A Tradition of Stewardship
A Commitment to Service

County Executive Office

FISCAL STATUS REPORT

SECOND QUARTER OF FY2008-09 (THROUGH DECEMBER 31, 2008)

February 10, 2009

Introduction and Background

On August 12, 2008, the Board of Supervisors approved a Fiscal Contingency Plan that provided a framework to help the County address a projected structural deficit in the County's General Fund, caused by the national economic downturn, and to deal with the potential impact on the County of the State's budget crisis. The approved Fiscal Contingency Plan included certain Guiding Principles and both long-term and short-term actions that would be taken, if necessary, to ensure the fiscal integrity of the General Fund over the five-year period through FY2012-13.

On December 16, 2008, staff provided the Board with an updated General Fund Five Year Forecast for the period of FY2008-09 through FY2012-13. Based on information available at the time, that Forecast projected that, on average, expenditures would exceed revenues by approximately 2% to 4% each year during this period, and the General Fund's fund balance would decline from approximately \$48.2 million at the end of FY2007-08 to between \$28.9 and \$38.9 million at the end of FY2012-13. On December 16th, staff also indicated that there was a growing concern about the potential impact on the County's cash flow of the State's increasingly dire fiscal situation, with the State threatening to defer up to seven months of payments to counties for certain programs, starting in February, 2009.

Given the above, on December 16th, the Board approved certain Fiscal Contingency Plan long-term actions which are now reflected in the FY2009-10 Budget Policies, and authorized implementation of four of the short-term actions in the Fiscal Contingency Plan through the end of January, 2009. The four short-term actions were:

- Continue the selective hiring freeze now in place, but harden the freeze to include all positions other than those necessary to meet critical health and safety needs, unless the positions are fully revenue-offset.

- Defer implementation of any new programs that are not fully operational or fully revenue-offset.

- Halt major office space remodels, unless they are required to address critical health and safety needs.

- Selectively defer approval of contracts for services not fully revenue-offset.

The four short-term actions were designed primarily to help the County conserve cash in light of the uncertainty surrounding the State's budget situation, with the understanding that the County's fiscal and cash status would be reviewed at the end of January 2009. This report constitutes that review, with a focus on the County's major operating funds.

State Budget Situation

As of this writing, the State is projecting that, absent any mitigating actions, it will face a two year (FY2008-09 and FY2009-10) cumulative deficit of approximately $41 billion. The Governor has proposed addressing this shortfall through a combination of spending cuts- including cuts to funding for counties- and revenue increases, but the Legislature has, thus far, been unable pass a deficit reduction plan with the required two thirds vote. At this point, the "big five" (the Governor and legislative leaders) are said to be in negotiations that could result in a budget deal any day, but the details of that deal are not available.

In the meantime, the State Controller has announced that he will begin deferring payments due to counties in a number of areas, including gas tax to the Road Fund and a variety of health and human services programs. It is not clear how long the State will defer these payments, nor when, exactly, it will pay the deferred revenue back. If the deferral were to continue for 7 months, staff estimates that Napa County's revenue loss would total in excess of $10 million.

