FY2017-18 Recommended Budget
ECONOMIC AND FISCAL CONTEXT

The national economy is continuing to grow at a steady but somewhat slow pace as it has for roughly the last seven years. The U.S. Gross Domestic Product (GDP) grew by 1.9% in the fourth quarter of 2016, slightly below the post-recession average of 2.1%, and most forecasts are projecting continuing growth at roughly this rate. For example, the most recent report from the Federal Reserve Open Market Committee reflects a median GDP growth forecast of 2.1% in 2017 and 2018.

In March, the national unemployment rate stood at 4.5%, down from 5% a year ago. The unemployment rate has been decreasing steadily since October of 2009 when it reached 10%, and most economists seem to think rates will remain at the current level for the next year or two. Further, the recent drop in the unemployment rate comes amid rising wages and an expanding labor force, indicating that the economy is creating jobs more rapidly than people are entering the labor market.

Housing has been one of the national economies strongest growth sectors over the past few years, and it appears that growth in this sector will continue over the near term. The U.S. Department of Commerce reported that housing starts in March climbed by 9.2% compared to the March 2016 rate, to an annual number of 1,215,000. Permits for new construction, a sign of future demand, are running 17% above the March 2016 rate. In the last quarter of 2016, home prices were 6.2% higher than they were in the first quarter of 2016.

Home prices in California are also continuing to rise, though at a more moderate pace than in the years immediately following the Great Recession when home prices grew by double-digit percentages. According to a recent report by Beacon Economics, the median price for an existing single-family home in California came in at $426,887 in the fourth quarter of 2016, a 5.8% increase over the same period one-year prior. Beacon Economics also notes that the inventory of homes on the market remains tight, which will support continued growth in home prices across the State.

Locally, the economy continues to improve. A September 2016 report from the U.S. Bureau of Economic Analysis indicated that region's economy grew by 3.5% in 2015, the fastest increase since 2005. In 2015, the four-County Sacramento region's GDP was approximately $119 billion, the highest the region's GDP has ever been. In March 2017, the County's unemployment rate declined to 5.1% from 5.5% a year ago, and the number of jobs in the Sacramento region increased by 20,000, or 2.1%, between March 2016 and

March 2017. In February, the median price of an existing home in Sacramento County was $310,000, up approximately 11% from February 2016. Zillow recently projected that home values in Sacramento County will rise 5.1% over the next year and identified Sacramento as one of the top 10 housing markets in 2017.

The Recommended Budget reflects some of the positive impacts of the improving economy. For example:

- Secured Property Tax and Property Tax in Lieu of Vehicle License Fee (VLF) revenue, which constitute over 65% of the County's discretionary revenue, are projected to grow by 5.9% compared to the FY2016-17 Adopted Budget level and 5.5% compared to FY2016-17 estimated actual amounts. This will be the fifth year in a row of increasing property tax revenue from these sources.

- Sales and Use Tax revenue is projected to grow by 6% compared to the FY2016-17 Adopted Budget level and 3.2% compared to the FY2016-17 estimated actual amount.

- Transient Occupancy Tax revenue is projected to grow by 15% compared to the FY2016-17 Adopted Budget level and 6.9% compared to the FY2016-17 estimated actual amount.

- Proposition 172 revenue, which comes from a statewide sales tax levy, is projected to grow by 4.6% compared to the FY2016-17 Adopted Budget level.

Collectively, we are projecting that discretionary revenue and reimbursements will grow by approximately $24 million, or 4% compared to the FY2016-17 Adopted Budget amount, and by $18.7 million (3.2%) compared to the FY2016-17 estimated actual amount. We are also projecting that we will receive an additional $8 million in SB678 revenue in the Probation Department. The impact of this and other good news on the County's General Fund is partly offset by a number of factors that include:

- The FY2016-17 Budget was balanced using approximately $1 million in one-time discretionary revenue and that revenue is not available in FY2017-18.

- The FY2017-18 Recommended Budget reflects a net $613,000 decrease in Non-CalWORKS Realignment revenue compared to the FY2016-17 Adopted amount, due in part to the fact that the allocation formula for Behavioral Health Realignment revenue changed in FY2016-17.

FY2017-18 Realignment revenue also reflects the one-time carry-forward of approximately $13.4 million in Realignment revenue received but not spent in prior years.

- The Recommended Budget includes approximately $7 million in Net County Cost funding for new or enhanced programs, including $4.1 million for initiatives to address the homelessness problem in the County, and $1.6 million as part of the effort to deal with mental health services in the jails. This $7 million is an on-going expenditure commitment, but is funded largely by one-time resources made available by cancelling various General Fund reserves.

- Collectively, departments requested over $36 million in Net County Cost funded Growth requests, and this Budget only recommends funding for approximately $7 million of that amount. Many of the remaining requests address significant community or organizational needs that will likely be an issue in future years' budgets.

