

- Emerging market growth, including China, has been slowing and is expected to stay low;

- There is uncertainty about the growth path in the European Union, particularly if Britain exists the Union;
- The stock market remains volatile; and
- The current economic expansion is now in its 7th year, and the average length of a post-recession expansion is about 5 years with the longest U.S. expansion having lasted 10 years, so we are due for another recession.

Locally, the unemployment rate declined to 5.5% in March from 6.3% a year ago. In April, the median price of an existing single family home in Sacramento County was $295,000, a 9.3% increase over the median price in April of 2015. The number of new residential units permitted in Sacramento County increased by 49% in calendar year 2015 compared to 2014, though the 2015 number was still less than a third of the new residential units permitted in 2004, at the height of the housing bubble.

The Recommended Budget reflects some of the positive impacts of the improving economy, including:

- Secured Property Tax and Property Tax in Lieu of Vehicle License Fee (VLF) revenue, which constitutes over 65% of the County's discretionary revenue, are projected to grow by 5.9% compared to the FY2015-16 Adopted Budget estimate. This will be the fourth year in a row of increasing property tax revenue from these sources.

- Supplemental Property Tax revenue, which captures the impact of new construction and property sales on assessed value, is projected to increase by 20% compared to the FY2015-16 Adopted Budget estimate, which itself reflected a 29% increase compared to the prior fiscal year's Adopted Budget estimate.

- The FY2016-17 Recommended Budget includes approximately $14 million in Realignment "Growth" revenue, which is driven largely by statewide sales tax and Vehicle License Fee revenue growth. This Growth revenue was used to cover increased Base Budget costs in realigned programs and, in some cases, to reduce Net County Cost that used use to fund Base Budgets in other departments.

Collectively, we are projecting that **on-going** discretionary revenue and reimbursements will grow by approximately $25 million, or 4.6%, in FY2016-17 compared to the FY2015-16 Adopted Budget estimate. We are also projecting that FY2016-17 Title IV-E Foster Care costs will come in approximately $9 million lower than the FY2015-16 Adopted Budget level and we will receive an additional $5 million in Title IV-E and other foster care related federal revenue. The impact of this and other good news on the County's General Fund is partly offset by a number of factors that include:

- The FY2015-16 Adopted General Fund Budget was balanced using approximately $15.8 million in one-time discretionary revenue and that revenue is not available in FY2016-17. Consequently, the FY2016-17 Recommended Budget actually only reflects a $9.2 million, or 1.6%, increase in discretionary revenue and reimbursements compared to the FY2015-16 Adopted Budget.

- The FY2016-17 Recommended General Fund Budget is balanced using a one-time carry-forward of approximately $13 million in Realignment revenue and by once again delaying the shift in responsibility for $2.8 million in COPS debt service from the Capital Construction Fund (CCF) to the Sheriff's and Animal Care budgets. If these actions are factored out, FY2016-17 budgeted Net County Cost would exceed available discretionary resources by approximately $15 million.

- FY2016-17 General Fund Base salary and benefit costs will increase by approximately $37.2 million (3.3%) compared to the FY2015-16 Adopted Budget, reflecting negotiated cost of living increases, health insurance cost increases and the impact of positions added during FY2015-16, such as the 27 new Sheriff's Department positions funded during FY2015-16 at cost of approximately $4 million in FY2016-17. In FY2016-17, most County employees will receive a 4% salary increase in accordance with collective bargaining agreements with the County's various unions.

- The Recommended Budget also includes approximately $1 million in increased Net County Cost funding for Homeless programs in the Human Assistance - Administration budget that was approved during FY2015-16 and an additional $5 million in Net County Cost funding for crisis residential and Psychiatric Health Facility (PHF) beds in the Health & Human Services budget, reflecting increasing demand for services.

- The Recommended Budget includes a minimal $1.9 million Contingency and limited discretionary reserves.

- The Recommended General Fund Budget only includes $2 million in Interfund transfer repayment, which is approximately $4 million less than the amount included in the FY2015-16 Adopted Budget. With this repayment amount, the General Fund will still owe approximately $42 million at the end of FY2016-17 and repayment of this amount will be an issue in future years' budgets.

- As noted above, Departments requested approximately $32 million in Net County Cost-funded Growth requests, and this Budget only recommends funding for less than $1 million of that amount. Many of the remaining requests address significant community needs or issues, including expansion of the Early Intervention Drug Court, increased residential drug treatment capacity, increased services in Foster Care, Child Protective Services and Adult Protective Services, Probation supervision for additional high risk felony offenders and the opening of a Neighborhood Alternative Center to provide alternative residential and non-residential services to youth on probation, and the renovation of the Warren E. Thornton Youth Center to serve commercially exploited, crossover foster youth and foster children in need of short-term, mental health placements under Child Welfare Continuum of Care Reform. Board members have also expressed an interest in providing a General Fund contribution to the Roads Fund to address road maintenance needs, and we are facing significant staffing issues in the County jails and the need for costly upgrades to the County's budget, property tax and elections software systems. Although discretionary resources were not available to fund these requests and needs in FY2016-17, the identified needs will likely be an issue in future year's budgets.