Total Cash Balance – All Funds

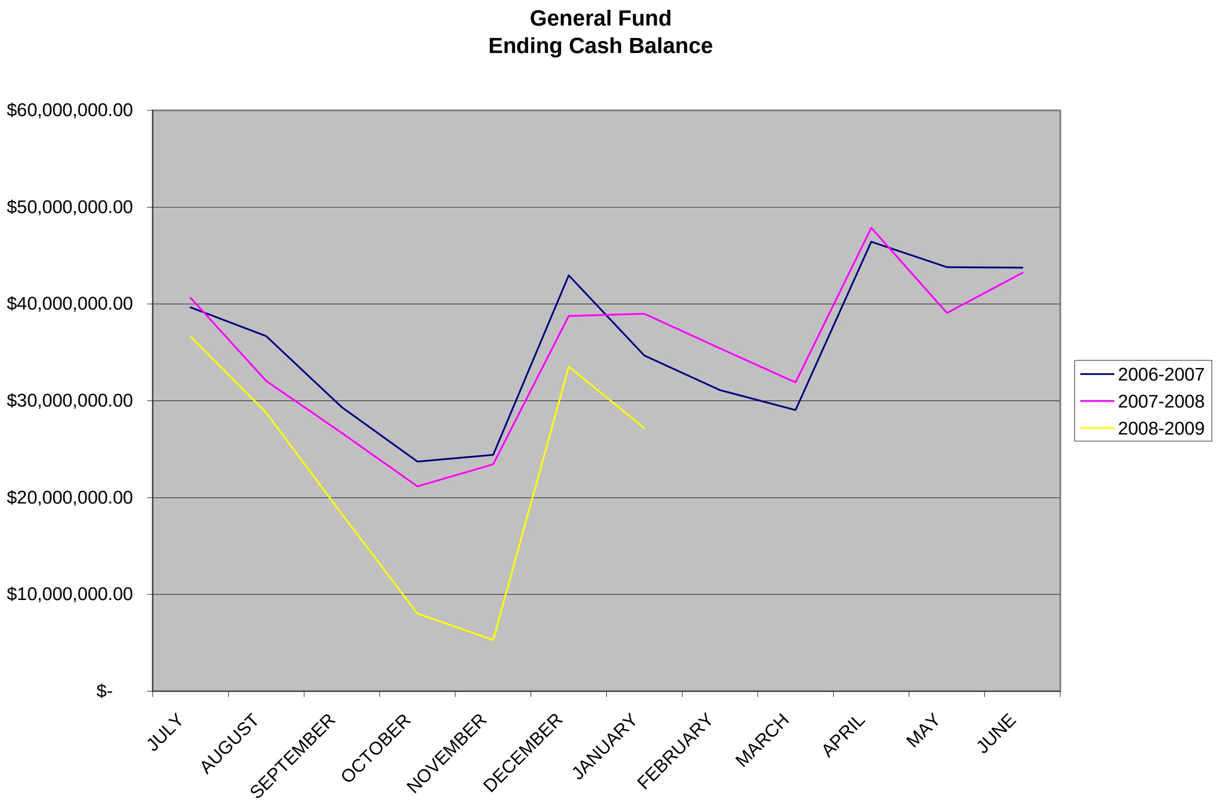
As of December 31, 2008, the cash balance for all County funds stood at approximately $128 million, a decrease of approximately $9 million from the FY2007-08 ending cash balance level of $136.9 million. The General Fund's cash balance stood at $31.1 million and the cash balance of all funds that are financed with discretionary revenues (General Fund, Accumulated Capital Outlay, Tobacco Settlement and Special Projects) totaled $57.5 million.

All of the County's cash is pooled for investment purposes, and the $128 million is money that can be used to cover cash shortages in any fund during the fiscal year. If it appears that any fund will end the year with a cash deficit, the $57.5 million, or whatever equivalent amount is available at the end of the fiscal year, can be loaned to that fund.

The General Fund

Revenue, Expenditure and Fund Balance Projections

As indicated, as of December 31, the General Fund had a cash balance of $31.1 million. This is approximately 18% below the General Fund's historical average cash balance at this time of year and reflects an $11.9 million, or 28%, decline in cash balance from the Fund's cash balance at the end of FY2007-08. The following table shows how the current year's General Fund cash balance compares to the situation in prior years:



Typically, General Fund expenditures exceed revenues during the first five months of a fiscal year (through November), resulting in a significant spending-down of cash balance. Then, during the remaining 7 months, revenues exceed expenditures (in total, not necessarily in each month), resulting in an increase in the cash balance, though not always to the beginning balance level. Staff is still analyzing all of the issues related to projecting cash balance through the end of the fiscal year, but has projected revenues, expenditures and fund balance on a budget (or accrual) basis under two different scenarios. These projections are illustrated in the table below and compared to the adopted Final Budget:

	Scenario 1	Scenario 2	Final Budget
Beginning Balance	$ 49,971,307	$ 49,971,307	$ 48,542,626
Revenues	$191,300,000	$191,400,000	$ 192,606,335
Expenditures	$ 196,900,000	$205,200,000	$ 207,797,395
Ending Balance	$ 44,371,307	$ 36,171,307	$ 33,351,566

The first scenario is based on preliminary FY2008-09 Mid-Year Review estimates provided by County departments. These projections have not been fully analyzed by CEO staff and will probably change, but provide what is likely a conservative estimate of where the General Fund will end the fiscal year assuming we adhere to the Board's "no backfill" of reductions in State revenue policy and assuming any revenue deferrals are paid to the County by the end of October, the deadline for accruing revenue in the prior fiscal year. These projections should reflect the impact of the recently imposed Fiscal Contingency Plan provisions.

