



AGENDA ITEM NO.
F2

COUNTY OF HUMBOLDT

For the meeting of: February 6, 2018

Date: December 20, 2017
To: Board of Supervisors
From: Amy S. Nilsen, County Administrative Officer *AN*
Subject: 2018 Seven Year Financial Forecast Report

RECOMMENDATION(S):

That the Board of Supervisors receive a staff report on the financial forecast of the county's major funds over the next seven years.

SOURCE OF FUNDING: General Fund, Department of Health & Human Services, Roads Fund, Library Fund, and Aviation Fund.

DISCUSSION:

The County Administrative Office provides the Board quarterly budget reports. Starting in 2013, a five-year financial forecast report was developed and is intended to provide the Board and public information on trends in anticipated revenues and expenditures for the county's major funds for the next five fiscal years. The attached report has been revised to forecast the next seven years and provides a baseline for measuring future year needs and resources based on current conditions. Ongoing financial uncertainties require financial planning beyond the current single year budget process. Budget decisions made in one year can have significant impacts on resources that are available for future years.

Prepared by Sean Quincey CAO Approval *[Signature]*
REVIEW: Auditor _____ County Counsel _____ Human Resources _____ Other _____

TYPE OF ITEM:
 Consent
 Departmental
 Public Hearing
 Other _____

PREVIOUS ACTION/REFERRAL:
Board Order No. _____
Meeting of: _____

BOARD OF SUPERVISORS, COUNTY OF HUMBOLDT
Upon motion of Supervisor *Bass* Seconded by Supervisor *Wilson*
Ayes *Bass, Fennell, Bohn, Wilson*
Nays _____
Abstain _____
Absent *Sundberg*

and carried by those members present, the Board hereby approves the recommended action contained in this Board report.

Dated: 2/6/18
By: *[Signature]*
Kathy Hayes, Clerk of the Board

This Seven-Year Financial Forecast report covers primarily General Fund forecasts and noteworthy changes or issues with other major funds over the seven year period. In preparation of the report, a number of publications were referenced to determine economic forecasts at the local, state and federal levels, such as the Congressional Budget Office report, Legislative Analyst Office California Fiscal Outlook, Beaconomics and the Humboldt Economic Index.

Economic indicators for the United States, California and Humboldt County show that the economy will continue to grow at a moderate pace in the short-term, while the Congressional Budget Office (CBO) predicts an average growth rate of 1.9 percent over the next 10 years. However, a variety of factors, including higher interest rates, could lead to a moderating or mild recession of the economy beginning in mid to late 2019.

The United States economy is now in the 9th year of its current expansion, and at this point there is little reason to believe that will end in 2018. In fact, this expansion will likely end up being the longest in U.S. history, with the longest period being 10 years. Historically recessions have occurred about five years apart and this suggests another recession may occur during the seven-year forecast period.

The good news is that unemployment continues to decline at a steady rate and there is slow but steady growth in the overall economy in Humboldt. Challenges such as affordable housing and availability of housing stock remain issues for sustained growth in the employment sector. Even though consumer confidence is moderately up, retail sales have declined but still remain positive and are predicted to show mild gains for the next several periods.

There are a number of financial issues facing the county in terms of meeting minimum obligations while still providing programs and services to the citizens of Humboldt County. Long-term fiscal stability is a Board priority (safeguarding the public trust by managing resources to ensure sustainability of services); therefore, the challenges present hurdles that can be managed to coincide with the Board's strategic framework. The main hurdles currently facing the county are a lack of adequate savings, the unfunded liability for the California Employee Pension Retirement System (CalPERS), Americans with Disabilities Act (ADA) consent decree with the Department of Justice (DOJ), and a large backlog of deferred maintenance costs and ageing facilities. The county continues to chip away at its outstanding pension obligations but will not see relief soon without an increased level of investment. Several funds, such as Mental Health and Library, are operating at or near a deficit due to declining revenue or operational imbalances, and if not addressed could further impact the General Fund.

The 2018 report results indicate that the General Fund's financial outlook depicts a mild downward trend compared to past budgetary cycles. Expenses are anticipated to outpace revenues in future years due to primarily slower property tax revenue growth, ADA requirements pursuant to the 2016 consent decree, increasing salary and benefit costs, and the need to fund capital projects in order to address ageing infrastructure. The moderate outlook for the General Fund over the seven-year forecast period depicts that revenues do not keep up with expenses and reserves, contingencies and deferred maintenance contributions remain well below policy level.

The value of a long-range financial forecast is that it provides an advance look at the county's financial health in time for corrective action to be taken. The Board has had an opportunity to receive the mid-year budget review, which sets the parameters for the fiscal year (FY) 2018-19 budget development.

FINANCIAL IMPACT:

Acceptance of today's report has no direct financial impact.

The seven-year financial forecast supports your Board's Strategic Framework: Priorities for New Initiatives by helping to manage county resources to ensure sustainability of services.

OTHER AGENCY INVOLVEMENT:

None.

ALTERNATIVES TO STAFF RECOMMENDATIONS:

Board discretion.

ATTACHMENTS:

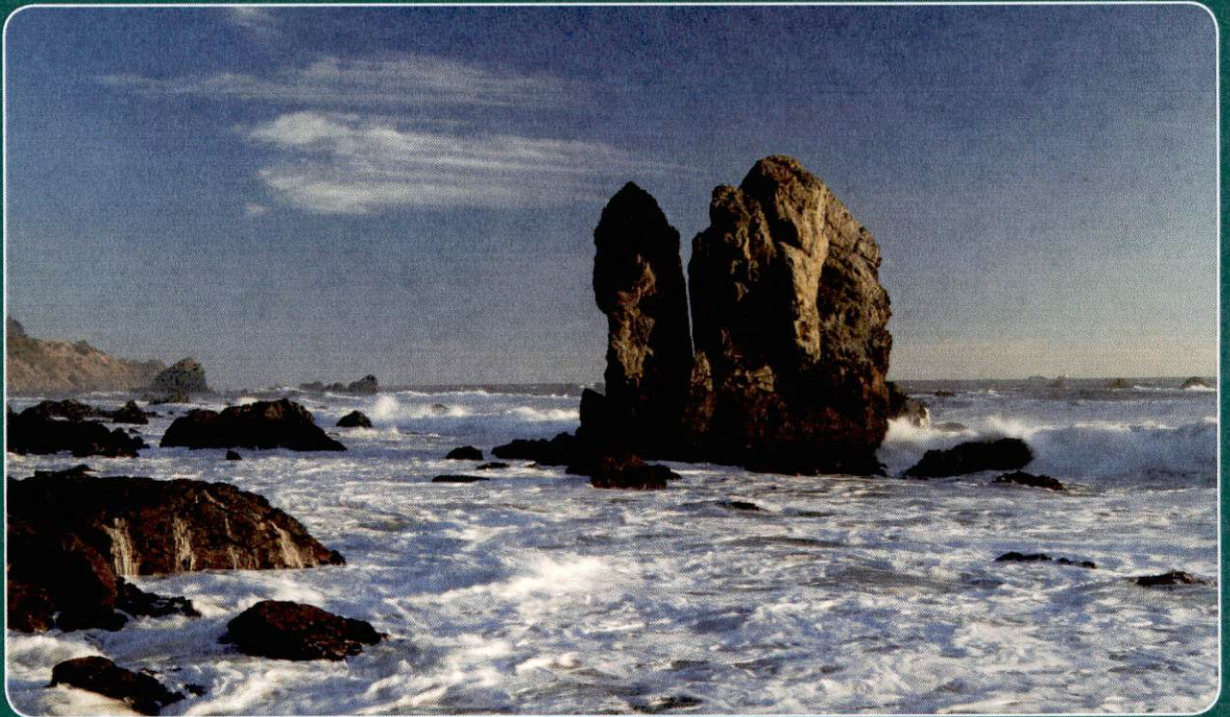
2018 Seven-Year Financial Forecast



HUMBOLDT COUNTY

2018-2019

7-Year Forecast



Board of
Supervisors



Virginia Bass



Rex Bohn



Estelle Fennell



Ryan Sundberg



Mike Wilson



Economic Outlook

Purpose

Humboldt County's Seven-Year Financial Forecast report is intended to provide the Board and public information on trends in anticipated revenues, expenditures and fund balance for the county's major operating funds for the next seven fiscal years. This report covers only the largest county funds and funds with significant deficits. Forecasts for funds not included were reviewed by county administrative staff and projected to have no noteworthy changes or issues over the seven-year period.

Economic Outlook

The US economy is now in the 9th year of its current expansion, and at this point there is little reason to believe that will end in 2018. Economic indicators for the United States (US), California and Humboldt County predict that the economy will continue to grow, according to federal Congressional Budget Office (CBO), for fiscal year (FY) 2018-19 and that over a 10-year outlook that growth will average 1.9 percent. However, a variety of factors, including higher interest rates, could lead to a moderating of the economy beginning in mid-to-late 2019. This expansion will likely end up being the longest in US history, with the longest period being 10 years. Historically recessions have occurred about five years apart and this suggest another recession may occur during the seven-year forecast period.

Local economy: The Humboldt Economic Index is a report produced by the Economics Department at Humboldt State University. It measures changes in the local economy using data from local business and organizations. The report includes a Composite Index which is a weighted combination of six individual sectors of the local economy. The November 2017 report states the Composite Index is up 0.4 points from this time last year. Retail sales have dipped 8.5 points lower when compared to October 2016. The Index of Home Sales has increased from this time last year by 2.2 points; moreover, the bigger issue is the availability of affordable housing and housing stock in general. The median home price compared to this time last year was \$305,000 versus \$300,000 at the time of this

report. The seasonally adjusted unemployment rate for Humboldt County decreased from 4.5 to 4.1 percent, which is comparable to the state rate decreasing from 5.1 to 4.9 percent. The national unemployment rate dipped slightly from 4.4 compared to 4.1 in October 2017.

Building permits: The numbers for local building permits have leveled off, and still remain low compared to pre-recession levels. Local building permit numbers when compared to the prior year for the same period reflect a slight gain of 1.4 points. However, overall, local building permits are relatively flat and show no significant deviation from October 2016.

Unemployment: The country's unemployment rate is 4.1 percent, the lowest in 45 years. However, due to a decline in growth of working age population and a drop in immigration, there is a lack of available workers. While the labor shortage should increase wages, it will slow economic growth in years to come.

Minimum wage: State law requires the minimum wage to increase to \$11 per hour at the beginning of calendar year 2018 for organizations with 26 or more employees, with the rate rising to \$15 by 2022. Between 30 and 35 percent of Humboldt County workers earn less than \$12.50 per hour, meaning that a large portion of citizens received a raise at the beginning of the year.

State economy: Beacon Economics Summer 2017 report states California's job growth has slowed but the overall economy continues to grow for the sixth consecutive year. In terms of economic indicators, California has been one the fastest growing states in the nation over the past year. The labor market is reportedly at full employment with overall job growth in the negative. However, sectors such as manufacturing, health care and retail depict positive job growth despite an overall decline. The job market is more or less stagnant but there are still many jobs going unfilled due to a lack of qualified candidates for some industries. Several major industries in California however posted declines in terms of job growth, such as technical, education and government. A tight labor market

with overall increases in statewide payrolls suggests wage gains on the rise, which equates to an increase in local expenditures and a potential for increased local government revenues from increased sales tax revenue. Home sales continued to increase in 2017, with the statewide median price at \$565,330 according to the California Association of Realtors. The median price has risen 6.7 percent, with a 1.3 percent increase in sales. The median home price for Humboldt County however is slightly down from October 2016's price of \$305,000 to \$300,000 for October 2017. While home sales continue to grow statewide, single-family home inventory continued to drop. A reduction in the number of available homes on the market also impacts the availability and price for rental housing.

