COUNTY OF HUMBOLDT

For the meeting of: 2/7/2023

File #: 23-9

To: Board of Supervisors

From: County Administrative Office

Agenda Section: Departmental

Vote Requirement: Majority

SUBJECT:
Mid-Year Budget Review for Fiscal Year (FY) 2022-2023 and Budget Outlook for FY 2023-2024

RECOMMENDATION(S):
That the Board of Supervisors:

1. Receive and file a review of the current FY 2022-23 budget and the budget outlook for FY 2023-2024;
2. Direct the County Administrative Officer (CAO) to prepare the FY 2023-2024 budget based on the following parameters;
    a. Set departmental allocations from the General Fund to remain the same as FY 2022-23 (including the 10% vacancy allowance);
    b. Limit requests for additional General Fund appropriations to only those which prevent layoffs and allow departments to recommend furloughs, hiring freezes, or staffing reductions in their departments in order to minimize impact to essential services;
    c. Allocate one-time funding to one-time expenditures to balance department budgets and prioritize use of department trust fund balances over new or increased General Fund allocations and requests;
    d. Set the annual departmental contributions to Public Agency Retirement Services (PARS) to 2% of annual salaries;
    e. Suspend the annual contribution to Deferred Maintenance Trust Fund (3464) for FY 2023-2024;
    f. Increase the transfer from the Tax Loss Reserve to $2 million, so long as the minimum reserve is retained;
    g. Reduce trust and reserve funds to the minimum balance required by county policy, ordinance or Government Code. Consider transferring to General Reserve as a fiscal precaution to an extended recession in Humboldt County;
    h. Reallocate ARPA funding not committed or expended by end of FY 2022-2023;
    i. Provide additional direction to staff on actions to close the FY 2023-2024 projected General Fund budget deficit;

3. Appoint two (2) Board Members to a Budget Ad Hoc Committee; and
4. Provide additional direction to staff as appropriate.

SOURCE OF FUNDING:
All county funds

DISCUSSION:
Historically, the CAO undertakes a mid-year financial review each fiscal year. The mid-year review serves the dual purpose of monitoring the county's budget for the current fiscal year and providing staff, your Board, and the public with a preview of the county's financial status going into the next budget year.

This report has been divided into four(4) key sections:

1. A review of the estimated financial condition of the General Fund and major revenue sources for FY 2022-2023;
2. An overview of the known factors which may affect the county's financial condition heading into the next fiscal year, including a potential recession;
3. A budget outlook for FY 2023-2024; and
4. Policy decisions for your Board to consider in evaluating the county's current and projected financial conditions.

Section 1: Review of Estimated Mid-Year Financial Condition for FY 2022-2023

1100 - General Fund

The General Fund contains the majority of the county programs. This fund is the source of discretionary money derived from local revenue sources, such as property tax, and is available to be spent on local needs.

Bradley Burns Sales Tax
The Bradley Burns Uniform Sales and Use Tax Law provides for a city/county rate of 1.25%. One-quarter cent of the levy is sent to the county-wide regional transportation fund and the balance or 1.0% supports local government general funds. Sales tax is allocated back to the jurisdiction (city or unincorporated county) where the sale was negotiated or order taken (point of sale). As such, the Bradley Burns Sales and Use Tax received by the county is associated with sales that originate in the unincorporated areas of Humboldt County.

Sales tax receipts for the first six (6) months of FY 2022-2023 are down 25% from the first six (6) months of FY 2021-2022. Not too surprising, the decrease, at least in part can be tied to the local cannabis industry. HdL Inc., the county's sales tax consultant, reported that revenue, as adjusted for economic data, collected in all unincorporated areas was down 24.2% for second quarter (2Q) of 2022 but down 36.2% in Southern Humboldt, where approximately 80% of the cannabis cultivators are located.

Sales tax collected in Southern Humboldt accounts for approximately 19.5% of sales tax for unincorporated areas of the county, depending on the quarter. For third quarter (3Q) of 2022, sales tax was down 13.2% in all unincorporated areas, but down 23.1% in Southern Humboldt. The largest decline for both 2Q and 3Q was in garden and agricultural suppliers, substantiating the impact of the cannabis industry on the county's local economy.

Further indication that the decline in revenue is associated with the challenges currently facing the cannabis industry is that other parts of the county are not experiencing the same level of decreases. Sales in the unincorporated county are down 13.2% for 3Q but county-wide sales were only down 7.1%.

The chart below provides a summary of the Bradley Burns adjusted revenues for all jurisdictions in the County.

HdL **HUMBOLDT COUNTY ALL AGENCIES** **Page 4**

SALES TAX TRENDS FOR ALL AGENCIES - 3Q 2022 SALES

Agency allocations reflect "point of sale" receipts

Agency Name	Count	Current Year 3Q 2022	Prior Year 3Q 2021	Share of County Pool	Actual Receipts % Change	Adjusted % Change
Blue Lake	46	8,246	7,300	0.2%	+ 13.0%	+ 24.9%
Ferndale	113	45,836	43,140	0.9%	+ 6.2%	+ 2.9%
Trinidad	33	51,090	52,444	1.0%	- 2.6%	- 3.2%
Eureka	1,264	2,473,181	2,585,496	50.8%	- 4.3%	- 4.2%
Fortuna	405	442,330	513,023	9.1%	- 13.8%	- 5.7%
Arcata	865	645,257	695,743	13.2%	- 7.3%	- 6.2%
Rio Dell	72	53,582	75,936	1.1%	- 29.4%	- 11.0%
Humboldt Co. Uninc	2,609	1,153,701	1,493,981	23.7%	- 22.8%	- 13.2%
Totals	5,407	4,873,223	5,467,064	100.0%	- 10.9%	- 7.1%
Humboldt Pool	8,863	1,175,174	1,235,620		- 4.9%	- 7.6%

HdL is projecting sales tax will be down $1.3 million from the original FY 2022-2023 budget of $7.3 million. The double-digit reductions are not consistent county-wide, nor do they reflect the state-wide trends. Overall California sales tax collections are up 8% for 3Q, only Garden/Agricultural Supplies and Drug Stores are down at the state level, by 2.2% and 1.9%, respectively (see Attachment 1).

