COUNTY ADMINISTRATOR

June 9, 2016

Honorable Board of Supervisors
Administration Building
Oakland, California 94612

SUBJECT: FISCAL YEAR 2016-2017 PROPOSED BUDGET

Dear Board Members:

The Proposed FY 2016-2017 Budget recommends a balanced $2.8 billion spending plan for County programs and services, including an increase of $117.9 million for the General Fund, and supports a workforce of over 9,600 employees. The Proposed Budget closes a $72.2 million funding gap through a deliberate and public process, and reflects the invaluable input provided by your Board, agency and department heads, the Budget Workgroup and other County stakeholders.

Alameda County's financial status has benefitted from the robust growth in the national and local economies. The County's March 2016 unemployment rate of 4.3% is less than half of what it was in early 2012. Most major industries have added jobs over the past year including private education, health services, as well as the trade, transportation and utility-related industries.

While there is some slight evidence of wage growth for working-class individuals, income growth for most people beyond the very wealthy, has remained flat or declined for decades. Recognizing that economic development relies on wage growth, policy makers have begun to address income stagnation through modest increases to the minimum wage, changes in overtime rules and extending an earned income tax credit for wage earners in California.

The rise in real estate values led to a 7.1% increase in the FY 2015-2016 assessment roll, resulting in much-needed general purpose revenues for the County. However, higher home values and rents reduce the stock of affordable housing, placing additional strain on those who are paying a larger share of their lower incomes for housing costs.

The County continues its efforts to document those most affected by economic disparities and cumulative State budget reductions. These "human impacts" are again included in a special section of the Proposed Budget.

STATE BUDGET

As stated by the Legislative Analyst's Office, the State of California's budget is better prepared for an economic downturn than it has been at any time in decades. The May Revision of Governor Brown's FY 2016-2017 budget proposes total discretionary reserves of $8.5 billion and $6.7 billion in the "Rainy Day" fund. These reserves together represent the equivalent of 45 days of working capital.

However, caution is warranted based on a recent Moody's fiscal "stress-test," that rated California the least prepared of the four most populous states to weather a potential recession in the next two years. The financial ratings firm noted California has much higher revenue volatility, less financial flexibility and lower reserve levels than does Texas, New York or Florida. Further, the seventh year of recovery has begun to show some signs of economic weakness, which may cause those same General Fund revenues to experience slow or even negative growth in the next three to five-year period. State General Fund revenues particularly personal income tax collections are now projected to be $1.9 billion ***less*** than the Governor had estimated in January. It is important to recognize that personal income taxes comprise 70.2% of the three largest revenue sources to the State's General Fund.

Given the Governor's commitment to budgetary prudence and restraint, very few proposals for new spending are found in the FY 2016-2017 budget submitted in January or in his May Revision. However, there are a few proposed appropriation increases and several examples of repurposing existing revenues for new statewide policy priorities, including:

- An additional $169 million for Medi-Cal administration costs associated with implementation of the Affordable Care Act (ACA);
- Lump sum payments to counties of $177 million for truing up health care realignment revenue after implementation of the ACA as directed by Assembly Bill 85;
- The first cost-of-living adjustment (COLA) in a decade for SSI/SSP recipients;
- A State Senate proposal to issue bonds for affordable housing using a portion of future Mental Health Services Act (MHSA) revenues;
- $100 million of carbon "cap and trade" revenues for local climate action proposals; and
- Increased funding of $55 million for the Continuum of Care reform efforts.

COUNTY BUDGET OVERVIEW

The FY 2016-2017 Proposed Budget for all funds totals $2.83 billion, an increase of $88.8 million or 3.24% from the FY 2015-2016 Final Budget. The General Fund, which supports most County operations, totals almost $2.55 billion, an increase of $117.9 million, or 4.86%.