The second scenario is based on a calculation that projects revenues and expenditures for the last six months of the fiscal year based on revenues and expenditures received through December, 2008 and the historic percentage of total revenues and expenditures received in each month over the last three years. These projections would not reflect the impact of the recently-imposed Fiscal Contingency Plan provisions.

Mid-year projections are typically more conservative than actual annual revenue and expenditure experience, so it is likely that the General Fund will end the year in a better financial condition than the above numbers suggest. As the Board may recall, the updated General Fund Five Year Forecast, prepared in December, projected that the General Fund would end the fiscal year with a fund balance of approximately $47 million.

With regard to cash flow and cash balance projections, the situation would likely be different than budget-based expenditures, revenue and fund balance projections, particularly if there are significant revenue deferrals such as those contemplated by the State. Nevertheless, as of December 31, the General Fund's actual cash balance of $33.5 million is fairly close to the actual budget-based fund balance of $32.5 million, so even if the State defers approximately $6 million in Health & Human Services revenue into next fiscal year (which would be 5 months worth of revenue in the identified program areas), it appears that the General Fund could end this year with a cash balance of at least in the $30 to $38 million range.

Major Discretionary and "Semi-Discretionary" Revenue Projections

Overall, staff's most recent estimates project that the General Fund will receive approximately $86.6 million in discretionary revenue this fiscal year, an increase of $2.2 million, or 2.7%, compared to the FY2008-09 Final Budget level. The following table shows what staff's projections are for each of the County's major discretionary revenue sources as well as two "semi-discretionary" revenue sources: Realignment (that funds a variety of Health and Human Services programs) and Proposition 172 (that funds a variety of public safety programs).

Tax	Final Budget	Projected Year-end	Difference
Property[1]	$ 62,151,861	$ 64,315,777	$2,163,916
Transient Occupancy	$ 9,213,660	$ 9,700,000	$ 486,340
Sales and Use	$ 5,617,637	$ 5,600,000	$ (17,637)
Realignment	$ 18,206,667	$ 16,255,067	$ (1,951,600)
Proposition 172	$ 11,600,000	$ 11,400,000	$ (200,000)
TOTAL:	$106,789,825	$107,270,844	$ 481,019

[1] Includes all property tax categories, including Triple Flip, secured, unsecured, prior year, etc.

One reason that Property Tax and Transient Occupancy Tax revenues are projected to come in slightly higher than the budgeted level despite the economic downturn is that the County is typically conservative in making budget estimates. For example, in the FY2008-09 Final Budget, secured property tax revenues were estimated based on an assumption that those revenues would increase by 4% above the FY2007-08 estimated secured property tax revenue level. However, Countywide assessed value actually grew by 5.95 % between FY2007-08 and FY2008-09 and the assessed value in the unincorporated County grew by over 8% (the County receives a higher proportionate share of property taxes in the unincorporated County than in the cities). The relatively small decline in Proposition 172 revenue, despite the significant reduction in statewide sales tax collections, reflects the fact that a particular counties' revenue allocation each year is based in part on the total amount of public safety sales tax collected statewide and, in part, on changes in the share of that sales tax allocated to each county. In Napa County's case, our "share" of the statewide allocation increased in FY2008-09.

It should be noted, however, that these revenue projections are still preliminary and could change. Transient Occupancy Tax (TOT), sales tax, Realignment and Proposition 172 revenue projections, in particular, are based on recent trends and, with the economy in flux, those trends could change for the worse quite abruptly. Staff will have a better idea what the status is of those revenue sources after the end of the Third Quarter.

<u>The Roads Fund</u>

As of the end of December, the Roads Fund had a **negative** cash balance of approximately $870,000. This reflects a decline of $1.6 million, or 250%, from the Fund's cash balance at the end of FY2007-08.