The trend in Humboldt County is also not consistent with other far north counties, which in total are just under 1% for Q3 of 2022 over Q3 of 2021. Del Norte realized the largest increase of 13.5% and Humboldt was the largest decrease at 7.1%. The far north counties also include Butte, Colusa, Glenn, Lake, Lassen, Mendocino, Modoc, Nevada, Shasta, Siskiyou and Tehama.

The early estimate by HdL for FY 2023-24 Bradley Burns sales tax revenue is $6.1 million. A reduction of $1.2 million from the current year budget and from the FY 2021-2022 Actual.

Measure Z Sales Tax

While Measure Z sales tax is collected on a different basis (destination or place of use vs. point of sale) than the county's Bradley Burns sales tax, it is also experiencing similar decreases in collection, although not as extensive. Add-in or local voter approved district sales taxes like Measure Z are collected county or district wide, so the revenue is reflective of the whole county in the case of Measure Z, including the incorporated cities. Thus, the decrease in Measure Z revenue is not as significant as the Bradley Burns. HdL is projecting Measure Z will be down $1 million from the original FY 2022-2023 budget of $14.4 to $13.4 million. The preliminary projection for FY 2023-2024 Measure Z sales tax revenue is $13.5 million, reflecting a very minimal increase over prior year estimates.

Proposition 172 Revenue
Proposition 172 (Prop 172) public safety funds are allocated to counties based on the percentage of statewide tax (Bradley Burns) generated by their county for the prior calendar year. The allocation of FY 2022-2023 is based on the calendar year 2021 sales tax receipts. During the pandemic, there was a shift in where sales taxes were generated. Los Angeles, San Francisco, Orange, San Mateo and Alameda counties, which normally generate the largest percent of sales taxes led the top five (5) counties experiencing decreases during the pandemic. During that time many rural counties, including Humboldt, fared better than the more urbanized counties.

Prop 172 revenue budget for FY 2022-2023 was reduced from the FY 2021-2022 actuals by more than $1 million in anticipation of this trend reversing. Revised projections for FY 2022-2023 are $671,000 more than the budget of $13.1 million. However, the eighteen (18) month delay in applying the collection percentage has caught up and in FY 2023-2024 Prop 172 revenue is projected to drop by nearly $2 million back to pre-pandemic levels. Due to the recent double-digit decreases in the county's Bradley Burns sales tax coupled with the eighteen (18) month delay, staff anticipates even further reductions to be realized in FY 2023-2024 Prop 172 public safety revenues.

Measure S
The Board's suspension of Measure S Cannabis Cultivation Excise Taxes for Tax Year 2023 and 2024, plus the very high delinquency rate (49% for Tax Year 2021 and 57% for Tax Year 2022) has resulted in a projected decrease of Measure S revenue for FY 2022-2023 of $3.8 million, reducing revenues from $5 million to $1.2 million. Measure S revenue for FY 2023-2024 is projected at a nominal amount of $200,000 and only reflects potential prior year delinquent collections from permit holders who have a need to maintain their licenses in good standing. This estimate is based on a portion of the cannabis industry’s past practice of paying the taxes when funds were available. As this revenue source has a short but volatile history, payment of past due projections have been and continue to be difficult to predict.

Transient Occupancy Tax (TOT)
The TOT revenue has continued to grow each year with actual collections exceeding budget, for well over ten years. From FY 2020-2021 to FY 2021-2022 the TOT revenue increased by 43%. Unlike the county's sales tax-based revenues, TOT continues to perform strong. Input from the lodging community indicates the some of the increase is the result of a bump in visitors after pandemic restrictions were lifted and increased room rates.

Last June, the voters approved Measure J increasing the TOT from 10% to 12% as of January 1, 2023. The to-date collections for FY 2022-2023 through November, already exceed the entire year's budget from FY 2021-2022 and are conservatively estimated to exceed budget by $840,000, which includes the increase from 10% to 12% for the last six (6) months of this fiscal year. Revenue for FY 2023-2024 is projected at $4,290,000.

In addition to traditional hotels, motels and lodges, the TOT is collected on short-term rentals of 30 days or less, such as vacation rentals including Airbnb and VRBO. As of January 1, 2023, Measure J also added private recreational vehicles and private campgrounds as subject to the tax. For FY 2021-2022, short-term rentals made up 24% of the total tax revenue collected, and account for much of the growth in this revenue, as these taxes where not as consistently collected in prior years. While revenues have increased, hoteliers are reporting a reduction of heads in beds which is indicative of changes in spending patterns and a potential recession.

Estimated FY 2022-23 General Fund - Fund Balance

Fund balance is the accumulation of revenues minus expenditures for all prior years' operations. It represents cumulative resources available for funding future county services. Fund balance also provides a measurement of the financial health of an organization's governmental funds. Increasing fund balance is typically a good trend indicating growing resources and indicates that current revenues are meeting and exceeding current expenditures.