General Fund Three Year Sensitivity Analysis

Recognizing that expenditure and revenue decisions made in one year can have a significant effect on the resources that will be available to General Fund programs in future years, but also recognizing the difficulties in predicting future year economic and fiscal conditions, we are providing the Board with a Three Year Sensitivity Analysis that suggests what the impact could be on the General Fund's fiscal conditions under three scenarios:

- A "Moderate Revenue Growth" Scenario that assumes total discretionary revenue and reimbursements will grow at an average annual rate of 5% over the projection period and that Net County Cost will grow at an average annual rate of 2%, after adjusting for known changes in Net County Cost, or some combination of the two that has the same effect (for example, a 6% average annual increase in discretionary revenue and reimbursements and a 3% average annual increase in Net County Cost). Based on recent economic trends and fiscal conditions, we believe that this is a reasonable scenario to use for fiscal planning purposes.

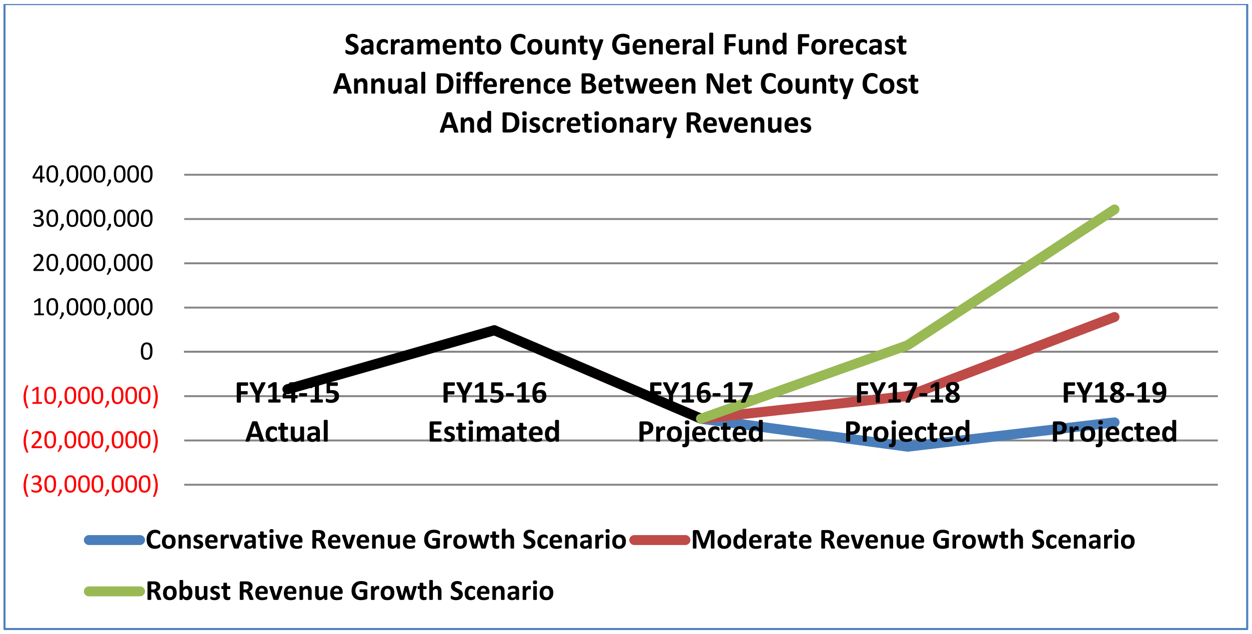
- A "Conservative Revenue Growth" Scenario that shows what the impact might be if discretionary revenue grew at a slower rate or Net County

Cost increased at a higher rate than the assumptions used in the Moderate Growth Scenario. This Scenario assumes total discretionary revenue and reimbursements will grow at an average annual rate that is 2% lower than the Moderate Growth assumption (i.e., 3% a year as opposed to 5%), but the effect would be the same if Net County Cost increased at rate that is 2% higher than the Moderate Growth assumption (4% compared to 2%) or if discretionary revenue grew at a rate that is 1% lower than the Moderate Revenue Growth Scenario and Net County Cost grew at a rate that is1% higher.

- A “Robust Revenue Growth” Scenario that shows what the impact might be if discretionary revenue grew at a faster rate or Net County Cost increased at a lower rate than the assumptions used in the Moderate Growth Scenario. This Scenario assumes total discretionary revenue and reimbursements will grow at an average annual rate that is 2% higher than the Moderate Growth assumption(i.e., 7% a year), but the effect would be the same if Net County Cost increased at a rate that is 2% lower or some equivalent combination of the two.

All projections use the FY2016-17 Recommended Budget discretionary revenues and reimbursements and Net County Cost as a starting point, adjust the budgeted Net County Cost downward to reflect the historic difference between budgeted and actual Net County Cost and make certain other adjustments based on known or likely changes, such as the full year implementation cost of partial year funding included in the FY2016-17 Recommended Budget and reductions or elimination in one-time costs or revenues.

The results of these different scenarios are shown in the following table:



As can be seen, depending on the assumptions used, the Sensitivity Analysis provides a fairly wide range of possible outcomes. Given all of the uncertainties involved in projecting into the future, it is likely that the General Fund's fiscal condition will be different from all three scenarios. Notwithstanding this, we believe it is possible to draw two conclusions:

- The General Fund will likely not be in structural balance over the three year projection period but, if costs can be controlled and revenues increase at a fairly robust rate, it is possible that structural balance can be achieved by FY2018-19.

Given the uncertainties involved in some of the assumptions, the fact that these assumptions only assume repayment of the Inter-fund balance transfers at a rate of $2 million a year and do not relieve the Capital Construction Fund of responsibility for Sheriff's and Animal COPs debt service costs and that the General Fund has only limited discretionary reserves, we believe it would be prudent over the next few years to focus on controlling costs and building reserves rather than adding or expanding programs.