In this case, staff has prepared cash-flow projections for the Roads Fund through the end of this fiscal year, with the following results:

Beginning Balance	$ 644,585
Revenues	$12,395,638
Expenditures	$12,566,750
Ending Balance	$ 473,473

The above projections do reflect the impact of the deferral of approximately $1.8 million in gas tax and Proposition 42 revenue in FY2008-09 (5 months worth of receipts). Notwithstanding this deferral, the Fund is projected to end the fiscal year with a positive cash balance in large part because the County has begun to receive reimbursements from the Federal Emergency Management Agency (FEMA), State Office of Emergency Services and the Federal Highway Administration for costs incurred during the December 2005/January 2006 Flood.

In terms of the budget (or accrual) condition of the Roads Fund, the preliminary (unanalyzed) Mid-Year Review projections prepared by the Public Works Department are as follows:

	Scenario1	Scenario 2	Final Budget
Beginning Balance	$ 2,256,961	$ 2,256,961	$ 3,355,422
Revenue	$10,001,323	$11,715,817	$15,805,169
Expenditure	$12,566,750	$12,566,750	$18,625,768
Ending Balance	$ (308,466)	$ 1,406,028	$ 534,823

The difference between Scenario 1 and Scenario 2 is that Scenario 1 assumes that 5 months of gas tax and Proposition 42 revenue will be deferred into Fiscal Year 2009-10 but not be paid to the County until after October 31, 2009, the Auditor's deadline for accruing revenue into the prior fiscal year. Scenario 2 assumes that all of that deferred revenue will be paid prior to October 31st, and will therefore be accrued (or recorded as revenue) in FY2008-09.

Given all that we know at this time, it is clear that the Roads Fund continues to be in a precarious financial condition, both from budget and cash flow perspectives. Revenues and expenditures in this Fund will need to be monitored carefully and any long-term deferral of State revenues could significantly impact the Fund's ability to continue to provide the current level of services.

The Fire Protection Fund

As of the end of December, the Fire Protection Fund had a cash balance of approximately $13.3 million. This reflects a $3.7 million, or 39%, increase from the Fund's cash balance at the end of FY2007-08.

The primary source of revenue to the Fire Protection Fund is property taxes so, similar to the General Fund, Fire Protection Fund expenditures typically exceed revenues in the first four to five months of the fiscal year. Then, during the remaining 7 or 8 months, revenues exceed expenditures. Staff has not completed a cash flow analysis of the Fire Fund, but has projected revenues, expenditures and fund balance on a budget (accrual) basis under two different scenarios. The projections are shown in the table below and compared to the adopted Final Budget.

	Scenario 1	Scenario 2	Final Budget
Beginning Balance	$ 9,495,749	$ 9,495,749	$ 9,493,275
Revenues	$10,400,589	$11,944,985	$ 9,737,949
Expenditures	$11,149,206	$ 7,095,474	$11,739,119
Ending Balance	$ 8,747,132	$14,345,260	$ 7,492,105

The first scenario is based on preliminary FY2008-09 Mid-Year Review estimates prepared by Fire Department staff. These projections have not been fully analyzed by CEO staff, but provide what is likely a conservative estimate of where the Fire Protection Fund will end the fiscal year.

The second scenario is based on a calculation that projects revenues and expenditures for the last six months of the fiscal year based on revenues and expenditures received through December, 2008 and the historic percentage of total revenues and expenditures received in each month over the last three years. The most significant difference between the two scenarios is that Scenario 1 assumes the County will pay CalFire the entire amount of their not-to-exceed contract. Scenario 2 reflects the fact that, historically, the County has not had to pay the full amount. The primary determinant of the amount of the contract that is paid in each year is the number and intensity of fires that occur in the County during the fiscal year. However, in reviewing Fire Protection Fund expenditures for the last 8 fiscal years, it appears that the County paid less then the full amount of the CalFire contract in every year- ranging from approximately 3% less than the contract amount to over 20% less - even years where there was significant fire activity. Thus, staff believes that it is likely that the Fire Fund will end the year closer to the projections in Scenario 2 than in Scenario 1.

It is also likely that the Fire Fund will end the year with an increase in cash balance.

The Library Fund

At the end of December, the Library Fund had a cash balance of approximately $8.8 million. This reflects a $500,000, or 6%, increase in cash balance from the Fund's cash balance at the end of FY2007-08.