Fund balance is a key fiscal planning tool for both the annual budget process and longer-term strategic planning. For example, agencies will often decide to build up fund balance and then fund a larger one-time or capital expenditure from available resources as opposed to financing the costs through debt. Those strategic investments from fund balance can be critical to the future of the organization. Examples include paying down pension liability, investing in facilities and critical infrastructure, economic development, and other long-term goals.

A revenue shortfall is projected in FY 2022-2023, with the largest impact to revenue projected to be from grants and financing associated with capital project that will not be completed in FY 2022-2023. These revenues are based on reimbursement of qualified expenditures, so there is a corresponding decrease in expenditures for capital projects. The projected net impact from the changes in revenues and expenditures, as detailed below and as previously discussed, is an increase in the use of fund balance from $13.5 at budget adoption to a projected $13.76 million.

FY 2022-23 General Fund Estimated Balance *(in millions)*		
FY 2022-23 Estimated Beginning Fund Balance	**$**	**41.10**
FY 2022-23 Budgeted Revenues		**153.40**
Measure S Revenue Under Budget		(3.80)
Proposition 172 Revenue Over Budget		0.67
Bradley Burns Sales Tax Under Budget		(1.30)
Transient Occupancy Tax (TOT) Over Budget		0.84
Planning & Building Revenues Under Budget		(1.33)
Capital Projects SB 863 Grant & Fin. Plan (Project Incomplete)		(23.89)
Increased Interest		0.25
FY 2022-23 Estimated Revenues		**124.84**
FY 2022-23 Budgeted Expenditures		**193.99**
ARPA Funded Expenses		(8.34)
Capital Projects Not Expended		(23.89)
Other Net Expenditure Adjustments		(1.81)
FY 2022-23 Estimated Expenditures		**159.95**
FY 2022-23 Estimated Other Financing Sources (Uses)		**21.35**
Estimated Use of Fund Balance		(13.76)
FY 2022-23 Estimated Ending Fund Balance	**$**	**27.34**
Primary Use of Fund Balance		
Increase General Reserve	$	5.00
Appropriate Measure Z Fund Balance		5.50
Remaining Contingency Funding		1.10
Other One-Time Expenditures		2.16
Total	**$**	**13.76**

Department of Health & Human Services Funds (1110, 1160, 1170, 1175, 1180, & 1190)

The Department of Health and Human Services (DHHS) is an integrated department providing prevention, intervention and targeted treatment services for Behavioral Health, Public Health, and Social Services. DHHS operates its many programs as separate but connected budget units. Much of the funding comes from the state and federal government as reimbursable grants and other contract programs. The challenge, for DHHS, is the time it takes for reimbursement of expenditures, which can extend many years. As a result, programs often operate at a deficit, and it is difficult to estimate when reimbursement will be received.

When programs operate at a deficit and for many years, other DHHS programs and/or the General Fund must provide the upfront cash to ensure that these programs that serve some of the most vulnerable residents in the county are able to operate without disruption. The delays in funding from the California Department of Health Care Services (DHCS) continue to strain the county's own fiscal position.

Staff in the CAO's office and at DHHS developed Fund Balance projections for the divisions, however, without completing the fiscal close for both FY 2020-2021 and FY 2021-2022, collectively it was determined that providing those estimates could be misleading and it was prudent to delay in providing such information.

Road Fund (1200)

The Road Fund provides for the construction, maintenance and administration of county roads. Like DHHS, most of the Road Fund projects are paid in arrears. Eligible projects may realize reimbursement of 75% to 94% of expenditures from the Federal Emergency Management Agency Disaster Funds (FEMA) and/or the California Governor's Office of Emergency Services (Cal-OES). The county funds the remaining expenditures that are not covered by FEMA or Cal-OES.

The Road Fund's estimated FY 2022-2023 Ending Fund Balance is projected at a negative $4.47 million. This includes the $7 million contribution from American Rescue Plan Act (ARPA) funding allocated by your Board in FY 2021-2022 and FY 2022-2023. To help alleviate the Road Fund deficit and provide the county a greater level of service, your Board has provided staff direction to explore a revenue-producing ballot measure in 2024 dedicated to funding county roads, along with other potential revenue sources.

Roads Fund FY 2022-23 Estimated Fund Balance *(in millions)*		
FY 2022-23 Estimated Beginning Fund Balances	$	(8.47)
FY 2022-23 Estimated Revenues		36.47
FY 2022-23 Estimated Expenditures		37.66
FY 2022-23 Estimated Other Financing Sources (Uses)		5.19
FY 2022-23 Estimated Ending Fund Balances	$	(4.47)