All Funds ($ in millions)	2015-2016 Final	2016-2017 MOE	2016-2017 Proposed	Change from 2015-2016
Appropriation	$2,744	$2,838	$2,833	$89
Revenue	$2,744	$2,766	$2,833	$89
Funding Gap	$0	$72	$0	$0
FTE	9,600.12	9,636.15	9,634.23	34.11

General Fund ($ in millions)	2015-2016 Final	2016-2017 MOE	2016-2017 Proposed	Change from 2015-2016
Appropriation	$2,429	$2,551	$2,547	$118
Revenue	$2,429	$2,479	$2,547	$118
Funding Gap	$0	$72	$0	$0
FTE	7,688.27	7,691.51	7,689.59	1.32

The Proposed Budget includes funding to provide mandated and essential services, meet debt service obligations, maintain a status quo level of infrastructure and capital funding, and adhere to the Board's financial management policies. Funding is recommended to support a workforce of over 9,634 full-time equivalent (FTE) positions and reflects a net increase of only 34 FTE, all of which were approved by your Board mid-year and are fully offset with new revenue.

The Proposed Budget funds cost-of-living adjustments (COLAs) for most of our employees based on negotiated labor agreements, and for many of our community-based organizations (CBOs). The Proposed Budget includes $500.8 million for services provided by 243 CBOs, an increase of $24.0 million from FY 2015-2016. This includes $80.1 million for services provided by the Alameda Health System (AHS). Other CBOs funded in the Proposed Budget include non-profit service providers, cities, school districts, and local hospitals. A list of all CBO contracts with funding recommendations is included in the Appendix of the Proposed Budget document.

Measure A, the voter-approved half-cent sales tax for essential health care services, which was reauthorized through 2034 by over 75% of voters on June 3, 2014 as Measure AA, continues to provide over $125 million a year in crucial funding for health services. AHS receives 75% of the revenue directly and the remaining 25% is allocated by the Board of Supervisors to support other essential health services. The Proposed Budget includes only $31.5 million in Measure A funds for non-AHS essential health services as per the three-year Measure A spending plan adopted by your Board in December 2015. While this represents an increase of approximately $2.0 million, or 7.0%, compared to the FY 2015-2016 Final Budget, it is $2.5 million less than the current year projected receipts of $34.0 million.

Consistent with your Board's financial management policies, the Proposed Budget recommends designating $6.3 million—the equivalent of 1% of discretionary revenue—for both capital projects and the general reserve. Contingencies for pending labor negotiations, benefit cost increases, and other contractual obligations are also included in the Proposed Budget.

CLOSING THE GAP

The Proposed Budget closes a funding gap of approximately $72.2 million that was projected based on the Maintenance of Effort (MOE) funding requirement. The funding gap was determined by identifying the difference between the cost of maintaining existing programs and projected revenues. The MOE Budget for the General Fund was just over $2.55 billion, an increase of $123.4 million or 5.1%. Available revenues to finance the projected MOE costs totaled about $2.48 billion, an increase of just $50.4 million, or 2.1%.

Your Board's Values-Based Budgeting (VBB) priorities and Strategic Vision initiatives were considered in developing balancing strategies within each program area. The table below summarizes the total proposed net cost reductions by program area:

PROPOSED BUDGET BALANCING
General Fund

Program Area	Net County Cost Reductions ($ millions)
General Government	$16.9
Health Care	17.6
Public Assistance	7.3
Public Protection	18.4
Countywide Strategies	12.0
Total	**$72.2**

Proposed solutions to close the $72.2 million funding gap included a combination of spending reductions, revenue increases, and one-time strategies. The $12.0 million in countywide strategies includes updated projections of property, sales, and aircraft taxes; one-time property tax penalties; and a reduction in risk management charges to departments.

The Proposed Budget recommends the use of $30.8 million or 43% in ongoing strategies and $41.4 million or 57% in one-time strategies, with most of the one-time savings coming from the Fiscal Management Reward Program (FMR). The FMR net savings have been generated through the efforts of County agencies/departments to operate their programs well within budget, mitigate future funding cuts and maintain the continuity of services. FMR is considered a one-time funding source as these savings may not be available to assist with balancing budgets in future years. A structural imbalance between ongoing revenues and expenditures remains, largely due to the State's ongoing shift of property taxes from local governments.

