FY2018-19 Recommended Budget
ECONOMIC AND FISCAL CONTEXT

The national economy grew at a solid but steady pace in 2017 and it appears likely that trend will continue into the near future. The U.S. Gross Domestic Product (GDP) grew at an annualized rate 2.3% in the first quarter of 2018. This is the same rate of GDP growth as in 2017 and is slightly above the post-recession average of 2.1%. Most forecasts are projecting continued growth at roughly this rate or higher for the next few years. For example, the most recent report from the Federal Reserve Open Market Committee reflects a median GDP growth forecast of 2.7% in 2017 and 2.4% in 2018.

After steadily decreasing since 2009, the national unemployment rate held steady at 4.1% for six months until, in April, it fell to 3.9%, the lowest point since 2000. A number of economists are projecting continued declines in the unemployment rate. For example, a recent Federal Reserve Open Market Committee report reflects a median unemployment rate forecast of 3.8% in 2018 and 3.6% in 2019. These are rates not seen since the mid to late 1960s.

In other good news, the number of jobs added each month has continued to increase and data suggests fewer people are facing layoffs: initial claims for state unemployment benefits hit 211,000 during the last week in April, the lowest level since March of 1973. On the other hand, despite significant job growth and the decline in unemployment, wage growth has remained relatively sluggish.

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, though possibly at a reduced rate. The U.S. Department of Commerce reported that housing starts in March climbed by 10.9% compared to March 2017, to an annual number of 1,319,000. Permits for new construction, a sign of future demand, are running 7.5% above the March 2017 level. However, much of the increase in homebuilding is in the more volatile multi-family market. Single-family homebuilding, which accounts for the largest share of the housing market, fell 3.7% in March compared to the prior month.

Despite recent projections of a slow-down by economists and housing industry analysts, home prices nationally are continuing to increase. The Home Price Index from real estate data provider CoreLogic showed yearly price growth of 6.7% in February, up from a 6.1% annual price gain in the prior three months. In the last quarter of 2016, home prices were 6.2% higher than they were in the first quarter of 2016. A report from Zillow showed that in March the median home price increased by 8% over the last year and Zillow projects the median price will increase by 4.2% over the next year.

Home prices in California are also continuing to rise. According to a recent report by Beacon Economics, the median price for an existing single-family home in California came in at $468,520 in the fourth quarter of 2017, a 9.8% increase over the same period one-year prior. Beacon Economics also notes that the inventory of homes on the market remains tight, which will support continued growth in home prices across the State.

Locally, the economy continues to improve. A September 2017 report from the U.S. Bureau of Economic Analysis indicated that the region's economy grew by 3.1% in 2016, higher than the statewide growth rate of 2.9%. In 2016, the four-County Sacramento region's GDP was approximately $128 billion, the highest the region's GDP has ever been. In March 2018, the Sacramento region's unemployment rate declined to 3.9% from 5% a year ago and the number of jobs in the region increased by 20,000, or 2.1%, between March 2017 and March 2018. The March 2018 unemployment rate in Sacramento County was also 3.9%. In March, the median value of an existing home in Sacramento County was $359,609, according to Zillow, up approximately 8.7% from March 2017. Zillow recently projected that home values in Sacramento County will rise 5.9% over the next year.

The Recommended Budget reflects some of the positive impacts of the improving economy. For example:

- Secured Property Tax and Property Tax in Lieu of Vehicle License Fee (VLF) revenue, which constitute over 65% of the County's discretionary revenue, are projected to grow by 6.2% compared to the FY2017-18 Adopted Budget level and 6.8% compared to FY2017-18 estimated actual amounts. This will be the sixth year in a row of increasing property tax revenue from these sources.

- Sales and Use Tax revenue is projected to grow by 3.6% compared to the FY2017-18 Adopted Budget level and 0.6% compared to the FY2017-18 estimated actual amount (there were a number of one-time adjustments in FY2017-18).

- Transient Occupancy Tax revenue is projected to grow by 7.1% compared to the FY2017-18 Adopted Budget level and 3% compared to the FY2017-18 estimated actual amount.

- Proposition 172 revenue, which comes from a statewide sales tax levy, is projected to grow by 4.6% compared to the FY2017-18 Adopted Budget level.

- Non-CalWORKS Realignment revenue, which comes from statewide sales tax and vehicle license fees, is projected to grow by 4.6% compared to the FY2017-18 estimated actual amount.

Collectively, we are projecting that discretionary revenue and reimbursements will grow by approximately $28.9 million or 4.8%, compared to the FY2017-18 Adopted Budget amount, and by $24 million (3.7%) compared to the FY2017-18 estimated actual amount. 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 FY2017-18 Budget was balanced using approximately $3.8 million in one-time discretionary revenue and the FY2018-19 Recommended Budget only includes $1.2 million in one-time revenue.

- The Recommended Budget includes a new $7.8 million Net County Cost payment to UC Davis under the terms of the recent litigation settlement agreement. The County will be making annual payments of this magnitude or greater for the next 15 years.

- The Recommended Budget includes approximately $8.5 million in Net County Cost funding for new or enhanced programs, including $2.95 million in funding for the Medi-Cal Alcohol and Drug Waiver. This $2.9 million commitment will double in FY2019-20 and become an on-going expenditure commitment.