Section 2: 2023 Greater Economic Factors as of January 2023

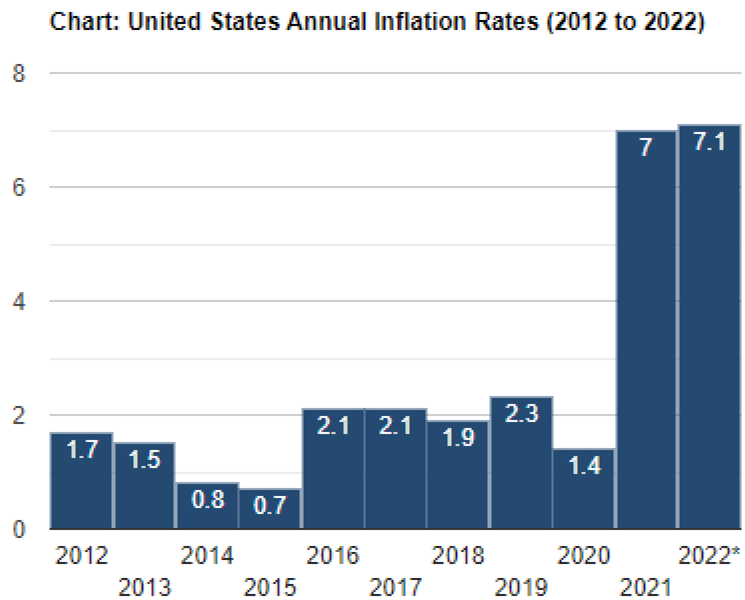
Preface

According to the California Employment Development Division, unemployment numbers for Humboldt County are at a 4-year low (presently 3.7%) and unemployment today is representative of pre-pandemic levels. Incomes for Humboldt residents, reflected as a rise in mean wages, are also more than 19% higher than they were in 2019. Despite lower unemployment numbers and higher pay, consumers in Humboldt County are spending less on goods and services. This can be illustrated by sharp decline in reported retail sales and sales tax revenue.

The decline in the cannabis industry is thought to be a contributing factor. And yet, there are a variety of other inflationary factors that are impacting consumers as a whole, and across other industry sectors. These factors are explored in more detail below.

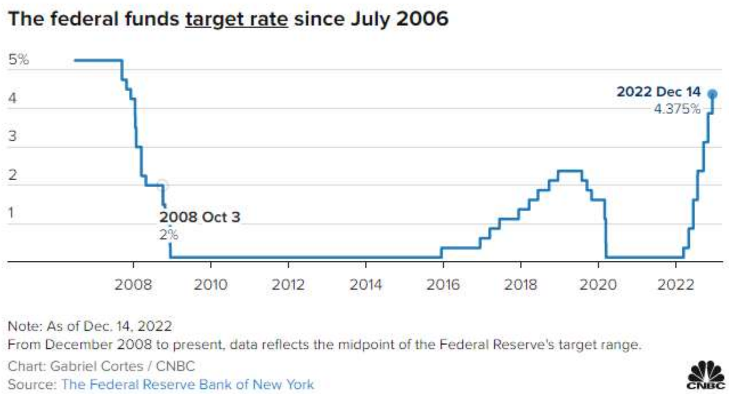
Inflation

Heading into the new year, national economists say that 2023 will likely bring changes. Inflation is expected to slow as the effects of the Federal Reserve's interest rate hikes continue to ripple through the economy. But that could also mean the United States slips into a recession as more consumers find it difficult to pay for cost-of-living necessities. As is illustrated below, in a chart containing data from the U.S. Bureau of Economic Analysis, the United States has experienced a very sharp increase in inflation over the last 24 months.



Interest Rates

The Federal Reserve continues its battle against inflation by raising its benchmark interest rate to the highest level in 15 years. The current Federal Reserve interest rate is 4.50% as of December 14, 2022. The latest increase reflected the seventh rate hike between 2021 and 2022. Although raising rates can be used as a tool to discourage inflationary activity, higher rates also means that the cost of capital for borrowers also increases. In some cases, this makes borrowing activity (especially for those who face challenges in accessing capital) too burdensome or cost-prohibitive.



Housing

According to the California Association of Realtors (CAR) home values in Humboldt County are down 6.5% from a highpoint in July of 2022, and slightly values were in November of 2021. The median home price in California is expected to decline by 8.8% in 2023. Inventory is also down due to rising interest rates, and as homeowners wait out the decline in values. In CAR's 2023 California Housing Market Forecast report, CAR predicts a 7.2% drop existing single-family home sale activity in 2023.