Sales tax: A review of the Hinderliter, de Llamas & Associates (HdL) comparison of sales tax allocations for the first quarter of 2016 and the first quarter of 2017 shows a 2 percent increase in point-of-sale tax revenue for Humboldt County. This validates the Beacon Economics analysis that local revenues are anticipated to steadily increase for 2018 and provides a positive sign for an improved local economy.

State and federal governments: The county receives a large amount of revenue that is dedicated to funding mandated state and federal programs. For this reason the state and federal budgets have the potential to impact the General Fund and programs delivered through various funds, several of which are maintained by the Department of Health & Human Services. Fortunately, the state has made significant progress towards building up Reserves and could have as much as \$19.3 billion by the end of 2018-19. This is good for local governments because Reserves have the potential to provide a buffer against state budget problems if a negative economic situation such as recession were to occur.

The state Legislative Analyst's Office (LAO) forecast is similar to last year, but pushes out economic growth one year. It assumes continued moderate economic growth for California for 2018 but recognizes the potential for mild recession as soon as mid-2019. The LAO assumes the state could weather deficits



created by a moderate recession through 2021-22, though new commitments or policy changes would affect the outlook.

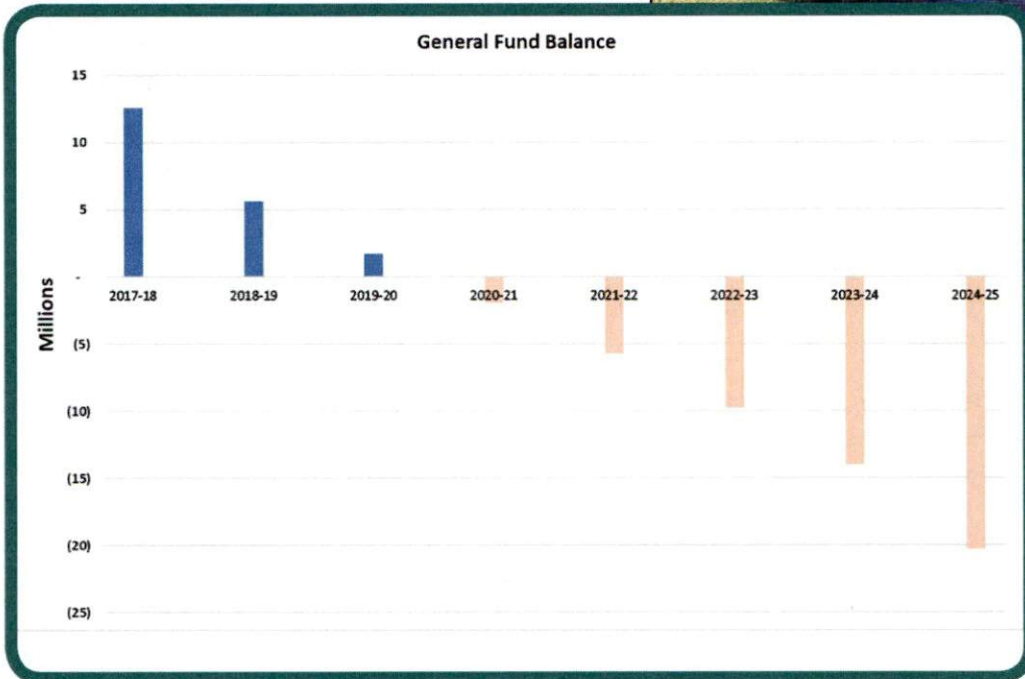
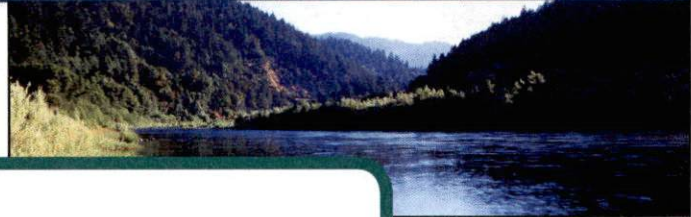
President Trump and Republicans make up a majority of both chambers of Congress. This has resulted in massive change in tax policy for the first time in more than three decades, and poses risk to state revenues especially. More major changes could be on the way for federal policies and programs, such as the Affordable Care Act.

The federal budget deficit is generally on an upward trend over the next decade, with 40 million baby boomers set to retire in the next 10 years and the recent tax package passed by Congress adding another 1.5 trillion to the debt. This could have serious consequences both for the economy and federal budget. This poses a risk to the local economy as well as the county budget and services, as the federal government would likely need to either raise taxes or cut spending to deal with the debt.

Conclusion: The good news is that unemployment continues to decline at a steady rate and there is slow but steady growth in the overall economy in Humboldt. Challenges such as affordable housing and availability of housing stock remain issues for sustained growth in the employment sector. Even though consumer confidence is moderately up, retail sales have declined but still remain positive and are predicted to show mild gains for the next several periods. The state government has built up its Reserves and is generally in good shape in case of a moderate recession or slight change in federal policy. Nationally, the economy is strong and signs show that growth could taper within the next two years. Federal policy changes have a chance to affect California and Humboldt County in a big way, but those effects are yet to be realized.



General Overview and County Outlook



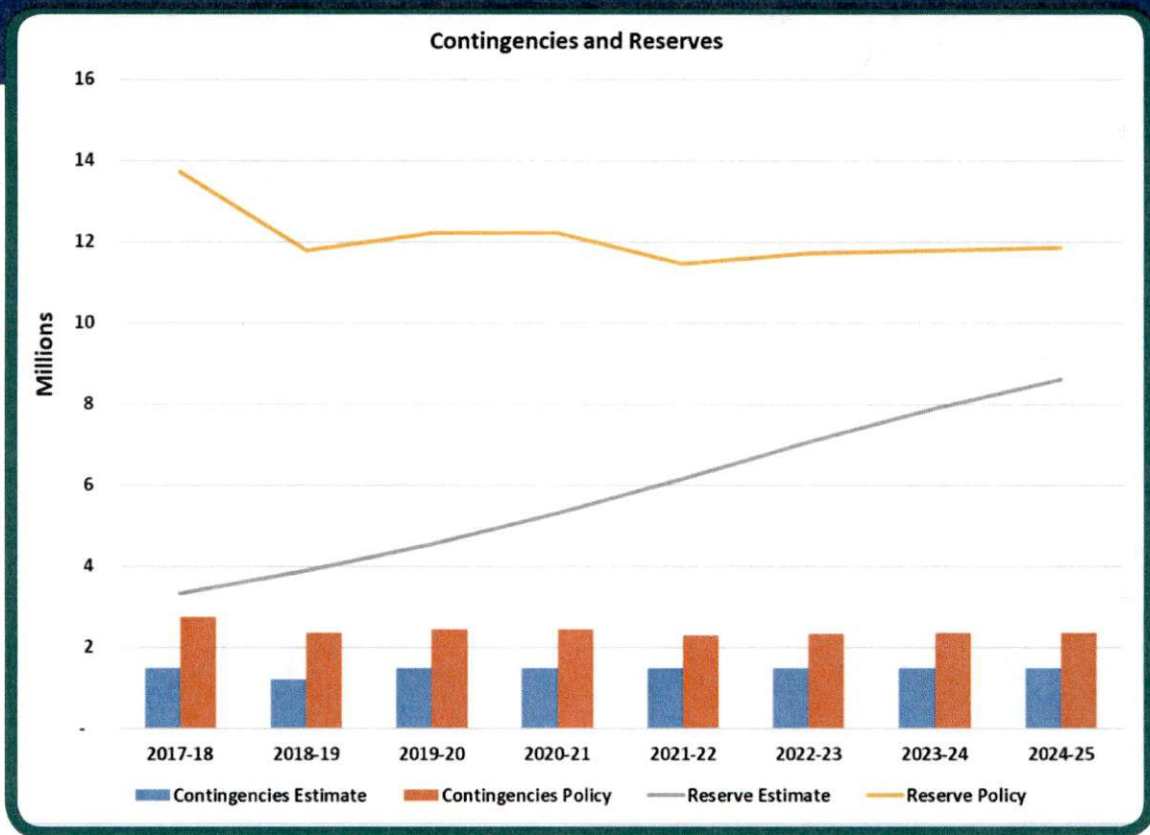
balanced budget will be required in future years if expenditures outpace revenues.

Property tax values and other tax revenues are significant factors in the forecast outcome. A change of 1 percent in property tax values is equivalent to approximately \$360,000 in revenue. There is potential that property taxes could be lower or higher than projected.

The seven-year forecast for the General Fund shows revenues exceeding expenditures until FY 2020-21, where the trend reverses and expenditures exceed revenues for the remaining four years of the forecast. A negative fund balance develops FY 2020-21 of the forecast, and at the end of seven-years the fund balance is projected to be negative \$20.3 million. Major contributing factors to the declining fund balance include increasing retirement and health insurance costs, and slow to moderate revenue growth, particularly property tax and Measure S. If either of these factors changes for the better, such as cannabis revenue, forecast figures would need to be revised and the fund balance issue would not portray such a bleak picture. In addition, since the Board cannot adopt an unbalanced budget, measures to reduce the negative fund balance and bring forth a

Property tax assumptions are based on recent trends in Humboldt County with a conservative growth factor being added to the estimated Consumer Price Index (CPI). However, trends and the outlook for steady growth even with factoring in a mild recession depict increasing property tax revenues throughout the span of the forecast.

The above depicted fund balance scenario, however, includes minimal contributions to Contingencies and deferred maintenance. With many unknown variables in both revenues and expenditures, it is important to retain fund balance and continue to contribute to the General Reserves and Contingencies to ensure that negative financial impacts can be absorbed without the threat of service reductions.



Contingencies would remain at \$1.5 million which is far lower than the policy level of \$7 million or 6 percent for FY 2018-19 and future fiscal years' General Fund revenues. General Reserves would be \$5.7 million if contributions are made at \$350,000 for all seven-years of the forecast. Per policy Reserves should be between 8 to 10 percent of revenues or between \$9.5 million and \$11.6 million at the end of the forecast period.

