FY 2019-20 Recommended Budget
ECONOMIC AND FISCAL CONTEXT

The national economy grew at a solid pace in 2018, with the Gross Domestic Product (GDP) increasing by 2.9% for the year. GDP growth in 2018 was the strongest since 2015 and significantly better than the 2.2% logged for 2017. GDP grew at an annualized rate 3.2% in the first quarter of 2019. This was a higher rate than most economists were projecting and the best start to a year since 2015. Notwithstanding the strong first quarter numbers, most forecasts project that the rate of growth will moderate over the year, and GDP growth in 2019 and 2020 will be closer to the post-recession average of 2.1%. For example, the most recent report from the Federal Reserve Open Market Committee reflects a median GDP growth forecast of 2.1% in 2019 and 1.9% in 2018 and a report from Beacon Economics projects GDP growth of 2.2% in FY 2019-20.

The national unemployment rate fell to 3.6% in April – the lowest rate since December of 1969 – continuing a decline that began in 2009. A number of economists are now projecting that the unemployment rate will stabilize at that level over the next few years. For example, a recent Federal Reserve Open Market Committee report reflects a median unemployment rate forecast of 3.7% in 2019 and 3.8% in 2020.

The number of jobs added each month has been relatively strong, with non-farm payroll increasing by 263,000 in April, on top of an average monthly gain of 213,000 over the prior 12 months. In addition, we are starting to see evidence of wage growth – though the rate is still less than robust. Over the year ending in April, average hourly earnings increased by 3.2%, which is higher than the rate of inflation. On the other hand, despite significant job growth and the decline in unemployment, the labor participation rate has not changed over the last year, the number of persons employed part-time for economic reasons has remained the same and there has been no change in the number of "discouraged" workers (persons not looking for work because they believe no jobs are available for them).

Housing has been one of the national economy's strongest growth sectors over the past few years, but it appears that this sector is facing some near-term uncertainty. The U.S. Department of Commerce reported that housing starts fell 0.3% in March, declining in six of the past seven months, and the February decrease in starts was revised upward to 12%. This is the largest decline in housing starts since May of 2017 – the result of persistent weakness in the single-family segment of the market. According to the Department of Commerce, housing starts in March 2019 were 14.2% lower than the number of housing starts in March of 2018. Permits for new construction, a sign of future demand, are running 7.8% below the March 2018 level.

Despite recent projections of a slow-down by economists and housing industry analysts, home prices nationally are continuing to increase. A report from Zillow showed that in March the median home price increased by 6.6% over the last year and Zillow projects the median price will increase by 4.1% over the next year.

Home prices in California are also continuing to rise, though at a slower pace. According to a recent report from Zillow, the median home price in California was $548,700 as of March of 2019, a 2.6% increase over past year. Zillow projects that California home prices will increase by 2% over the coming year.

Locally, the economy continues to show signs of improvement, though not all indicators are positive. A September 2018 report from the U.S. Bureau of Economic Analysis indicates that the Sacramento region's economy grew at an inflation-adjusted rate of 2.4% in 2017, higher than the 2.1% growth rate for all metropolitan areas but slightly lower than the region's 2016 inflation-adjusted growth rate of 2.5%. Between March 2018 and March 2019, the region added 28,300 jobs, a 2.8% increase. However, in March 2019, the region's unemployment rate increased to 4.3% from 4% a year ago. The March 2019 unemployment rate in Sacramento County was also 4.3%. In March, the median value of a home in Sacramento County was $370,400, according to Zillow, up approximately 4.4% from March 2018. Zillow recently projected that home values in Sacramento County will rise 2.2% 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 6.3% compared to the FY 2018-19 Adopted Budget level and 6.5% compared to FY 2018-19 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 3.5% compared to the FY 2018-19 Adopted Budget level and decline by 0.4% compared to the FY 2018-19 estimated actual amount (there were a number of one-time adjustments in FY 2018-19);

- Transient Occupancy Tax revenue is projected to grow by 4.4% compared to the FY 2018-19 Adopted Budget level and FY 2018-19 estimated actual amount;
- Proposition 172 revenue, which comes from a statewide sales tax levy, is projected to grow by 6.7% compared to the FY 2018-19 Adopted Budget level.

Staff projects that on-going discretionary revenue and reimbursements will grow by approximately $31 million or 4.9%, compared to the FY 2018-19 Adopted Budget amount, and by $26.9 million (4.2%) compared to the FY 2018-19 estimated actual amount. However, this growth is partly offset by the following factors:

- The FY 2018-19 Budget was balanced using approximately $14.1 million in one-time discretionary revenue and the FY 2019-20 Recommended Budget includes less than $500,000 in one-time reimbursements. Thus, staff projects that total FY 2019-20 discretionary revenue and reimbursements will only grow by $17.4 million (2.7%) compared to the total FY 2018-19 Adopted Budget level;
- The Recommended General Fund Budget reflects a $17 million (2.6%) increase in Semi-discretionary reimbursements, not including CalWORKS Realignment. With some limitations, these reimbursements can be used interchangeably with Net County Cost;
- To fund the General Fund's FY 2019-20 Base Budget (that is the cost of funding current staffing and service levels) would require a Net County Cost and/or Semi-discretionary revenue increase of almost $80 million (10%), due largely to salary and benefit increases for existing staff, the full-year cost impact of staffing and program increases funded for half a year in FY 2018-19 and reductions in certain revenue sources;
- The Recommended Budget includes approximately $24 million in Net County Cost and Realignment funding for new or enhanced programs, including approximately $21 million for staffing, contracted services and facility planning and design costs to address deficiencies in the County's jails as part of a multi-year effort to remedy issues raised in the current lawsuit concerning conditions of confinement;
- Balancing the General Fund budget required over $40 million in program and service level reductions, including the elimination of almost 200 vacant positions. It also required the cancellation of approximately $12.3 million in General Fund reserves;

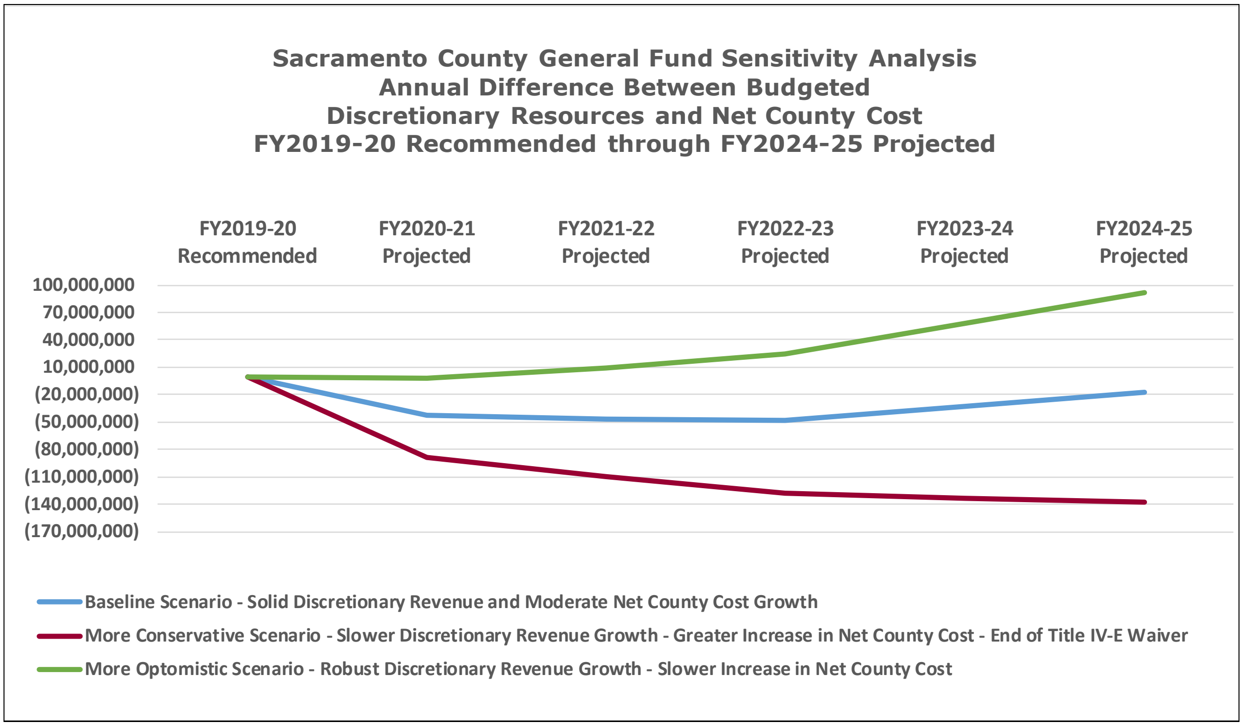
General Fund Five-Year Sensitivity Analysis

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 an annual average rate of 5% over the projection period and that Net County Cost will grow by 4.5% in FY 2020-21 (the last year of the three-year phase-in of the impact the County Retirement System's discount rate reduction) and then at a moderate average annual rate of 3%, after adjusting for known or likely changes in Net county Cost. This scenario also assumes that each year's beginning available balance will be 8% of the prior year's budgeted 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%. This scenario also assumes that the Foster Care Title IV-E Waiver is not renewed, effective with FY 2020-21, and that the General Fund backfills the $29 million reduction in revenue and that each year's beginning available balance will be 6% of the prior year's budgeted Net County Cost. However, this scenario does not assume additional costs associated with the Hardesty lawsuit;
- 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%, that Net County Cost will grow at 4.5% in FY 2020-21 and an average annual rate of 2% thereafter, and that the beginning available balance will be 10% of the prior year's budgeted Net County Cost.

All projections use FY 2019-20 Recommended Budget discretionary revenues and reimbursements and Net County Cost (which already reflects significant reductions in staffing and programs) as a starting point and make certain adjustments based on known or likely changes. Known or likely changes include reductions or elimination of one-time costs or revenues and likely future cost increases, such as estimated costs to address conditions of confinement/Americans with Disabilities Act issues in the County jails. None of the scenarios provide funding to cover cost of the Hardesty lawsuit, if the appeals court decision ultimately goes against the County.

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



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, 2018.