Rentals

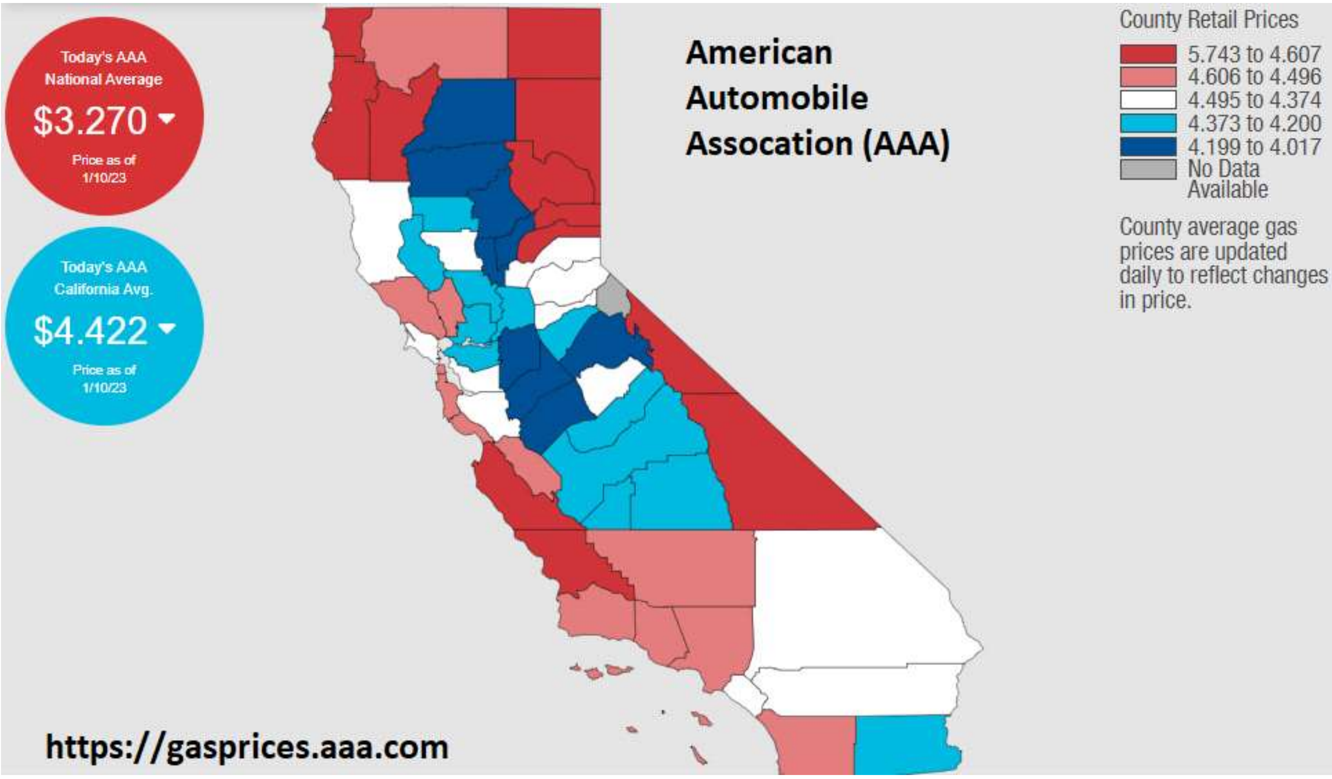
According to a 2022 report by the National Low Income Housing Coalition, Humboldt County residents need to make more than minimum wage in order to afford rental housing. A county resident would need to make $21.38, or $44,480 annually, to afford a $1,112 rental, according to the report. Young individuals (normally a top renter demographic) are also experiencing transitionary challenges and are moving back in with their parents/guardians' at an increasing rate. According to Pew Research, nearly one (1) in four (4) millennials said they were living with their parents as of December 1, 2022, more than half of whom said they had moved back in with family in the past year. Housing unaffordability was cited as a top reason for moving back home.

Cost of Goods and Services

In the United States, the Consumer Price Index (CPI) measures changes in the prices paid by consumers for a basket of goods and services. Data from the Bureau of Labor Statistics reflects that the Consumer Price Index for All Urban Consumers "rose 0.1 percent in November 2022, seasonally adjusted, after increasing 0.4% in October." Over the past twelve (12) months, the index has increased 7.1%. Noteworthy increases include energy and utility costs which have increased 13.1% over the last year and food costs which have increased 10.6%.

Fuel

Humboldt County continues to fall into the top tier of gas prices for the state of California. As of the writing of this report, the American Automobile Association reports that Humboldt County's average cost per gallon (of regular fuel) is $4.85, making the cost of fuel in Humboldt roughly 10% higher than the state average and nearly 50% higher than the national average.



Savings

The personal savings rate which tracks how much individuals are saving (i.e., a percentage of disposable personal income) reached a high during the pandemic as many Americans received stimulus checks and reduced their expenditure activity. However, that savings rate has come down since, in large part due to inflation and the increasing cost of living. According to the Bureau of Economic Analysis the national savings rate fell to just 2.3% in the fourth quarter last year. Goldman Sachs economists have described the current savings activity as an "exceptionally low," noting in a report that current saving trends are just barely above the record low of 2.15% set during the housing boom of 2005. In contrast, the savings rate in 2019 approached 9% (according to a report by Moody's).

Healthcare

U.S. employers expect healthcare costs to rise an additional 6% next year. This comes after a 5% increase to premium and plan costs which was felt by consumers in 2022. Over half (54%) of employers polled (representing more than 8 million employees) reported that their healthcare costs will be over budget this year. In all, between 2020 to 2040, healthcare costs are expected to increase another 44%, according to Willis Towers Watson, a leading provider of compensation, benefit and employment practice data.

Conclusion

Positive key indicators by which to gauge our present situation include the county's current unemployment levels, wage levels, and nationwide consumer confidence. However, savings rates are at an all-time low as necessary goods and services (food, housing, fuel, energy, healthcare, etc.) continue to rise. Moreover, home values are decreasing while rental rates rise, and the lack of housing inventory creates lack of competition which negatively impacts consumers. The decrease in spending on goods and services will ultimately result in less tax revenues for government operations and programs. The full impact of the December earthquake, and its disruption residents, business, and to holiday spending during a critical shopping week, are also not yet known.

Nationwide, economists are divided on whether or not the country will see a mild recession take place, or whether there will be any recession at all (i.e. a soft landing). Some experts believe that a severe recession is not off the table. Two-thirds of economists surveyed by The Wall Street Journal predict a recession will occur this year as the Federal Reserve raises interest rates to try to get inflation under control. The Humboldt County community is not immune to global economic conditions either. If the global oil and grain supply is further strained by Russia's war against Ukraine, or if China's zero-COVID policies significantly worsen supply chain issues, Californians and Humboldt residents alike could begin to feel even further adverse economic impacts at home.