Like the Fire Fund, property taxes are the largest revenue source for the Library and, generally speaking, expenditures exceed revenues through the first 5 months of the fiscal year, with that situation reversing in the last 7 months. Most property tax revenues are received in December. Staff has not completed a cash flow analysis of the Library Fund, but Library Department staff has completed Mid-Year Review projections of revenue, expenditures and fund balance on a budget (or accrual) basis. These projections have not yet been analyzed by CEO staff but are provided below:

	Mid-Year Estimate	Final Budget
Beginning Balance	$8,242,279	$7,641,146
Revenues	$6,718,661	$7,077,647
Expenditures	$6,258,020	$6,868,536
Ending Balance	$8,702,920	$7,850,257

As indicated above, Mid-Year Review projections tend to be conservative, so it is likely the Library Fund will end the fiscal year in a better condition than the above number suggests. It is also clear that the Library Fund will end the year with a substantial cash balance.

The Building Code Enforcement Fund

As of the end of December, the Building Code Enforcement Fund had a cash balance of approximately $1,763,000. This reflects an increase of approximately $42,000, or 2%, from the Fund's cash balance at the end of FY2007-08.

The Building Code Enforcement Fund's primary revenue source is building permit fees for building projects in the County's unincorporated areas. Because of the recent economic downturn, and in particular, because that downturn has hit the construction industry particularly hard, it is difficult to project building permit revenues based on past trends. Nevertheless, based on the most recent data available, the Conservation, Planning and Development Department prepared Mid-Year Review projections on a budget (or accrual) that indicate the following:

	Mid-Year Estimate	Final Budget
Beginning Balance	$1,656,775	$1,382,838
Revenues	$2,545,736	$2,707,500
Expenditures	$2,836,481	$2,974,471
Ending Balance	$1,366,030	$1,115,867

The Department's Mid-Year projections have not yet been analyzed by CEO staff and are usually conservative and the Building Code Enforcement Fund has a significant cash balance as of the end of December. Nevertheless, given the uncertainties surrounding the economy generally, and the construction industry, in particular, there is cause for concern about the longer-term budget and cash status of this Fund. The Department is currently adhering to the Fiscal Contingency Plan actions approved by the Board, but will need to monitor this Fund closely.

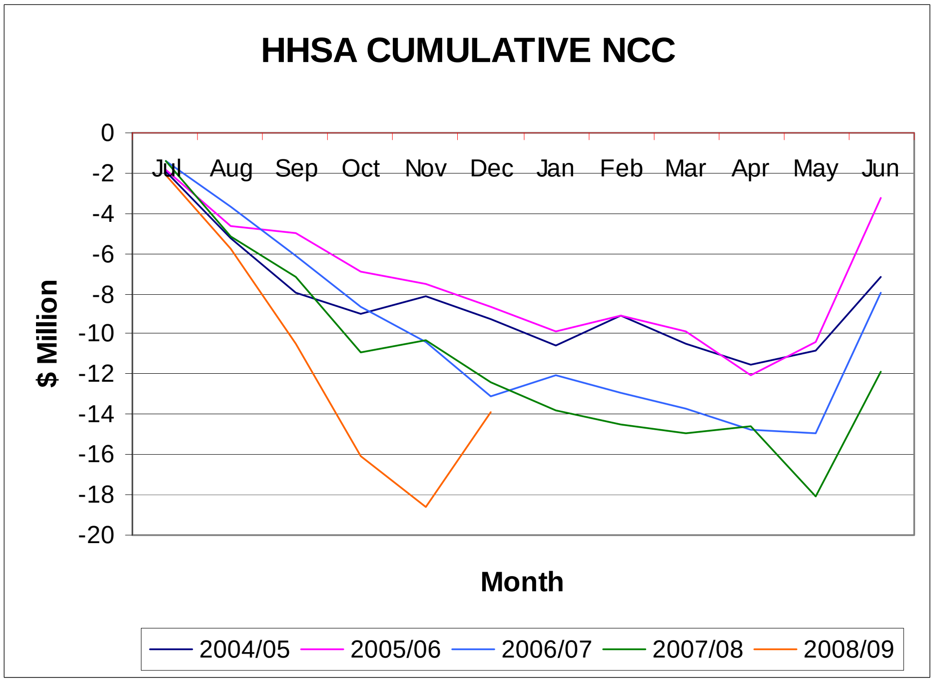
The Health and Human Services Agency

The Health and Human Services Agency's budget, which totals approximately $72 million, is included in the General Fund. Most of the funding for the Agency comes from the State and Federal government. By Board policy, the Agency is provided a "bottom line" Net County Cost of approximately $11 million (which includes General Fund money to meet maintenance of effort [MOE] and match requirements as well as additional, non-mandated, General Fund support for various programs) and is required to manage its budget within that amount.