Proposed Budget Balancing Strategies	Net County Cost Reductions ($ millions)
Ongoing Strategies	
Program appropriation reductions	$3.4
Program revenue increases	27.4
Subtotal Ongoing Strategies	**$30.8**
One-Time Strategies	
Fiscal Management Reward (FMR) Savings	$28.6
One-time appropriation reductions	2.1
One-time revenues	10.7
Subtotal One-Time Strategies	**$41.4**
Grand Total Balancing Strategies	**$72.2**

PROGRAM AREA NET COST REDUCTIONS AND FUNDING CONCERNS

General Government – The General Government program area contributed net cost savings of $16.9 million through $0.2 million in spending reductions, $0.8 million in increased revenue, and $15.9 million in FMR savings.

In July 2014, your Board's policy to allocate $90.0 million of former redevelopment agency (RDA) tax increment funds over five years to fund "Tier 1" capital projects in the unincorporated areas was amended to align expenditures with slower-than-anticipated receipt of former RDA property tax revenues. However, the completion of "Tier 1" projects could be further delayed if tax receipts do not keep pace with project plans, project cost increases and timelines. Additionally, there will be $5.0 million ***less*** available per year for "Tier 1" capital projects based on your Board's December 2015 decision to allocate the first $5.0 - $7.5 million of property tax revenues based on prior year receipts, toward affordable housing programs starting in FY 2016-2017.

Housing has emerged as a key area of concern for County residents. Reductions in federal housing funding such as the HOME Investment Partnerships Program and the Community Development Block Grant result in less funding available for the County to meet community needs and to cover the administrative costs of compliance monitoring. Your Board has continued to respond to these challenges by investing over $100 million annually in housing programs across various agencies and departments. In addition, your Board has also committed the aforementioned $5.0 - $7.5 million per year of limited discretionary funding towards affordable housing programs across the County.

Another significant funding concern is the State Board of Equalization's decision to lower the excise tax rate for gasoline for the third year in a row. Effective July 1, 2016, the excise tax rate will be $0.022 lower, following reductions of $0.06 and $0.035 in FY 2014-2015 and FY 2015-2016, respectively. Lower excise tax revenues may jeopardize the Public Works Agency's ability to complete a variety of traffic and pedestrian safety projects in the unincorporated areas. The Public Works Agency estimates that reduced excise taxes may result in a $6.0 - $10.0 million loss of critical transportation infrastructure funding.

Health Care – The Health Care Services Agency contributed net cost savings of $17.6 million through $0.7 million in appropriation reductions, $4.8 million in increased revenue, and $12.2 million in FMR savings. The spending reductions included savings of $0.3 million from the elimination of 1.92 vacant, funded positions and a $0.5 million reduction in medical expenses and discretionary services all in the Public Health department. Revenue increases include the use of $1.7 million in one-time Tobacco Master Settlement funds, $0.5 million in Medi-Cal revenue, $1.0 million from growth in 1991 realignment, $0.1 million in Household Hazardous Waste revenue, and the allocation of an additional $1.5 million in Mental Health Services Act (MHSA) funding.

The County continues to have concerns about Medi-Cal reimbursement rates not covering the cost of care for our safety net health providers. This adversely affects the entire health care network and constrains the ability of providers to invest in their systems. The Public Health department continues to experience a decline in federal funding for Nutrition and the Women, Infants and Children (WIC) programs. County general funds of $1.2 million have been included in the Proposed Budget to maintain these programs at the current service levels.

In Behavioral Health, the potential diversion of future MHSA funds to finance a statewide housing bond may impact funding available to support services to the severely mentally ill. While statewide associations are pushing for counties to remain whole (i.e. receive a proportional share of bond proceeds to the MHSA revenue they may lose), this is not guaranteed. In Environmental Health, a statewide shortage of qualified inspectors has slowed hiring, resulting in lower fee revenue collections.

Public Assistance – The Public Assistance program area achieved net cost savings of $7.3 million through revenue increases including a $4.0 million adjustment from the CalWORKs Single Allocation redistribution, $1.2 million in CalFresh Match Waiver close-out, and $2.1 million from prior years' close-out of multiple social service programs.

Given that the Medi-Cal caseload in Alameda County has increased nearly 90% since January 2014, additional Medi-Cal administrative funding is needed to meet increased workloads and maintain case management standards. In addition to the underfunding of Medi-Cal, federal and State base funding for older adults programming has remained relatively flat in the past decade despite the rapid growth in the senior population.