And yet, Humboldt County does sit at the precipice of great economic opportunity. The nearly half-billion-dollar state investment in the local university will have a significant positive impact on the community. While fixed numbers are not yet certain, other models demonstrate that polytechnic universities can generate tens of millions of new dollars in communities where they reside. The aquaculture industry is also set for growth with the adoption of the Nordic Aquafarms project by the Planning Commission. The Nordic project is anticipated to create several hundred new jobs in the area and will reflect hundreds of millions of dollars in investment into the defunct mill site on the Samoa Peninsula.

Moreover, the potential for offshore wind places Humboldt in line for a genuine prosperity boom. Two international developers have cumulatively bid over $330 million dollars for the right to develop federally designated wind areas off our coastline. Studies by the Bureau of Ocean Energy Management, the National Renewable Energy Laboratory, and the California Energy Commission, predict that offshore wind is expected to create thousands of living wage jobs for the region and result in billions of dollars in economic impact over the 30-year life cycle of the project. Tourism into the county is up nearly 20% after the pandemic sparked a renewed interest in rural and remote communities. And the County of Humboldt continues to invest in economic vehicles such as the Enhanced Infrastructure Financing District (EIFD) and other investments in childcare initiatives, workforce, and housing programs.

If a recession does come Humboldt's way, the prudent course of action would be to implement necessary short-term protections to maintain economic stability until the aforementioned opportunities are able to come to fruition.

Section 3: County Budget Outlook for Fiscal Year 2023-2024

Expenditure Increases for FY 2023-2024

The challenge in FY 2023-2024 will be that expenditure growth continues to outpace revenue growth. In fact, overall revenues are anticipated to decline consistent with the FY 2022-2023 revised projections and there are indications as discussed earlier, that local revenues could decrease further, even if the United States and/or California avoids a recession in the fiscal year.

Salaries and benefits will continue to strain the county's operating budgets. While the increases are not as significant as those negotiated for FY 2022-2023, salary and benefit costs continue to rise in FY 2023-2024 as the result of increases for department heads, additional equity adjustments and the increase in minimum wage and associated compaction issues at the lower end of the county's pay scale, as well as additional Cost of Living Adjustments (COLA).

Pre-Budget Adoption Projected Salary and Benefit Expenditure Fund Comparison
(in millions)

Fund/Group of Funds	FY 2021-22	FY 2022-23	% Change	FY 2023-24	% Change
General Fund	$ 71.1	$ 82.7	16.3%	$ 85.6	3.5%
Measure Z	7.8	9.0	15.4%	10.8	20.0%
Economic Development	0.9	1.2	33.3%	1.3	8.3%
Dept. of Health & Human Services	117.0	140.1	19.7%	146.2	4.4%
Internal Service Funds	6.2	6.9	11.3%	7.3	5.8%
Aviation	0.9	2.0	122.2%	2.1	5.0%
Roads	9.9	11.1	12.1%	11.2	0.9%
Library	2.3	2.7	17.4%	2.9	7.4%
Child Support Services	4.1	4.6	12.2%	4.3	-6.5%
Special Revenue Programs	1.8	3.3	83.3%	3.1	-6.1%
	$ 222.0	$ 263.6	18.7%	$ 274.8	4.2%

**Projections in the chart above are developed in advance of the budget adoption.*

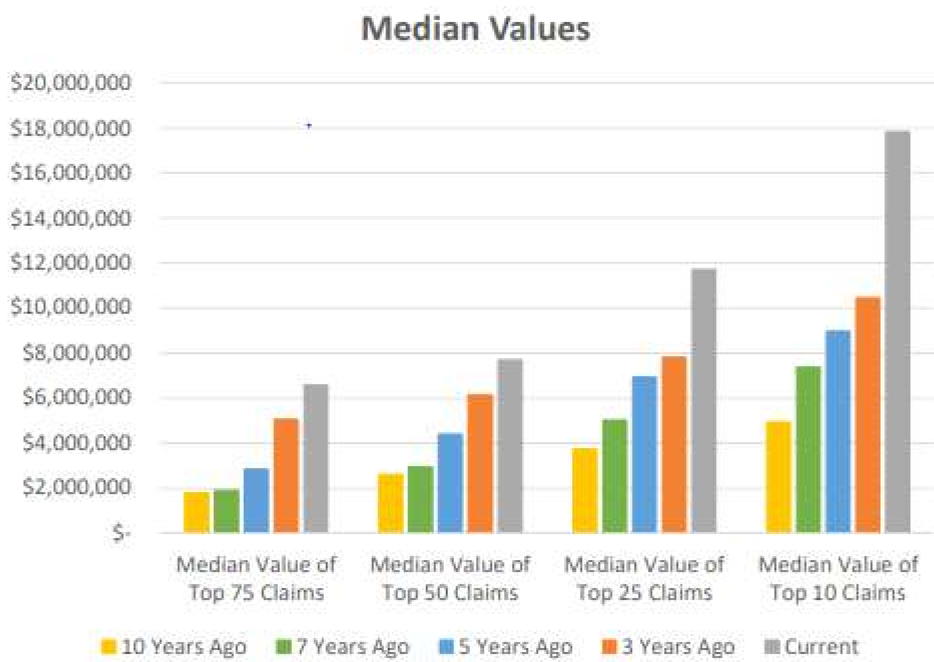
Overall, county-wide salaries and benefits are projected to increase 4.2% or by $11.2 million. The equity adjustments, salary increases, new positions and 6 months of the 2-3% increase in total pay from FY 2022-2023 to 2023-2024 accounts for 50% or $5.6 million of the increase. Health benefits increased $3.4 million or 30%, retirement benefits by $1.85 million or 16% and other benefits by $435,000 or 4%.