Using figures from the Contingency and Reserve Policies presented to your Board during the mid-year budget report, an additional \$6.57 million or about \$935,532 annually for all seven-years would be required to start to meet policy funding levels for general Reserves and Contingencies. To put this in perspective, an increase of roughly 2.5 percent in the General Fund share of property taxes would be required to generate \$1 million. These policy changes mentioned above include contributing 10 percent of

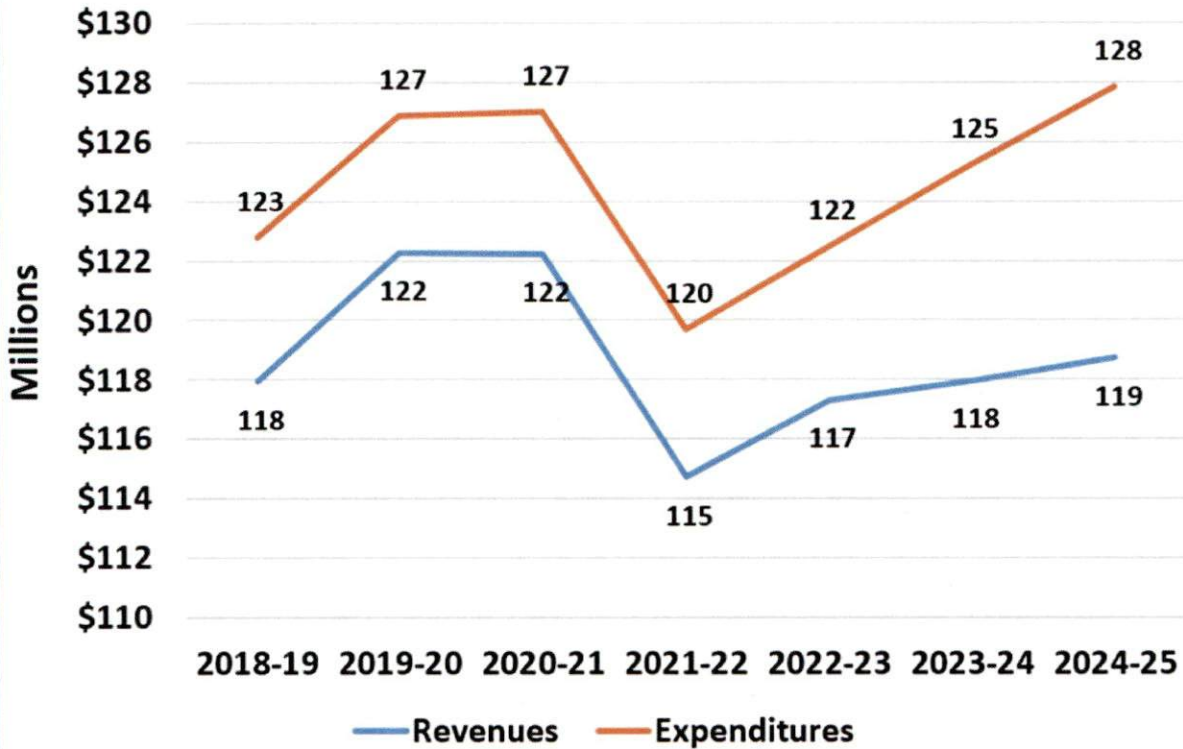
Measure S revenues to the General Reserve until the General Reserve has a fund balance that is equal to 10 percent of General Fund revenues. The revised Contingency Reserve policy now requires that it be funded annually at a level equal to 2 percent of General Fund revenues. Healthy Reserves are vital to weathering economic recessions and minimizing disruptions to programs and services.

Based on the forecast, the General Fund is starting to show improvement, however revenues and expenditures are still not in agreement and that disparity is apparent in future years with declining and negative fund balance predictions. There are a number of fiscal concerns/issues, such as insufficient Reserves; fixed costs increasing faster than revenue growth; loss of Measure Z revenue; and reliance on fund balance to produce a balanced budget, that are manageable with a long-term plan and a disciplined approach.



Challenges

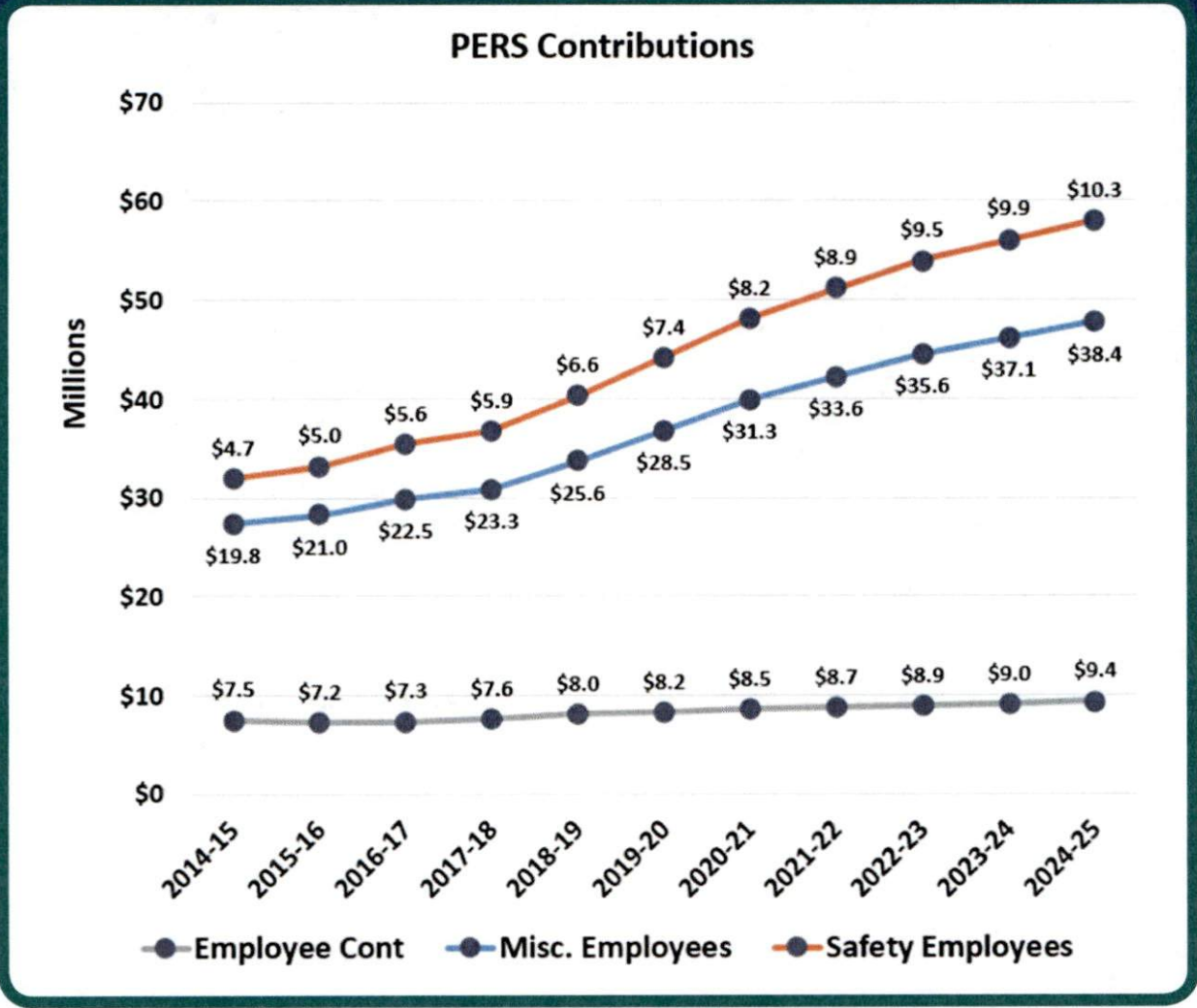
General Fund: Revenues vs Expenditures



There are a number of financial issues facing the county in terms of meeting minimum obligations while still providing programs and services to the citizens of Humboldt County. Long-term fiscal stability is a Board priority in safeguarding the public trust by managing resources to ensure sustainability of services. Therefore, the challenges present hurdles that can be managed to coincide with the Board's strategic framework. The main hurdles currently facing the county are annual increases to health insurance, the unfunded liability for the California Employee Pension Retirement System (CalPERS), Americans with Disabilities Act (ADA) consent decree with the Department of Justice (DOJ) and a large backlog of deferred maintenance costs and aging facilities.

The county continues to chip away at its outstanding pension obligations but will not see relief soon without an increased level of investment. Several funds, such as Mental Health and Library, are operating at or near a deficit due to declining revenue or operational imbalances, and if not addressed could further impact the General Fund.

Retirement: Humboldt County provides defined-benefit pensions to its retirees through the California Public Employees Retirement System (CalPERS). These plans are pre-funded, meaning both employer and employee make contributions during the working life of the employee and these contributions are then invested and the earnings achieve their targets over



the working life of the employee, there will be sufficient funds available at the employee's retirement date to pay a defined benefit over the remainder of the employee's life span. Given CalPERS is a pre-funded plan, changes to, or a failure to realize, any of the assumptions that underlie its targets for funding must be made up by adjusting employer contributions in future years. In the past decade, several changes have occurred that have resulted in an unfunded liability of over \$262 million for FY 2017-18 and is expected to increase to \$287 million in the coming FY 2018-19.

Retirement costs continue to increase, but growth rates may slow. The county's contribution rates towards pension costs are expected to rise through the full seven-years of the forecast. CalPERS

is now requiring fixed payments towards the county's unfunded liability, rather than a percentage of payroll, which should provide predictability to contribution amounts. The estimated minimum required total employer contribution for FY 2018-19 is \$32.2 million and employee contribution is \$8 million, which reflects the annual required contribution but does not address the increasing unfunded liability. In addition, CalPERS has lowered its estimates on expected returns, which is forcing local governments to contribute more to retirement. The chart represents the estimated total employer contribution (which includes employee, employer and unfunded liability contributions annually) for the depicted forecasted timetable.



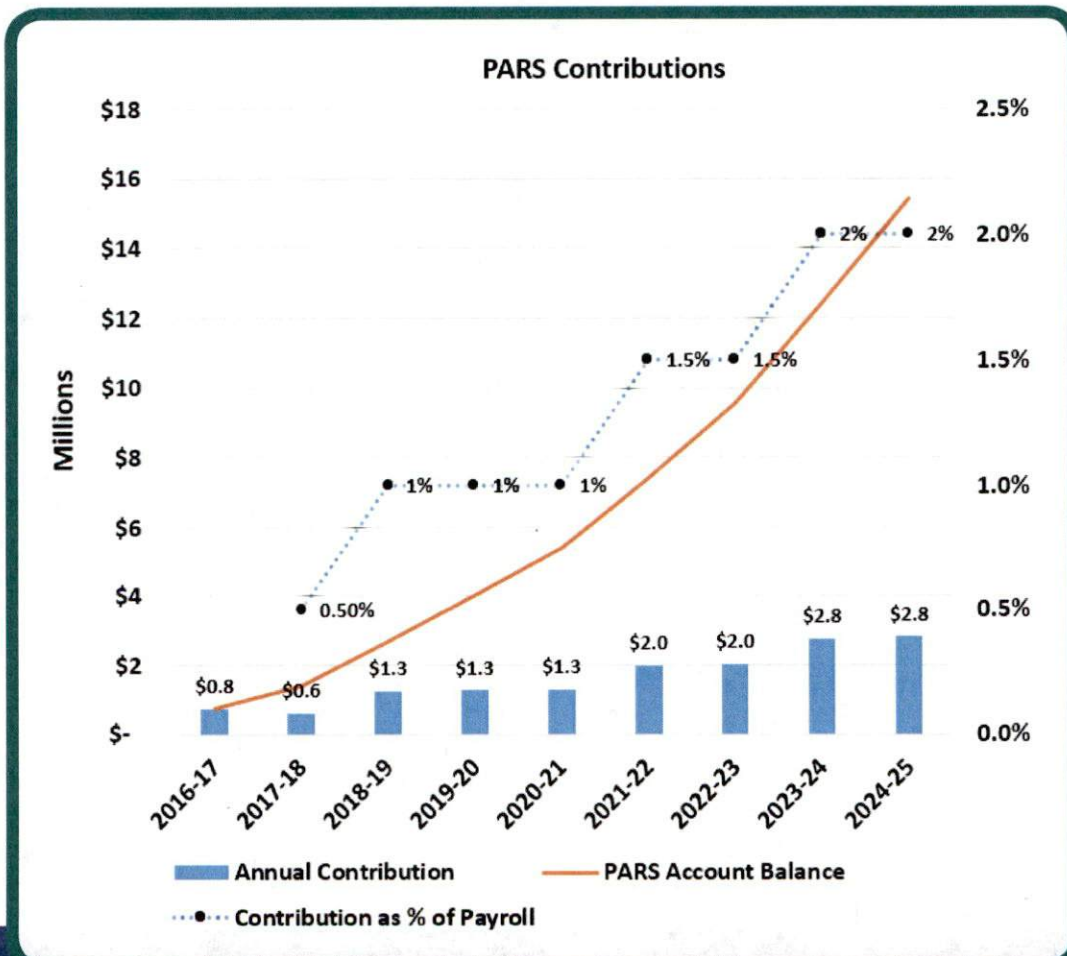
Challenges

Pension stabilization:

The Board of Supervisors approved a Public Agency Retirement Services (PARS) Pension Rate Stabilization Program (PRSP) in order to begin addressing the mounting unfunded liability. Contributions to PARS will help stabilize the contribution rates set by PERS. As the balance in the PARS trust grows and produces investment returns, those funds can be utilized to reduce the contribution rate increases, thereby reducing the effect of the contribution rate increase on the county and potentially preventing service reductions. The FY 2017-18 budget development incorporated an annual departmental contribution to PARS equal to .5 percent of salaries totaling \$592,354.