As the Board is aware, the County's Health and Human Services programs are targeted for reductions in program-specific State funding as well as for deferral of payments by the State. In addition, as discussed above, Realignment revenue is a major source of funding for many Health and Human Services programs, and that revenue is allocated to counties based on a formula that considers caseload growth in certain programs as well as sales tax and vehicle license fee revenues collected statewide. Both of these statewide revenue sources are currently in decline as a result of the national recession.

The following information summarizes the current status of the Agency's budget.

For the last few fiscal years, the level of State support for the various Health and Human Services programs has been declining and, more recently, the Agency has seen increasing delays in payments from the State for services provided. This situation is illustrated in the following table.



As can be seen, as of December, 2008, the cumulative Net County Cost for the Agency was approximately $14 million which is higher than the Net County Cost level at this point in time in any of the last four fiscal years. Typically, Net County Cost will decrease toward the end of the fiscal year as State and Federal revenue comes in to the Agency at a higher rate. Agency staff believe that this will occur this year as well, though the situation is complicated by the State's fiscal problems and the national economic downturn.

Based on the most recent information available, Agency staff has prepared Mid-Year Review projections (on a budget-or accrual- basis) for the Agency. These projections assume that the approximately $6 million in deferrals recently announced by the State are received by the end of October, 2009 and thus will be accrued as revenue in FY2008-09. The projections also do not, at this point, reflect all of the expenditure reductions that would be necessary to ensure the Agency stays within its $11 million Net County Cost allocation. The Agency's Mid-Year projections are as follows:

	Mid-Year Estimates	Adjusted Budget
Revenue	$ 59,980,202	$60,881,252
Expenditures	$ 71,816,911	$71,891,586
Net County Cost	$ 11,836,709	$11,010,334

One of the factors that is influencing projected Agency expenditures and workload is that there appears to be an increase in demand for services, most likely as a result of the economic downturn. For example, between the last quarter of FY2007-08 and the first quarter of FY2008-09, the number of applications processed at the Agency's Employment Center increased by 71%. The number of CalWORKS application increased by 19% in the first nine months of 2008 compared to the first nine months of 2007; the number of Food Stamp applications increased by 21% in the first nine months of 2008 compared to the same period in 2007. The Agency expects to see demand for these services continue to increase.

Agency staff will be addressing how the Agency plans to manage the current year's and next fiscal year's budget risks in more detail in a separate agenda item on today's agenda.

Position Vacancy Status

As noted above, one of the short-term Fiscal Contingency Plan actions implemented by the Board of Supervisors was to harden the selective hiring freeze that was previously in place. Since only one month has elapsed since that hardened freeze was implemented, it is too early to fully evaluate its impact. However, as of this writing, approximately 40 vacant positions have been "frozen," and the following table provides some historical information on the status of position vacancy and recruitment activities.

Vacancy Table

Period	Positions Filled	New Vacancies	Outstanding Vacancies	Vacancy Rate
07/11/08-08/08/08	13	14	90	6.6
08/09/08-09/05/08	17	16	88	6.5
09/06/08-10/03/08	14	19	93	6.8
10/0408-10/31/08	12	9	90	6.6
11/01/08-11/28/08	9	6	88	6.5
11/29/08-12/26/08	15	13	83	6.2
12/27/09-01/23/08	7	17	93	6.9

If the economic downturn continues and deepens, as many economists predict, we would expect to see fewer employees leaving the County, since it is likely that there will be fewer job opportunities with other local governments, and since past experience suggests that, in difficult economic times many employees are reluctant to change jobs. Thus, the vacancy rate may not increase substantially, but there should be a decrease in the number of positions filled.

Based on a review of the positions currently being held vacant, staff believes that it may be necessary to modify the current "hard" hiring freeze. Currently, that freeze applies to all positions, except those funded by a dedicated funding source or that are deemed necessary to meet critical health and safety needs. However, there are certain positions, in payroll and Information Technology Services, for example, that if not filled could impair the effective operations of all County departments.