Note: The significant increase in Measure Z is the result of adding eleven positions and moving five positions from the regular department to the Measure Z budget unit during the FY 2022-2023 budget process. The decrease in Child Support is the result of deallocating five positions during the FY 2022-2023 budget process. Similarly, the decrease in Special Revenue Programs, which sums up smaller programs, is the result of net reduction in staff allocations during the FY 2022-2023 budget process.

General Liability and Workers Compensation

In addition to the labor cost increases, general liability and workers compensation insurance costs are also expected to continue to increase. Overall, liability insurance for the county is projected to increase by $700,000 or 7.6% and Workers Compensation is anticipated to increase by $600,000 or 12.16%. Although these increases are less than the last couple of years, it may still be difficult for some departments to continue to absorb these increases, particularly those allocated higher percentages of the costs based on prior claims history.

For much of the last two decades, the liability market has had relatively modest loss experience, ample capacity and sufficient competition to support stable and relatively affordable liability insurance rates. However, in recent years, plaintiff demands, jury verdicts and claims settlements have skyrocketed, resulting in significant increases in liability coverage. The chart below illustrates the increasing value of claims, which is driving costs upward.



Revenue Changes for the General Fund

As discussed above, overall revenue is projected to decline in FY 2023-2024. As a reminder, many departments have established "trust funds" or revenue reserves to set aside funds in anticipation of potential downward trends in revenue. The projected decrease of $2.0 million from Proposition 172 Public Safety fund has the potential to be offset by other public safety funding, including but not limited to fund balance in the Law Enforcement Services Account (Fund 3741), which is currently estimated at more than $21 million. The $1.3 million shortfall in Planning & Building Revenue is not expected to rebound in FY 2023-2024 but like the lost public safety funding may be offset by various Planning & Building reserve or trust funds with estimated fund balances nearing $5 million.

The revenue short fall in the Bradley Burns Sales Tax may be offset by use of reserves in the Tax Loss Reserve (Fund 3010) and other funds that have built balances in excess of what is mandated or required by county policy or California Government Code. It is important to keep in mind that continued use of one-time money to fund ongoing expenses is not a financial best practice and it is recommended that once the county's financial reporting is current, staff and the Board work towards long-term financial solutions through sustainable financial planning.

The following chart details the projected shortfall in the General Fund for FY 2023-2024.

General Fund Preliminary Estimated FY 2023-24 Shortfall *(in millions)*			
Revenue Changes from Estimated FY 2022-23			
Proposition 172 Decrease		$	(1.97)
Measure S Revenue Decrease			(1.00)
Planning & Building Potential Decreases			(0.80)
Other Increases			0.98
Interest Earnings Increases			0.25
	Total	**$**	**(2.54)**
Salary & Benefit Increase			
Salary Increases			1.35
Health Benefits Increases			0.77
Retirement Increases (includes PARS @ 2%)			0.67
FICA/Medicare Increases			0.16
	Total	**$**	**2.96**
ARPA Funded Staff from FY 2022-23 Expenditures			
Sheriff $4,385,728			
Assessor $103,385			
Auditor-Controller $69,057			
Public Defender $165,950			
Conflict Counsel $71,839			
Headwaters Administration $171,029			
Economic Development $362,790			
	Total	**$**	**5.33**
Prior Year Use of Fund Balance			
Non-One-Time Expenditures			0.36
Contingency			1.10
	Total	**$**	**1.46**
	Preliminary Estimated FY 2023-24 Shortfall	**$**	**(12.29)**

General Fund Shortfall

The chart below details potential funding sources to fill the projected FY 2023-2024 shortfall in the county's General Fund. The chart presents options and does not necessarily recommend one over another. Your board may mix and match the source to cover the $12.29 million projected shortfall. The challenge with each of the options below is that all are one-time or temporary funding sources. None of these sources fund the current long-term structural deficit and are heavily dependent on annual budget savings, future budget reductions and/or identifying, and successfully implementing future, revenue streams.

The result of relying on short-term and one-time funding is the inability to create longer-term strategic goals that require new or increased funding sources.

Potential Sources to Fill General Fund Shortfall *(in millions)*		
Potential Use of Certain Trust Funds	$	7.68
Use of Fund Balance (portion of or up to)		12.29
Eliminate PARS Contribution for FY 23-24		1.16
Maintain 10% Vacancy in GF Allocation (no increase)		-
Deferred Maintenance Annual Trust Fund Contribution Suspension		0.64
Eliminate Contingency		1.10
Use all or a portion of General Fund Reserve (up to)		10.59
Increase use of Tax Loss Reserve		2.00
Across All Departments - 8.5% Budget Cut		13.60
Use of PARS Account Balance to fund Pension Costs		7.00
Total of All Options	**$**	**56.06**

1. The table below provides estimated balances for “Trust Funds” and other reserve accounts that have the potential to supplement department budgets in FY 2023-2024:

Fund Number	Description	Fund Balance
3680	Delinquent Tax Sales Trust	$ 901,990
3010	Tax Loss Reserve	4,955,716
3018	Overage Fund	50,998
3070	Property Tax Reduction Fund	29,103
3108	Property Tax Suspension Fund	693,917
3109	Secured-Suspense	51,597
3107	MH/Build Transfer Deposits	555,575
4492	Capitalization Fund	498,562
3697	Cannabis Planning	431,995
3698	General Plan User Fee	586,634
3440	Code Enforcement Trust Fund	84,381
3564	Building Inspection Fees - Pr Year	1,211,681
3575	EIR Contractors	2,154,102
3741	Law Enforcement Services Account	21,723,011
3446	Advanced Disaster Assistance	78,984

2. The projected General Fund - Fund Balance as of June 30, 2023 is $27.34 million and could fund the shortfall in its entirety.