- Collectively, departments requested over $33 million in Net County Cost-funded Growth requests, and this Budget only recommends funding for approximately $8.5 million of that amount. Many of the remaining requests address significant community or organizational needs (including investments to address operational and capital deficiencies in the jails) that will likely be an issue in future years' budgets.

General Fund Five-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 Five-Year Sensitivity Analysis that suggests what the impact could be on the General Fund's fiscal condition under three scenarios:

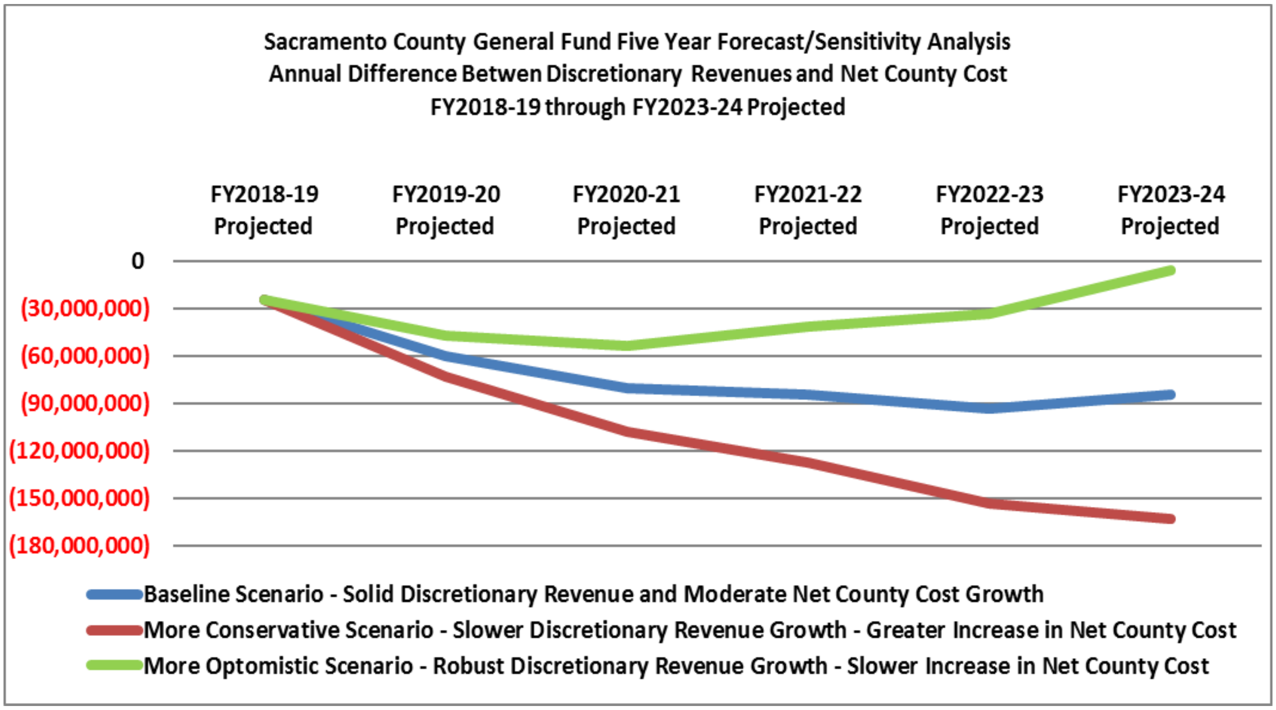
- A “Baseline” Scenario that assumes discretionary revenue and reimbursements will grow at a solid annual average rate of 5% over the projection period and that Net County Cost will grow at a moderate average annual rate of 3%, after adjusting for known or likely changes in Net county Cost. Based on recent economic trends and fiscal conditions, we believe that this a reasonable scenario to use for fiscal planning purposes.

- A “More Conservative” Scenario that shows what the impact might be if discretionary revenue grew at a slower rate and/or Net County Cost increased at a higher rate than the assumptions used in the Baseline Scenario (the impact of slower discretionary revenue growth is essentially the same as the impact of a greater increase in Net County Cost). This Scenario assumes that both discretionary revenue and reimbursements and Net County Cost will grow at an average annual rate of 4%.

- A “More Optimistic” Scenario that shows what the impact might be if discretionary revenue grew at a faster rate and/or Net County Cost grew at a lower rate than the assumptions used in the Baseline Scenario. This Scenario assumes that total discretionary revenue and reimbursements will grow at an average annual rate of 6% and that Net County Cost will grow at an average annual rate of 2%.

All projections use FY2018-19 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. Known or likely changes include the full year implementation cost of partial year funding included in the FY2018-19 Recommended Budget, reductions or elimination of one-time costs or revenues and likely future cost increases, the future year impact of the phase-in of the decrease in the Sacramento County Retirement System’s (SCERS) discount rate, likely cost increases associated with the continued implementation of IHSS MOE increases and estimated costs to address conditions of confinement/Americans with Disabilities Act issues in the County jails.

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 five-year projection period.
- It would be prudent over the next few years to focus on reducing costs and building reserves.

The following table shows the amount of discretionary fund balance as a percent of revenue for the general funds of selected large counties.

Discretionary fund balance as a percent of revenue, general fund, selected large counties.
Data from CAFRs for Fiscal Year ending June 30, 2017.