While this is a significant contribution, it does not allow for an aggressive approach to addressing the unfunded liability. Staff anticipates the FY 2018-19 budget development will include a recommendation to increase the contribution rate to 1 percent, bringing the contribution to approximately \$1.25.

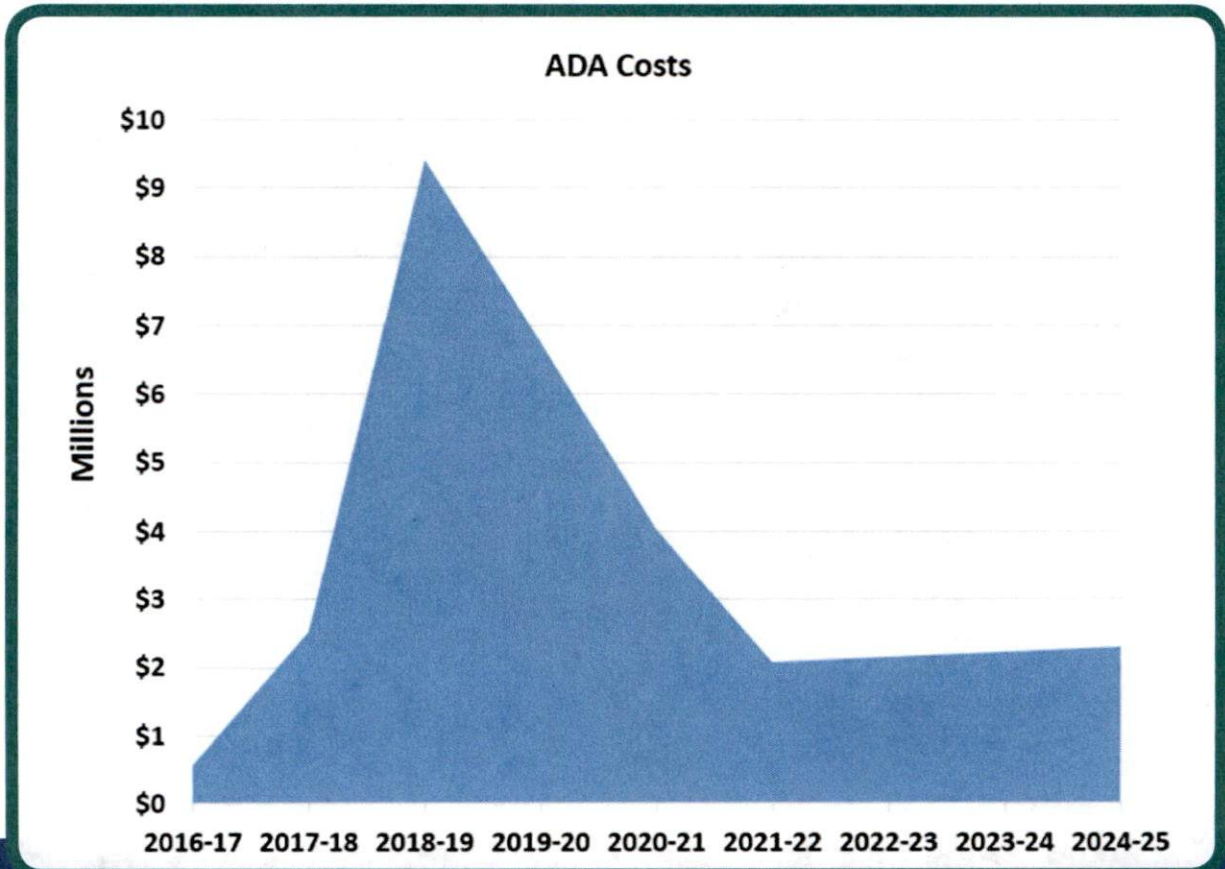
The chart below reflects a FY 2018-19 PARS contribution rate of 1 percent or a \$1.25 million contribution and increased contribution rates in subsequent years in an effort to depict possible growth rates to include an estimated interest earned rate between 3 and 6 percent.



Americans with Disabilities Act (ADA): The county continues to work with the Department of Justice (DOJ) to implement ADA-related projects laid out in its 2016 consent decree with Humboldt County. The county, as a requirement of the consent decree, retained an independent licensed architect (ILA) in April 2017. The ILA is responsible for assessing all county facilities for compliance with the ADA that offer a program, service or activity to the public. The ILA is also tasked with certifying barrier removal performed by the county and reporting the county's progress in terms of compliance with the consent decree to the DOJ. The county has also retained the services of four design firms for project design and project management for ADA barrier removal. Additionally, the county has also increased staffing with an ADA Coordinator, Project Manager and extra help for project management and barrier removal



in order to address ADA issues identified within the consent decree. As the ADA consent decree projects progress, the county has established an internal service fund (ISF) to pay for and allocate costs for barrier removal and required modifications. Cost estimates in terms of barrier removal in the form of public projects, including the \$7.5 million for curb ramp modifications, total \$25 million. In addition staff costs, design firms, and ILA costs are anticipated to cost upwards of \$4.7 million over the forecasted period. The chart represents estimated costs for the next seven-years and depicts a sharp increase for the next two fiscal years based upon a number of factors that include curb ramps, barrier removal and ILA costs.





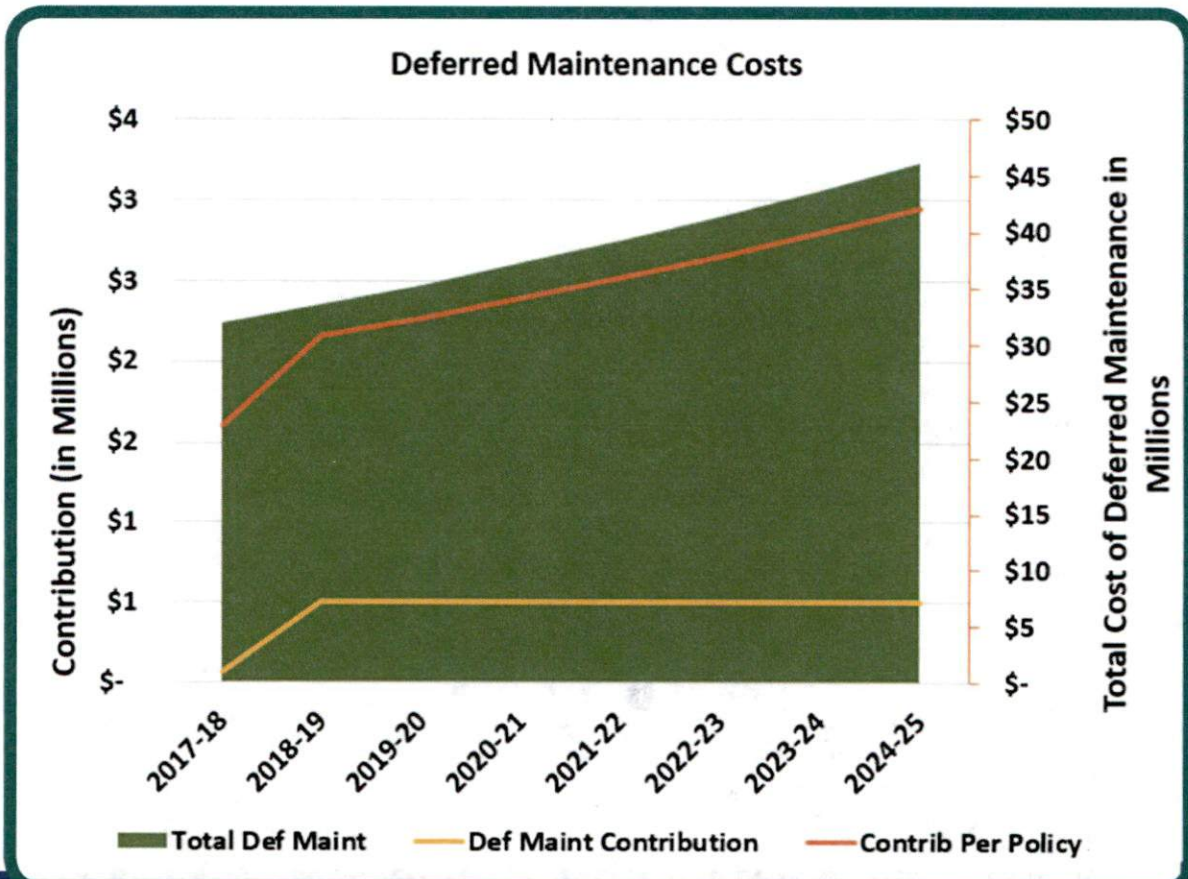
Challenges

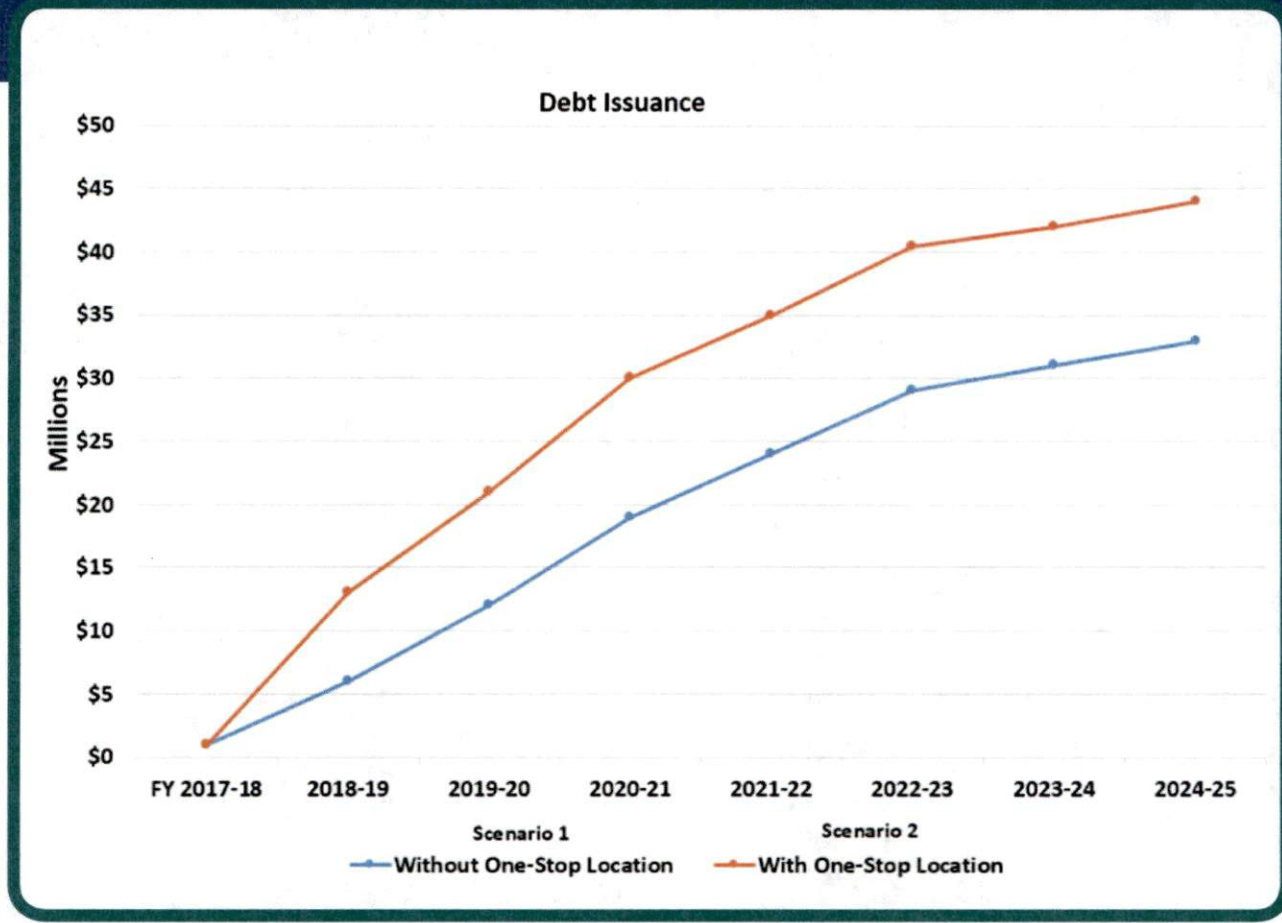
Deferred maintenance: Deferred maintenance costs continue to rise,