3. A 2% department contribution to the Public Agency Retire Services (PARS) account is a $1.16 million projected expense to the General Fund, including Measure Z. County-wide a 2% contribution is estimated at $3.34 million. This option is not recommended because long-term pension expenses is a contributing factor to the structural deficit and the PARS Trust is one way to reduce those long-term costs.

4. In FY 2022-2023, the departmental General Fund Allocations factored in a 10% staff vacancy rate, if this is eliminated for FY 2023-2024 it will increase the projected General Fund budget by $8.1 million.

5. Annually, the General Fund contributes to the Deferred Maintenance Annual Trust Fund of approximate $640,000 plus inflation. The estimated balance of the Deferred Maintenance Fund (3464) as of July, 1, 2022 is $5.4 million. This contribution could be temporarily suspended.

6. Traditionally, the county budgets a certain amount as a set aside for contingencies and other needs that arise throughout the year. This amount varies depending on the budgetary health of the county. Typically, it is set between $1 million and $2.5 million. This option is not recommended because contingency funds are more important during tight budget years, when there is little or no ability to absorb emergency and unexpected expenses during the year.

7. The ending balance as of June 30, 2023 in the County's General Reserve (Rainy Day) fund will be $10.59 million. Your Board may, by a 4/5, vote agree to use all or a portion of those funds to balance the budget in FY 2023-24. This action is not recommended for the FY 2023-2024 Budget but could be reconsidered during the FY 2024-2025 budget development, if a recession or downturn continues into the following year.

8. Over the years, the balance in the Tax Loss Reserve Fund has grown, as the balance continues to exceed the Board policy level. There is a sufficient balance to increase the transfer to the General Fund by $1.5 to $2.0 million.

9. A traditional way to balance the budget is to simply allocate the shortfall equally across all budget units. The current shortfall equals 8.5% of the projected General Fund Expenditures for FY 2023-2024. This option would likely result in layoffs and/or staffing reductions through attrition.

10. The current balance in the Public Agency Retirement Services (PARS) account is approximately $7.0 million, depending on current market value. The 115 Trust has the flexibility to be used at any point to offset one-time employer CalPERS contributions. This is not recommended because it reduces the county's ability to manage the long-term increases in pension costs.

11. Consider holding on any and all county personnel salary negotiations following implementation of Phase 2 for the Class and Compensation Study adjustment.

12. Place a hold on all position changes that are not net neutral in short and long-term costs.

13. Consider voluntary separation agreements.

14. Consider retaining all Measure Z and TOT revenues to fund core county programs and services.

CAO Recommended FY 2023-24 Budget Parameters and actions to close General Fund Deficit

The CAO makes the following recommendations for establishing parameters for preparing the FY 2023-2024 Budget:

1. Set departmental allocations from the General Fund to remain the same as FY 2022-23 (including the 10% vacancy allowance).
2. Limit requests for additional General Fund appropriations to only those which prevent layoffs and allow departments to recommend furloughs, hiring freezes, or staffing reductions in their departments in order to minimize impact to essential services;
3. Allocate one-time funding to one-time expenditures to balance department budgets and prioritize use of department trust fund balances over new or increased General Fund allocations and requests;
4. Set the annual departmental contributions to Public Agency Retirement Services (PARS) to 2% of annual salaries;
5. Suspend the annual contribution to Deferred Maintenance Trust Fund (3464) for FY 2023-2024.
6. Increase the transfer from the Tax Loss Reserve to $2 million, so long as the minimum reserve is retained.
7. Reduce trust and reserve funds to the minimum balance required by county policy, ordinance or Government Code. Consider transferring to General Reserve as a fiscal precaution to an extended recession in Humboldt County.
8. Reallocate ARPA funding not committed or expended by end of FY 2022-2023.

Your Board previously discussed a desire to have more involvement and understanding into the budget process. Accordingly, staff requests that your Board appoint two (2) Board Members to a Budget Ad Hoc Committee. These Board members will have an opportunity to attend Budget Kickoff, departmental budget meetings and participate in the County Administrative Offices budget compilation. This appointment may require significant contributions of time in the months of March, April, May and June.

FINANCIAL IMPACT:

Narrative Explanation of Financial Impact:

The financial impact of past, present and future actions or decisions are the topic of this staff report and presented throughout the report.

STAFFING IMPACT:

Narrative Explanation of Staffing Impact:

All position and benefit funding decisions impact the budget and are therefore addressed throughout this staff report and are integral to the budget and fiscal management of the county

STRATEGIC FRAMEWORK:

The recommended actions support the Board of Super Strategic Framework by managing our resources to ensure sustainability of services.

OTHER AGENCY INVOLVEMENT:

None

ALTERNATIVES TO STAFF RECOMMENDATIONS:
Board discretion

ATTACHMENTS:
1. Humboldt 3Q Sales Tax Report
2. FY 2023-2024 Budget Calendar with Measure Z Milestone Dates

PREVIOUS ACTION/REFERRAL:
Board Order No.: D-1, E-1
Meeting of: 9-27-2022, 9-12-2022
File No.: 22-1177,22-1178