Though the May Revision includes the first cost-of-living adjustment (COLA) to the State Supplementary Payment (SSP) in a decade, the COLA falls substantially short of reversing the impact of deep cuts to SSI/SSP made to help close budget shortfalls during the Great Recession. These cuts have compromised the ability of low-income California seniors and people with disabilities to afford basic needs such as housing and food, and are exacerbated by ineligibility for food programs.

<u>Public Protection</u> – The Public Protection program area achieved net cost savings of $18.4 million through $3.2 million in appropriation reductions, $14.6 million in revenue increases, and $0.6 million of FMR savings. Appropriation reductions include decreased discretionary operating expenses in the Sheriff's Office of $2.7 million and $0.6 million in indigent defense contract costs. Public Protection revenue adjustments totaled $14.6 million including increases in the Sheriff's negotiated contracts and Utility User's Tax receipts ($5.5 million overall); District Attorney's revenue from fines and forfeitures ($3.0 million); additional juvenile justice funding for Probation programs ($3.4 million); and the Public Defender's case management revenue ($0.2 million).

FMR savings contributed by the Public Defender and Probation department further reduced the net cost of this program area.

If Governor Brown's Public Safety and Rehabilitation Act of 2016 appears on the November 2016 ballot and is enacted by voters, State inmates convicted of non-violent felony offenses who have completed the full sentence of their primary offense will be eligible for parole. Parolees would then be released to Post Release Community Supervision (PRCS), which would be administered by the counties. Although the goal is to reduce the prison population and spending at the State level, it is unknown if additional funding will be made available for counties to support this new Probation population.

While the State formula for the distribution of AB 109 Public Safety Realignment funding has been established, it is still unknown whether the County's FY 2016-2017 base allocation will be sufficient to fund the cost of Public Safety program responsibilities realigned by the State. Furthermore, the allocation of future growth will be dependent on the development of statewide performance metrics.

Trial Court Funding revenue continues to decline due to the State's revised methodology that reallocates fines and forfeiture revenues to other jurisdictions. This revenue reduction results in a significant increase in County General Fund support to meet our mandated Trial Court Funding commitments. The County may also incur increased security-related costs for the new East County Courthouse in Dublin unless additional funding is guaranteed from the State.

FISCAL MANAGEMENT REWARD (FMR) SAVINGS

Your Board's FMR Program allows General Fund departments to carry over net savings each fiscal year to be used in subsequent years for budget balancing, one-time expenditures and/or program enhancements. Through ongoing cost-saving and revenue generation efforts, County agencies/departments contributed $28.7 million in prior-year FMR savings to help balance the FY 2016-2017 budget.

Program Area	Use of FMR ($ millions)
General Government	$15.9
Health Care	12.2
Public Assistance	0.0
Public Protection	0.6
Total FMR	**$28.7**

Ongoing efforts by agencies and departments to reduce spending and conserve resources have enabled the County to mitigate major program reductions and maintain vital services. However, departments must continue to balance these efforts with the need to fund increased costs and meet the growing demand for essential services in all program areas.

UNFUNDED OBLIGATIONS

While your Board has adhered to your long-standing financial management policies, which include strategies and guidelines to build and maintain prudent reserves, the County has unfunded obligations that must be considered. At the close of FY 2014-2015, the County estimated its long-term unfunded obligations were approximately $2.79 billion or about $100.1 million more than the close of the prior year. Pension costs for current and future retirees account for $1.4 billion of the total unfunded liabilities. In addition, to date the County has issued debt of $607.0 million related to construction of the Acute Care Tower Replacement project for the Alameda Health System (AHS) and has remaining pension obligation bond debt of approximately $300.0 million. Other outstanding debt includes the County's shared ownership of the Coliseum/Arena and other prior capital commitments for essential facilities like the Juvenile Justice Facility and Santa Rita Jail. The updated five-year Capital Improvement Plan identifies over $200 million of unfunded capital projects and deferred major maintenance on County-owned properties that, if not addressed, will increase dramatically as buildings and infrastructure continue to age.