policy levels require a contribution of 5 percent of estimated deferred maintenance costs to be allocated on an annual basis; however, due to a number of internal and external factors policy levels have yet to be realized. There are several county facilities that require extensive repair and/or rehabilitation, while many others are well behind in regular maintenance. The county contribution to these projects is not keeping up with costs and will require increased funding to address deferred maintenance issues and maintain facilities in a serviceable condition. The annual contribution to meet policy levels, however, may go up based upon increases in deferred maintenance costs to include

rising construction costs each year that deferred maintenance projects are delayed due to insufficient budgetary allocations. Providing for and maintaining infrastructure is one of the Board's core roles in the 2017 strategic framework. Currently, as depicted in the Deferred Maintenance Costs graph, FY 2017-18 deferred maintenance costs are estimated at \$32 million.

Without a predictable and steady allocation, deferred maintenance costs will continue to increase annually based upon an average construction cost increase of 3.5 percent. Even if an annual allocation of \$500,000 instead of the 5 percent Board policy were to occur, deferred maintenance costs would continue to increase over a seven-year period by an estimated \$12.5 million.





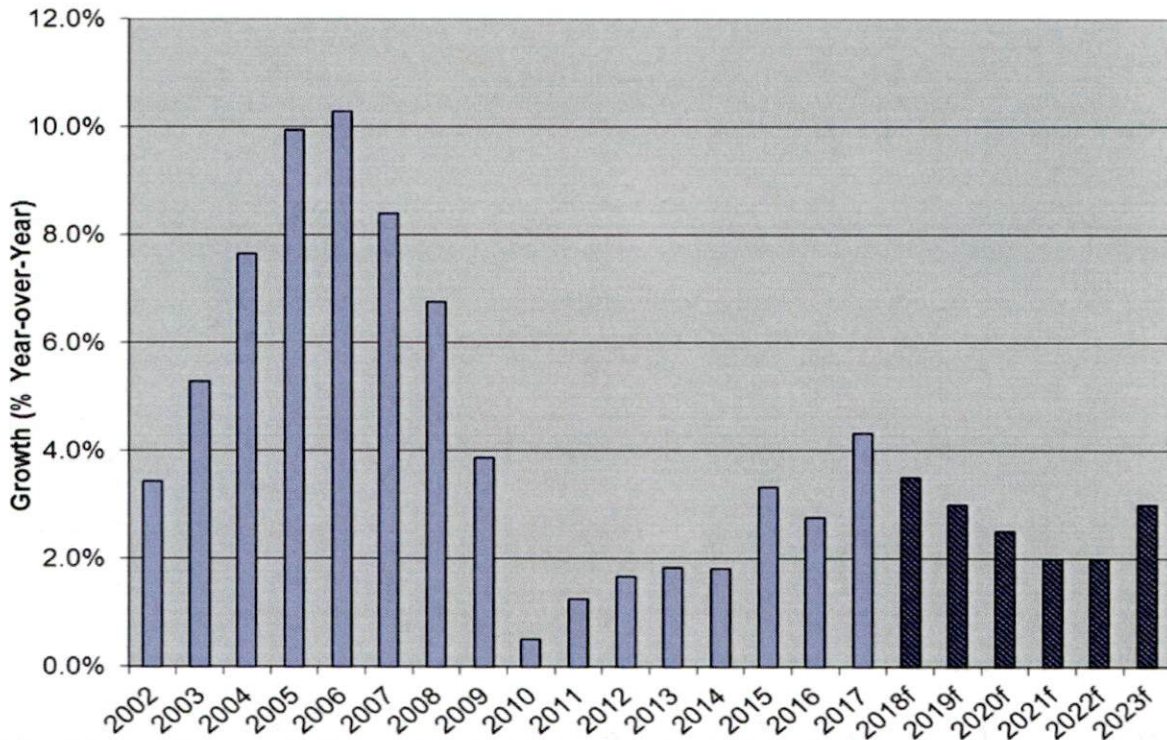
Debt issuance: In February 2016, the Board of Supervisors approved the 2016 Finance Plan to fund capital improvement projects, which are approved, designed, and built over a period of years. Since capital improvement projects are usually done in stages/phases, it is more cost effective to borrow money as needed for each stage of the project versus borrowing the amount needed for the entire project at the beginning, or first stage of the project. These are projects which often take years to get to the point of actual construction, but which have significant costs leading up to that construction including design, site work, and match funding for state and federal grants. The method of this type of as-needed borrowing is known as 'interim period financing', which allows the county to secure debt on an as-needed basis. Interim period financing is typically refunded or paid back by replacing it with long term or permanent financing.

The current 2016 Finance Plan has sufficient debt capacity to finance approved capital projects and ADA barrier removal in scenario one of the Debt Issuance chart (\$19,000,000). The debt capacity of the 2016 Finance Plan would be reached in FY 2020-21. Incurring debt means that it has to be paid back over a period of time and the cost to the county over a 30-year period would equate to \$820,000, or more depending on current market rate, (principal and interest) per year. Taking into account scenario two, which also includes co-locating like services, the debt capacity for the 2016 Finance Plan would be met at FY 2019-20. In either case, there is a need to address ADA barrier removal and still proceed with capital improvement projects for the next seven-year period. That need would entail expanding the debt capacity and also utilizing General Fund monies to pay back such financing on an annual basis.



Revenues

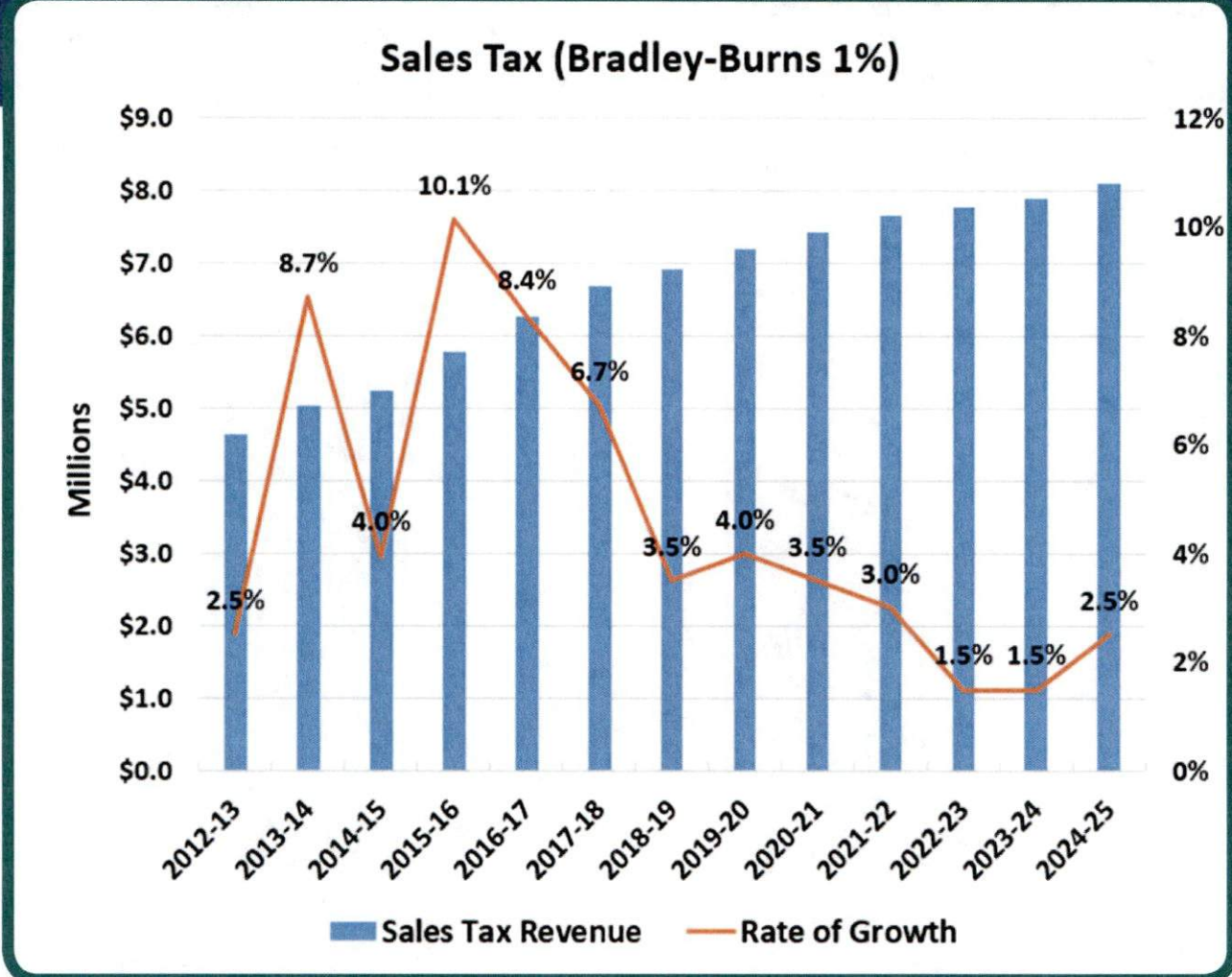
Change in Humboldt County Assessed Property Tax Value



Property tax growth stabilizing: Increases in assessed values have seen three consecutive years of growth that is more typical of the steady growth patterns witnessed in the late 1990s and early 2000s, and is generally a good sign in terms of future stability. The forecast includes an increase of 3.5 percent in FY 2018-19, 3.0 percent the following year and then 2.0 and 2.5 percent for future years. Historically Humboldt County assessed values have increased 4.5 percent annually (1.7 from CPI and 2.8 from growth), however increases have not been as strong since the recession. For the last five years local sales and new construction have increased an average of 1.21 percent. Included in that average is one negative growth year; if it is removed the average is over 1.56 percent. For FY 2018-19 the forecast of 3.3 percent includes a CPI and growth

factors. For the next two years a CPI value of 2.0 is projected plus 1 percent growth. After that a mild recession is assumed.