General Fund Five-Year Sensitivity Analysis

Recognizing that expenditure and revenue decisions made in one year can have a significant effect on the resources that will be available to General Fund programs in future years, but also recognizing the difficulties in predicting future year economic and fiscal conditions, we are providing the Board with a Five-Year Sensitivity Analysis that suggests what the impact could be on the General Fund's fiscal condition under three scenarios:

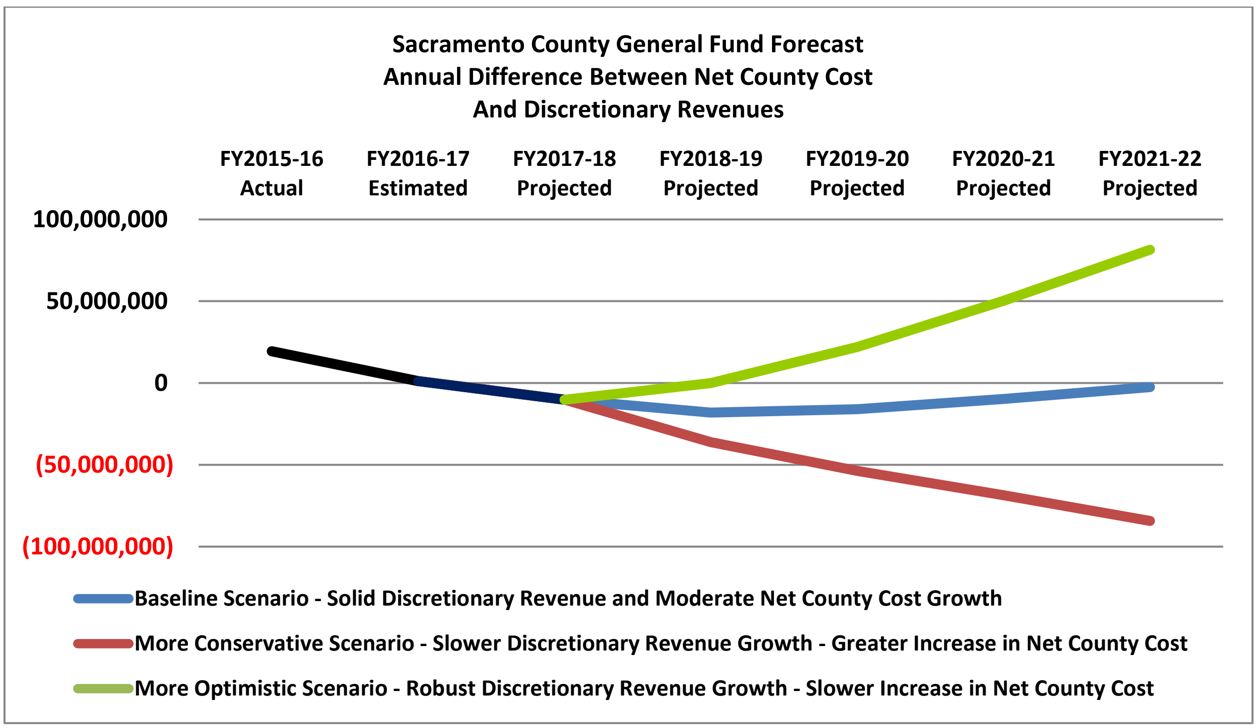
- A "Baseline" Scenario that assumes discretionary revenue and reimbursements will grow at a solid annual average rate of 5% over the projection period and that Net County Cost will grow at a moderate average annual rate of 3%, after adjusting for known or likely changes in Net county Cost. Based on recent economic trends and fiscal conditions, we believe that this a reasonable scenario to use for fiscal planning purposes.

- A "More Conservative" Scenario that shows what the impact might be if discretionary revenue grew at a slower rate and/or Net County Cost increased at a higher rate than the assumptions used in the Baseline Scenario (the impact of slower discretionary revenue growth is essentially the same as the impact of a greater increase in Net County Cost). This Scenario assumes total discretionary revenue and reimbursements will grow at an average annual rate of 3% and Net County Cost will grow at an average annual rate of 4%.

- A "More Optimistic" Scenario that shows what the impact might be if discretionary revenue grew at a faster rate and/or Net County Cost grew at a lower rate than the assumptions used in the Baseline Scenario. This Scenario assumes that total discretionary revenue and reimbursements will grow at an average annual rate of 7% and that Net County Cost will grow at an average annual rate of 2%.

All projections use FY2016-17 Recommended Budget discretionary revenues and reimbursements as a starting point, adjust the budgeted Net County Cost downward to reflect the historic difference between budgeted and actual Net County Cost, and make certain other adjustments based on known or likely changes, such as the full year implementation cost of partial year funding included in the FY2017-18 Recommended budget, reductions or elimination of one-time costs or revenues and likely future cost increases. Significantly, none of the scenarios assume any impact from the Governor's proposal to eliminate the IHSS MOE.

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



As can be seen, depending on the assumptions used, the Sensitivity Analysis provides a fairly wide range of possible outcomes. Given all of the uncertainties involved in projecting into the future, it is likely that the General

Fund's fiscal condition will be different from all three scenarios. Notwithstanding this, we believe it is possible to draw three conclusions:

- The Baseline Scenario is generally consistent with current trends in economic conditions, discretionary revenue and Net County Cost growth, while the other two Scenarios would require significant changes in economic and fiscal conditions either positively or negatively.

- The General Fund will likely not be in structural balance over the five-year projection period but if costs can be controlled, and discretionary revenue comes in at a rate only slightly above the Baseline assumptions, structural balance is potentially achievable without significant expenditure reductions.

- It would be prudent over the next few years to focus on controlling costs and building reserves rather than adding or expanding programs.

The following table shows the amount of discretionary fund balance as a percent of revenue for the general funds of selected large counties.