The debt incurred by the County for capital improvements was based on responsible financial plans that identified revenue sources to retire the debt over time and ensure that the County was also able to maintain its core services and other mandated commitments. The Proposed Budget includes funds for annual debt service payments and the County's annual required contributions to the pension fund through the Alameda County Employees' Retirement Association (ACERA). In addition, in response to your Board's directive that the County Administrator and Auditor-Controller consider options to reduce the County's unfunded pension liability using existing designations and reserves, your Board has authorized transfers totaling $400.0 million into a new designation to help reduce the County's portion of the unfunded pension liability. Further, your Board has committed to designate up to $100 million more in each of the next four years. Paying down future liabilities will reduce annual principal payments and interest, and will ultimately improve the County's ability to plan for and invest in future projects and initiatives while maintaining strong credit ratings.

PENDING FACTORS

Although the economy continues to improve, ensuring adequate and stable long-term funding for County programs and services remains a challenge. Given the length of the current economic recovery, there are concerns that sales tax and vehicle license fee-based revenues may not be sufficient in the short to intermediate-term to fund fully the cost of program responsibilities transferred by the State to counties in health care, public assistance and now public safety. Our growing reliance on federal and State funding bears careful monitoring given the specter of election-driven policy changes and fiscal challenges that could result in funding cuts or further shifts of program responsibilities to counties without adequate financial resources.

Alameda County residents rely on many important County-provided health, public safety and economic assistance services to, in the words of the County's mission statement, "enrich their lives." Long-term financial issues such as the increased costs of health care, employee salary and benefit costs, and economically-sensitive revenue sources will continue to challenge our limited discretionary resources. Careful assessment of existing services, diligent review of proposed services and strategic decisions about the use of available financial resources will be vitally important over the next few years to focus on effective and efficient service delivery and long-term financial stability.

A healthy economy, in the seventh year of a recovery, has reduced unemployment, spurred automobile sales and increased home values. Even now, Alameda County continues to experience a structural deficit where ongoing expenses are greater than ongoing revenues. Moreover, while we have been able to contribute regularly to reserve funds, a dip in the economy that reduces property values and taxes and sales tax revenue will quickly increase the size of future budget gaps. Unfortunately, that decline in the economy and vital discretionary revenue is now closer than ever. Attention will be required to identify solutions to the structural deficit and address the increasing amount of unfunded capital projects and deferred major maintenance needs. These and other key issues may require policy decisions by your Board to guide departments on effectively managing future operating cost increases in coordination with development of sustainable revenue sources.

RECOMMENDATIONS

County stakeholders have balanced the FY 2016-2017 Proposed Budget through a collective effort to develop a sustainable approach to providing services in the coming year. In addition, balancing the FY 2016-2017 Proposed Budget using a significant amount of one-time funds will necessitate careful monitoring throughout the year to ensure that expenditures remain within budget and estimated revenue is fully realized.

As you conduct public hearings and deliberate on the FY 2016-2017 Proposed Budget, your Board's leadership and strong fiscal management will assist the County in maintaining that critical balance between service demands and limited financial resources.

Therefore, it is recommended that your Board:

1. Accept the FY 2016-2017 Proposed Budget for review pending public hearings;

2. Set public hearings on the Proposed Budget to commence on Wednesday, June 22, 2016, at 1:00 p.m. as outlined in the Attachment; and

3. Schedule public hearings and/or public meetings to consider charges for the Emergency Medical Services District, Fire Department Emergency Medical Services, Flood Control District, and Clean Water Protection as detailed in the attached budget hearing schedule.

Respectfully submitted,

/s/
Susan S. Muranishi
County Administrator

Attachment
c: Agency/Department Heads
Budget Workgroup
Legislative Advocates
Community-Based Organizations
Labor Representatives

x

Attachment

FISCAL YEAR 2016-2017
COUNTY BUDGET HEARING SCHEDULE

Date/Time		Program
Thursday, June 9	2:30 p.m.	Presentation of Proposed Budget
Wednesday, June 22	1:00 p.m.	Opening Comments Health Care* Public Assistance
Thursday, June 23	1:00 p.m.	Public Protection** General Government*** Other Issues/Final Adjustments
Friday, June 24	1:30 p.m.	Final Budget Deliberations
Tuesday, June 28	1:30 p.m.	Adoption of Final FY 2016-2017 Budget

* Includes public meeting to set charges for Emergency Medical Services
** Includes public meeting to set charges for Fire Emergency Medical Services
*** Includes public hearings to set charges for Flood Control District and Clean Water program.