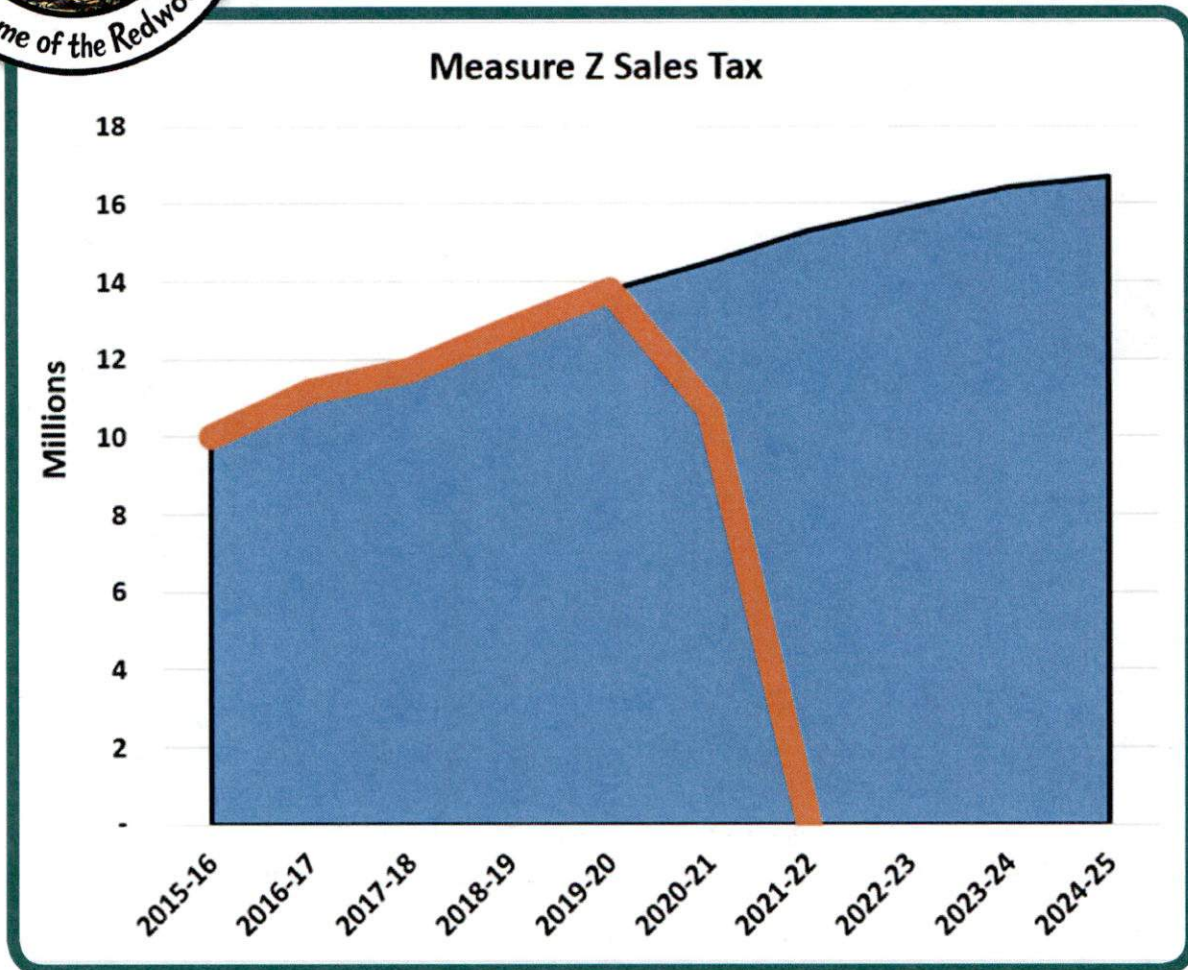
Assessed property values are estimated by combining the CPI (from the LAO and Department of Finance, which cannot exceed 2.0 for property taxes per Proposition 13) and local growth (sales and new construction). Over the last 20 years assessed property tax values in Humboldt County have grown on average by 4.5 percent. However, over the last five years the average growth has been only 2.81 percent. Also of note is that there have only been two times where the assessed property values in Humboldt grew less than the state inflation rate, with both of those occurring in the last six years. The changes in growth since the last recession continue to make forecasting property tax revenues difficult.



Sales tax: Bradley-Burns Sales Tax is based on state-wide sales tax and is expected to trend in the direction of slow revenue growth over the last several years of the forecast. Based on actual revenue received for the first six months of this fiscal year this revenue is forecasted to increase 9.4 percent above estimates made when the budget was adopted. Therefore, a modest increase of 3.5 percent is forecast for FY 2018-19 followed by two years of slower growth to correlate with a modest recession beginning in 2019-20. This is based on the sales tax trends from HdL Companies November 2017 California Forecast for FY 2018-19 and Beacon Economics projections.



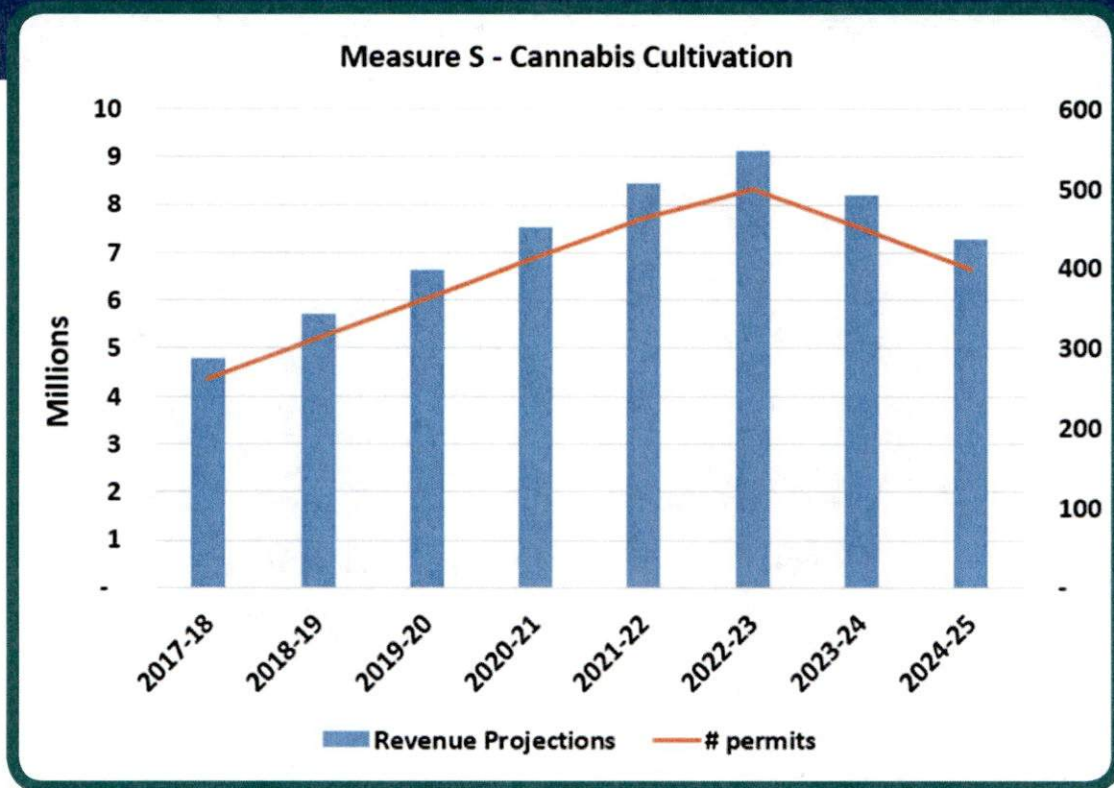
Revenues



Local sales tax: Measure Z Sales Tax to remain strong in the short term but will have a drastic impact on those programs and services supported by the measure, if not renewed, in future years. Based on current year trends, this is projected to increase 5.5 percent by FY 2017-18 year-end. This sales tax includes the incorporated cities and does not directly correlate to the Bradley-Burns sales tax. Local sales tax growth trends have climbed over the last 5 years. A positive 3.5 percent growth rate is forecast for FY 2018-19 with a gradual decline in rate of growth in future years. This is based on the sales tax trends

from HdL Companies October 2016 California Forecast for FY 2017-18 and Beacon Economics projections.

This forecast assumes that Measure Z is not renewed by voters and ends in 2020. It is up to your Board to choose whether to ask voters if they want to renew this public safety measure. If it is not renewed, steps will likely need to be taken to account for more than 60 staff supported by Measure Z revenues. If Measure Z is renewed, revenue growth is likely to taper off in the out years and any increases in spending should be done with that in mind.



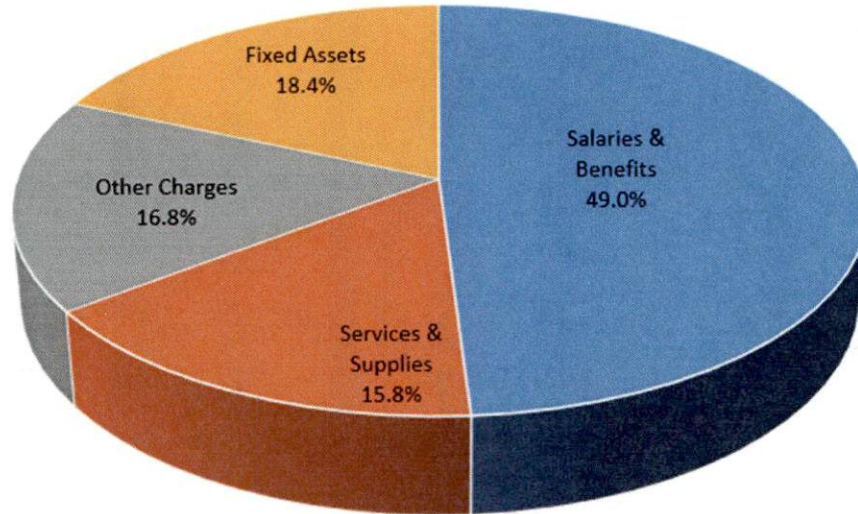
Cannabis cultivation tax: Measure S, a local commercial marijuana cultivation excise tax (general tax) on the Nov. 8, 2016 ballot, was approved by the voters. Revenues generated from this measure may maintain essential services, such as public safety, mental health services for children and families, drug prevention and rehabilitation services, and environmental clean-up and restoration. In FY 2017-18, \$4.8 million was budgeted for the first full year of cannabis excise tax revenue. However, due to a tumultuous journey towards legalization at the state level, politics and policy at the federal level and the pace of permit issuance, providing a forecast for future revenue potential is being approached from a conservative standpoint. Utilizing Measure S revenues to fund ongoing expenses requires careful consideration as this excise tax is a new revenue source and the cannabis industry is in its infancy in terms of legalization. Confidence in Measure S revenues, yet to be proven as a reliable and consistent form of revenue, will be more predictable

once the industry matures and historical trends have been established. Nevertheless, current permit counts allow for predictions of slow growth over the next five years, culminating in roughly \$9 million in annual revenue by 2022-23 (assuming 500 cultivation permits are issued). It should be noted that revenues are forecast to decrease in the outlying years as the law governing cultivation size limits sunsets.

Other taxes: Other revenue sources such as Transient Occupancy Tax (TOT) are trending upward. In FY 2016-17, \$1.95 million was received in comparison to an estimated \$1.99 million to be received year end FY 2017-18. The upward trend continues through the seven-year forecast using conservative increases even for the predicted mild recession that may occur in and beyond FY 2019-20. TOT may not be a significant source of revenue but it appears to provide an indication of a steadily growing economy.



Expenditures



Generally, expenditures are split out into four major categories depending on the type of cost. These categories are: salaries and employee benefits; services and supplies; other charges; and fixed assets. For the financial forecast different categories may be used for each fund based on the relative size of the expenditure type and influencing factors.

Salaries and wages: Salaries and employee benefits are the costs for employing permanent and extra help workers to conduct county business. Salaries and wages forecast at a minimum a 2 percent increase each successive fiscal year. Any change in benefits, wage increases and cost of living increases impact available revenues. Increases to salaries and wages are considered ongoing costs that the county must account for and budget in current and future years. Overall salaries and benefits for FY 2017-18 represent 51.1 percent of total county expenditures, while representing 49.0 percent of the county's General Fund costs.

Supplies and services: This category includes the bulk of non-salary expenses, ranging from insurance

and utilities to office supplies to contracts with outside professionals. These expenses are forecast to increase at a rate slightly below the average annual CPI increase over the last five years.

Other charges: These consist of a number of different expenditures not included in the categories above, including support for persons (such as assistance payments and jail medical), costs related to grants, payments on county debt, contributions to other county funds and non-county agencies, and intra-fund transfers which are reimbursements of expenses. Similar to services and supplies, increases related to CPI are forecasted.

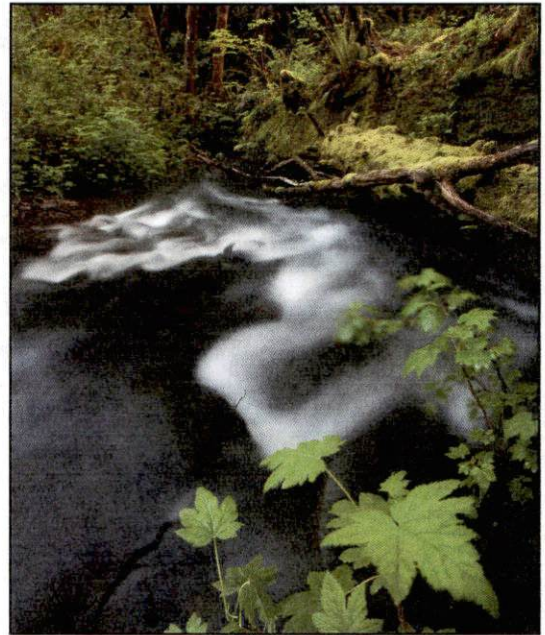
Fixed Assets: Expenditures for long-term capital outlays with an expected life in excess of one-year and an initial value in excess of \$5,000. Fixed assets also include contributions to deferred maintenance, capital improvements and ADA compliance. Fixed asset contributions will see increases during the forecast period due to the need to make facility improvements, and funding levels are largely dependent on policy decisions made by your Board.



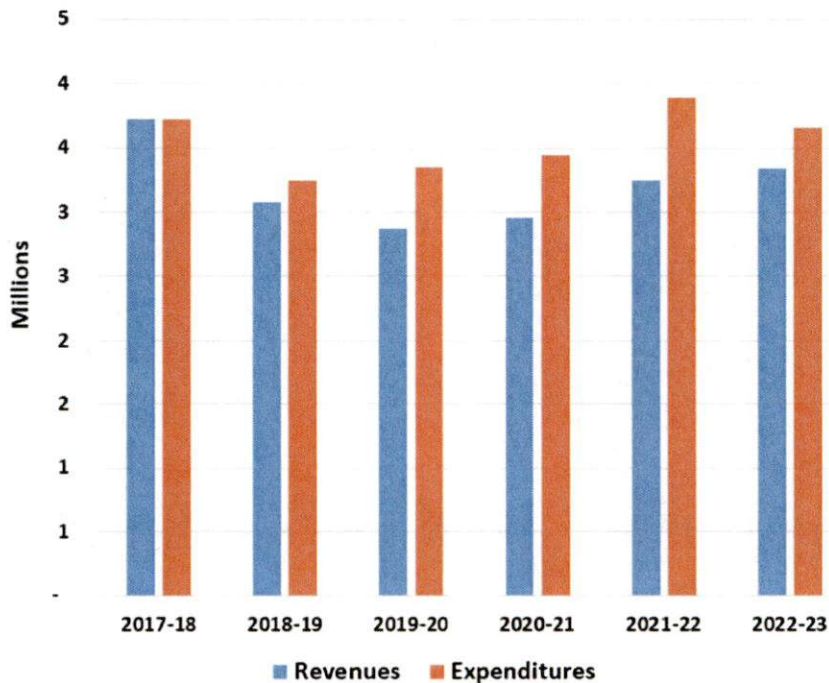
Other Funds

Other concerns and possible financial challenges include Aviation, Mental Health and Library funds.

Aviation Enterprise Fund: This fund ended FY 2016-17 with a negative fund balance of (\$327,005), which represents an improvement in the fund balance of \$218,239. The budget submitted and adopted for FY 2017-18 proposed a balanced budget and remains on track at the time of this report. A primary factor in reducing the negative fund balance is due to Measure Z funding. When Measure Z sunsets in 2020 and the Aviation Enterprise fund no longer receives the support of the General Fund, it is anticipated that a structural deficit will occur. However, the Board of Supervisors in December 2017 directed staff to create an Airports Department headed by an Airports Director. Associated costs of creating a new department and hiring a department head will initially be borne by the General Fund. Initial costs to create a new department may cost the General Fund upwards of \$350,000 until the new department is self-funded. The county remains committed to maintaining a regional airport that offers commercial air service and will continue to research solutions to ensure Aviation's long-term sustainability.



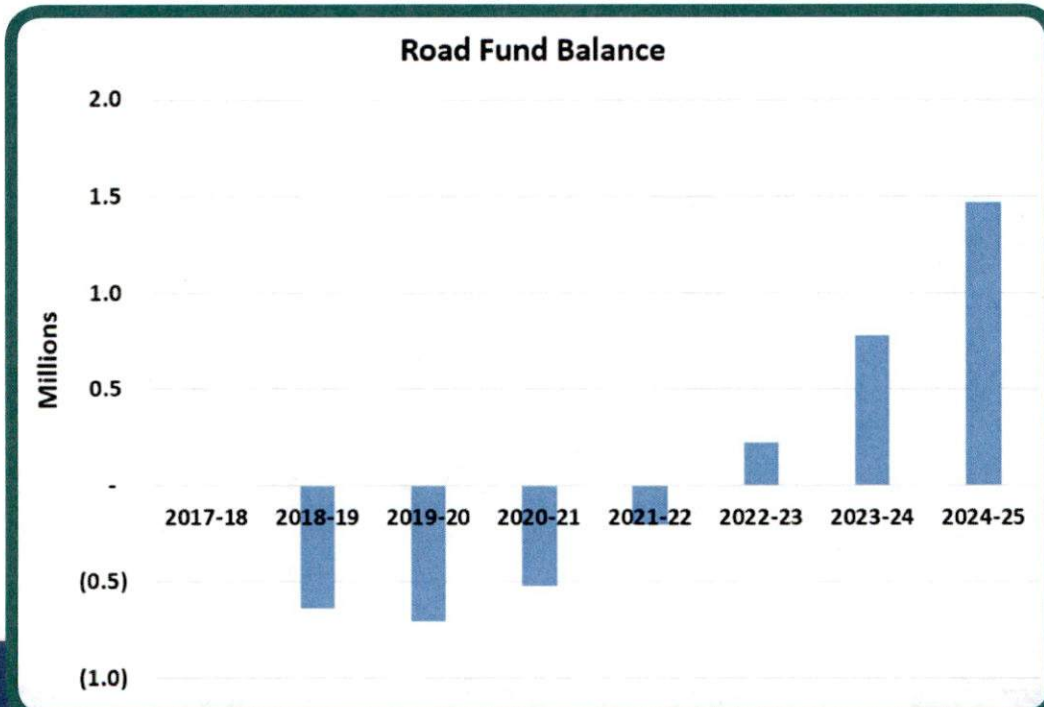
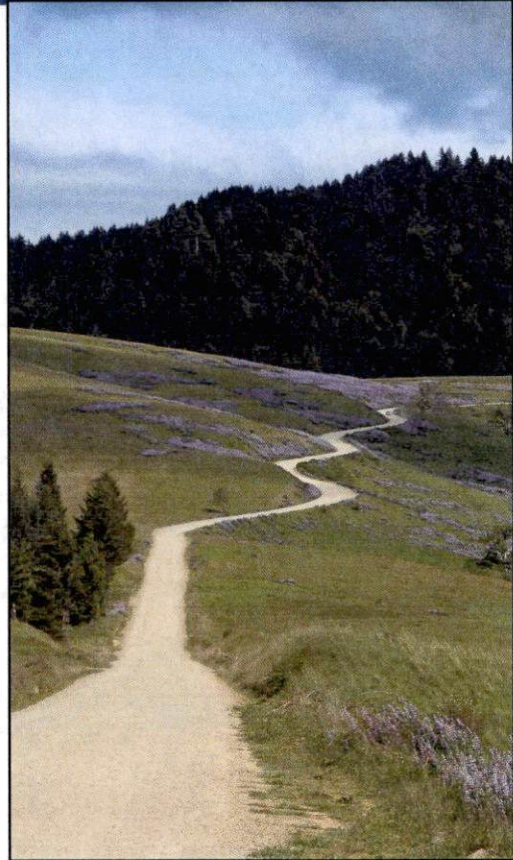
Aviation Revenues vs Expenditures





Other Funds

Roads Fund: The Roads fund ended last fiscal year with a fund balance of \$900,048, a decrease of \$3.4 million from the previous year. Due to catastrophic road damage caused by winter storms, fund balance was utilized in order to address road accessibility. Emergency funding has been requested from the Federal Emergency Management Agency (FEMA). While it is anticipated this funding will be granted, it has not yet been approved. The declining revenues for the Roads Fund are due to a loss of Gas Tax as more and more alternative fuel vehicles take to the road in the state. The California Governor signed Senate Bill (SB) 1, the Road Repair and Accountability Act of 2017, which provides an increase in road funding through an increase in the gas tax. The estimated amount to be received in the current fiscal year is \$1.8 million. In FY 2018-19 \$4.8 million in SB 1 funding is anticipated with the \$4.8 million increasing by \$300,000 each successive fiscal year. The Roads Fund also has to budget for ADA barrier removal in the form of curb ramps located throughout the unincorporated areas of the county. The estimates to make said repairs are currently stated at \$7.5 million. Nevertheless, the SB 1 funding will allow the Roads Fund to stabilize and then allocate funding to needed repairs to county roads. Nevertheless, the SB 1 funding will allow the Roads Fund to stabilize and then allocate funding to needed repairs to county roads.

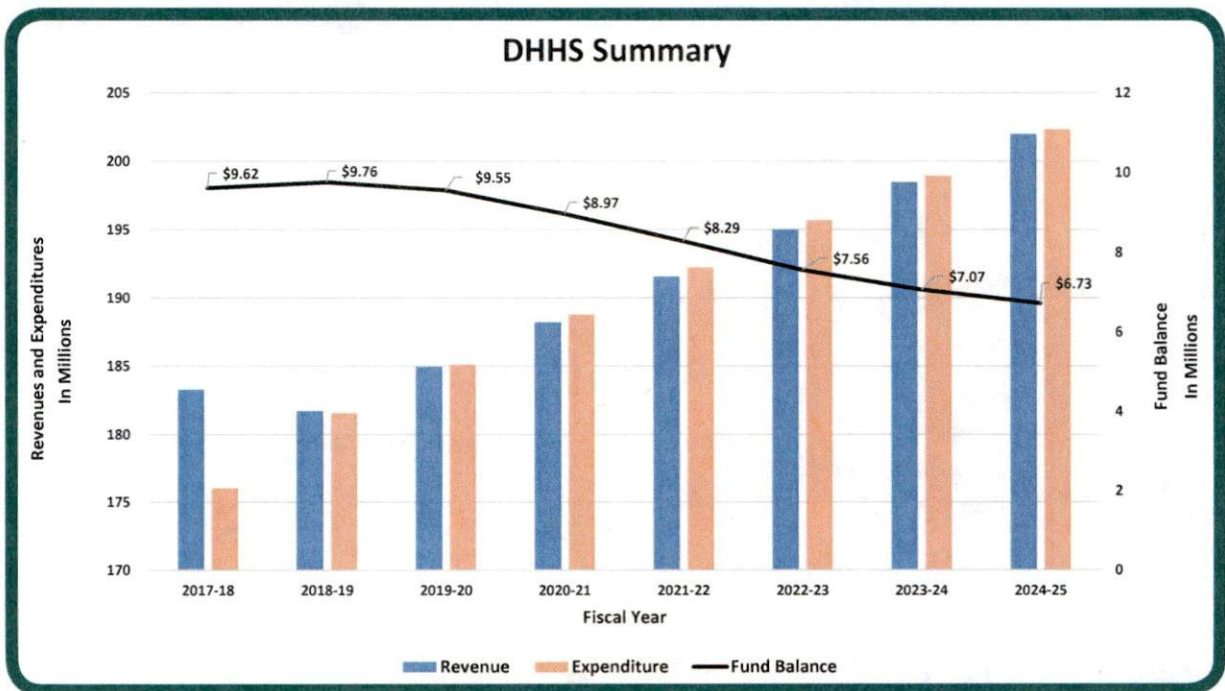


Mental Health Fund: The Department of Health and Human Services Mental Health fund balance is of concern and is something to monitor closely. Long term resolutions to eliminate the negative fund balance for Department of Health and Human Services, Mental Health Division are difficult due to the delay between when services are paid and when federal reimbursement is ultimately received. This delay is caused by the claims adjudication process that can take several months to close, and the cost report/settlement process that can take multiple fiscal years to reconcile.

Long term receivables for cost report settlements due from the Department of Health Care Services (DHCS) and Substance Abuse Prevention and Treatment (SAPT) block grant total an estimated \$13.7 million. These receipts go back as far as FY 2011-12. The reason these receipts continue to be outstanding is due to the state's lengthy cost settlement process. These receipts would further

reduce the negative fund balance for Mental Health.

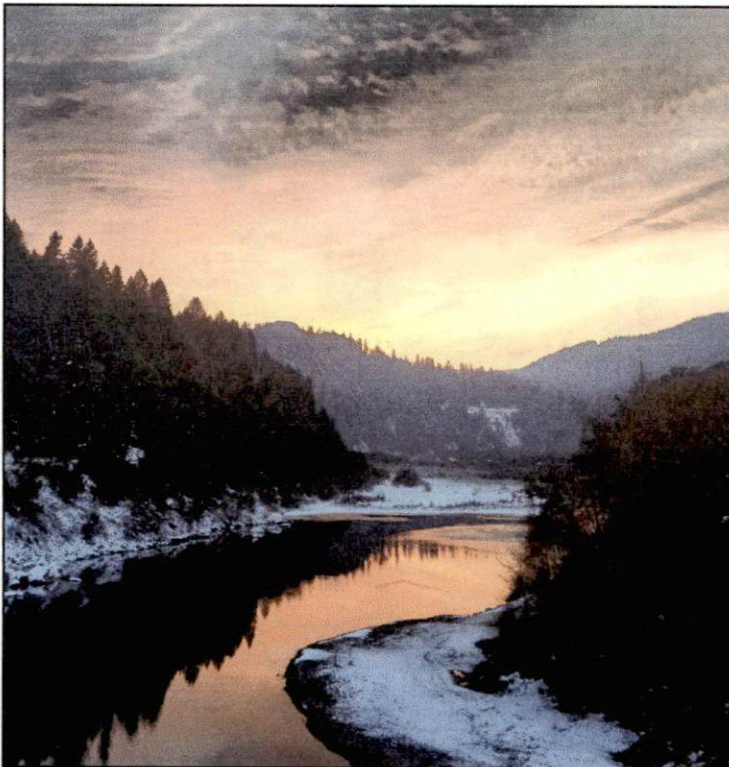
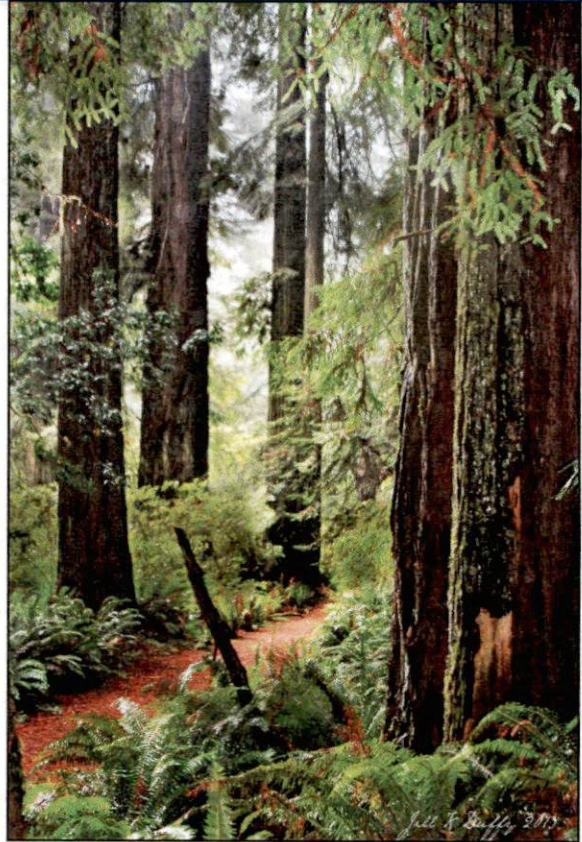
Many counties are facing declining revenues in comparison to the cost of providing services due to the methodology used by DHCS in determining reimbursement rates. Currently reimbursements are calculated using an interim reimbursement rate that is based on prior years cost reports. These rates do not sufficiently account for the fluctuations in costs from year to year such as salary and benefits, infrastructure costs, health care inflation, etc. Many counties, including Sonoma and Humboldt, are proposing DHCS consider a policy change to update the reimbursement methodology so that published rates reflected in the fee schedule would be used in determining reimbursement rates as these rates reflect the current cost of providing services. Implementing a rate setting methodology that reflects a county's actual costs is consistent with Medicare cost reimbursement principals.





Other Funds

DHHS ended FY 2016-17 with a fund balance of \$2.38 million, a decrease of \$11.6 million from the previous fiscal year. During the FY 2016-17 closing process DHHS-Social Services and Public Health transferred a combined \$4.9 million to Mental Health (MH). This action left MH with negative a fund balance of \$7.7 million. After the year-end closing, it was discovered that MH accounts receivables (AR) in the amount of \$7.2 million posted in FY 2017-18 were actually receivables for FY 2016-17 but were not included in the year-end closing process and therefore were not attributed to the appropriate fiscal year. Had the ARs posted to the correct fiscal year, the projected fund balance for MH would be (\$542,592) and DHHS' overall fund balance would reflect an estimated \$9.6 million. DHHS anticipates that the year-end fund balance will be \$9.6 million as the revenues anticipated in FY 2016-17 will be realized in FY 2017-18.



Library Fund: The Library continues to explore additional revenue options while improving business practices to reduce operating costs in order to maintain an adequate fund balance. However, the Library Fund needs to be monitored closely as fund balance for this fund continues to decline due to expenditures exceeding revenues.



Summary

Considering all of the economic uncertainties, forecasting revenues and expenditures seven-years into the future is a difficult task. This report is intended to provide a baseline to help understand potential impacts of changes in revenues or costs to the county's budget. This report summarizes the County Administrative Office's assessment of the economy and county budget. The forecast focuses on projecting a middle of the road scenario, which assumes continued economic growth at a moderate pace. It is likely that there will be differences between what is being projected and actual amounts, even if key assumptions are correct.

The forecast does not attempt to predict the budgetary decisions that will be made by state and local elected leaders. Difficult choices must be made between the benefits of spending funds now on much needed services and programs versus increasing Reserves. When an economic downturn occurs, Reserves can help maintain services. The projections are an estimate of the county's fiscal condition if current law, policies and economic conditions remain mainly unchanged through FY 2024-25.

One example of the type of change that could occur is the decision of the Board to increase wages for county employees in FY 2017-18. Any increase in salaries and wages will impact available fund balance and increase operational expenditures thereby reducing revenues that may support programs and services in future fiscal years.

With that said, the seven-year financial forecast results indicate that the General Fund will experience some level of financial distress. Structural changes will be required to maintain a positive fund balance over the next seven-years. Based on current economic trends it is unlikely that property tax revenue growth will return to previous level highs in the next seven-years for the county.

The General Fund contains the majority of county programs and receives discretionary revenues primarily from property taxes. Unfortunately the General Fund forecast shows a trend of costs growing faster than revenues. Revenue growth alone is not going to be sufficient to address the predicted financial imbalance.

Over the next seven-years the county will need to address the imbalance between revenues and expenditures in order to maintain a sustainable financial outlook. There are definitely looming financial concerns that need long-term financial discipline such as pension and retirement liabilities, ADA barrier removal, and the backlog of deferred maintenance. The county has taken steps towards allocating resources to address unfunded retirement liabilities and stabilize the fluctuations in the discount rate set through CalPERS via the PARS Trust. Nevertheless, a focused and disciplined approach to managing liabilities may possibly lead to some difficult decisions sooner than later.





Glossary of Terms

ADA – Americans with Disabilities Act: is a federal law that prohibits unjustified discrimination based on disability, requires covered employers to provide reasonable accommodations to employees with disabilities, and imposes accessibility requirements on public accommodations.

CPI – Consumer Price Index: A government-issued growth factor based on the retail prices of basic household goods and services.

DHHS – Department of Health and Human Services: An integrated County department providing health and human services previously provided by six separate county departments – Mental Health, Public Health, Social Services, Employment Training, Veterans Services and Public Guardian.

DOJ – United States Department of Justice: A federal department responsible for the enforcement the law and administration of justice in the United States.

EDD/LMID – Employment Development Department/ Labor Market Information Division: A California department that tracks and reports employment and labor statistics for the state.

FY – Fiscal Year: The designated accounting and budgeting year for the County. In California, the fiscal year is July 1 through June 30.

LAO – Legislative Analyst's Office: A nonpartisan governmental agency that provides fiscal and policy advice to the California Legislature.

OPEB – Other Post-Employment Benefits: Employee benefits other than pension received after retirement. For the County this represents a required contribution to retiree health insurance premiums for insurance through CalPERS.

PARS – Public Agency Retirement Services: a company that provides retirement services to public agencies. The county contracts with PARS for administration of an irrevocable trust for pensions that allows funds to be set aside to help smooth retirement rate increases in future years.

PERS – Public Employee's Retirement System: Also called CalPERS is an agency in the California executive branch that administers health and retirement benefits for local agencies, public schools and State employers.

PTAF – Property Tax Administration Fee: A fee charged by the County to special districts, school districts and cities for their proportionate share of costs related to the administration of property tax collection.

RDA – Redevelopment Agency: An agency formed by a local city or county government for the purpose of providing for the improvement, rehabilitation and redevelopment of blighted areas. On February 1, 2012 all RDAs within the State were dissolved.

TOT – Transient Occupancy Tax: A 10 percent tax charged on lodging accommodations unless the stay is for a period of 31 days or more. The charge is authorized under State Revenue and Taxation Code Section 7280.







HUMBOLDT COUNTY

CALIFORNIA



7-YEAR FORECAST
FY 2018-2019