FY 2024-25 Recommended Budget
GENERAL FUND MULTI-YEAR SENSITIVITY ANALYSIS

Introduction and Approach

In developing the budget for the upcoming fiscal year, it is important to understand the potential impact of budget year decisions on future fiscal years. A budget that is not structurally balanced, with ongoing expenditures exceeding ongoing resources, can lead to funding shortfalls in future years with expenditure needs greater than available resources. Additionally, known or expected changes in future revenues and expenditures should be considered when making budget year decisions to ensure the sustainability of budgeted service levels on an ongoing basis.

Because future year revenues and expenditures depend on a number of factors that cannot be predicted with certainty, it is useful to evaluate different scenarios based on a range of assumptions to understand the possible outcomes. This analysis looks at three possible scenarios to produce a range of projected revenues and expenditures for Fiscal Year (FY) 2024-25 through FY 2031-32. For each of the three scenarios, the analysis evaluates the projected annual difference between General Fund discretionary revenues and Net County Cost (use of discretionary resources) and the resultant impact on the General Fund's discretionary fund balance.

Projection Scenarios and Assumptions

The three scenarios used for this analysis are:

- Baseline Scenario
- Conservative Scenario
- Optimistic Scenario

Common Assumptions

All three scenarios start with the FY 2024-25 Recommended Budget as the base year for revenues and budgeted expenditures. Additionally, to reflect the fact that actual Net County Cost is generally less than budgeted Net County Cost, the analysis projects Net County Cost at 6% below the budgeted level, consistent with the difference between budgeted and estimated actual Net County Cost for FY 2023-24.

All three scenarios also include adjustments for the following known or likely changes in future year revenues and expenditures:

- Changes in existing debt service requirements, in particular for the County's Pension Obligation Bonds, which have significant scheduled debt service reductions in FY 2025-26 and FY 2026-27 and are scheduled to be fully paid off in FY 2030-31
- Additional assumed debt service associated with the Mays consent decree Framework 2 facility improvement recommendations approved by the Board on December 7, 2022
- Increases in staffing and other operating costs to comply with the Mays consent decree, reflecting a total of approximately $20 million of ongoing growth in addition to expenditures included in the FY 2024-25 Recommended Budget
- Future payments associated with the County's settlement of a lawsuit with UC Davis, with annual amounts of approximately $8 million through FY 2032-33, except for the FY 2027-28 payment of approximately $16 million
- An assumed $10 million of additional ongoing Net County Cost growth each year
- Reductions in revenue neutrality payments from cities in the County as those arrangements wind down over the forecast period

All three scenarios also assume that:

- Semi-discretionary and departmental revenue will generally keep pace with cost increases, and
- Underlying expenditures, or "cost of doing business" will increase at an average annual rate of 3%.

Baseline Scenario

The Baseline Scenario is meant to reflect a continuation of the status quo, with revenue and expenditure assumptions generally in line with historical growth rates. This scenario is the most realistic to use for long-term planning purposes and assumes that discretionary revenue will increase at an average annual rate of 4.5%.

Conservative Scenario

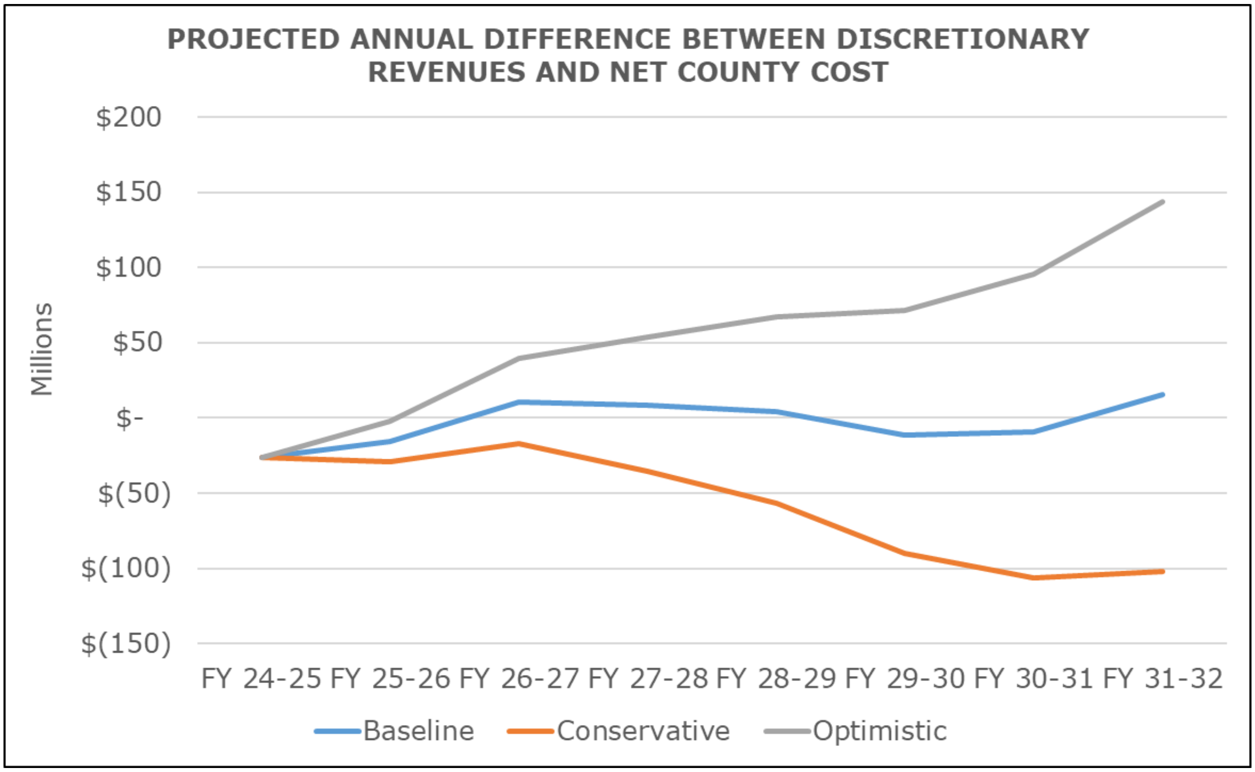
The Conservative Scenario assumes a less optimistic rate of revenue growth compared to the Baseline Scenario in order to illustrate the potential impact of somewhat less favorable economic conditions. This scenario assumes that discretionary revenue will increase at an average annual rate of 3%, compared to 4.5% in the Baseline Scenario.

Optimistic Scenario

The Optimistic Scenario assumes a more optimistic rate of revenue growth compared to the Baseline Scenario in order to illustrate the potential impact of somewhat more favorable economic conditions. This scenario assumes that discretionary revenue will increase at an average annual rate of 6%, compared to 4.5% in the Baseline Scenario.

Projected Results

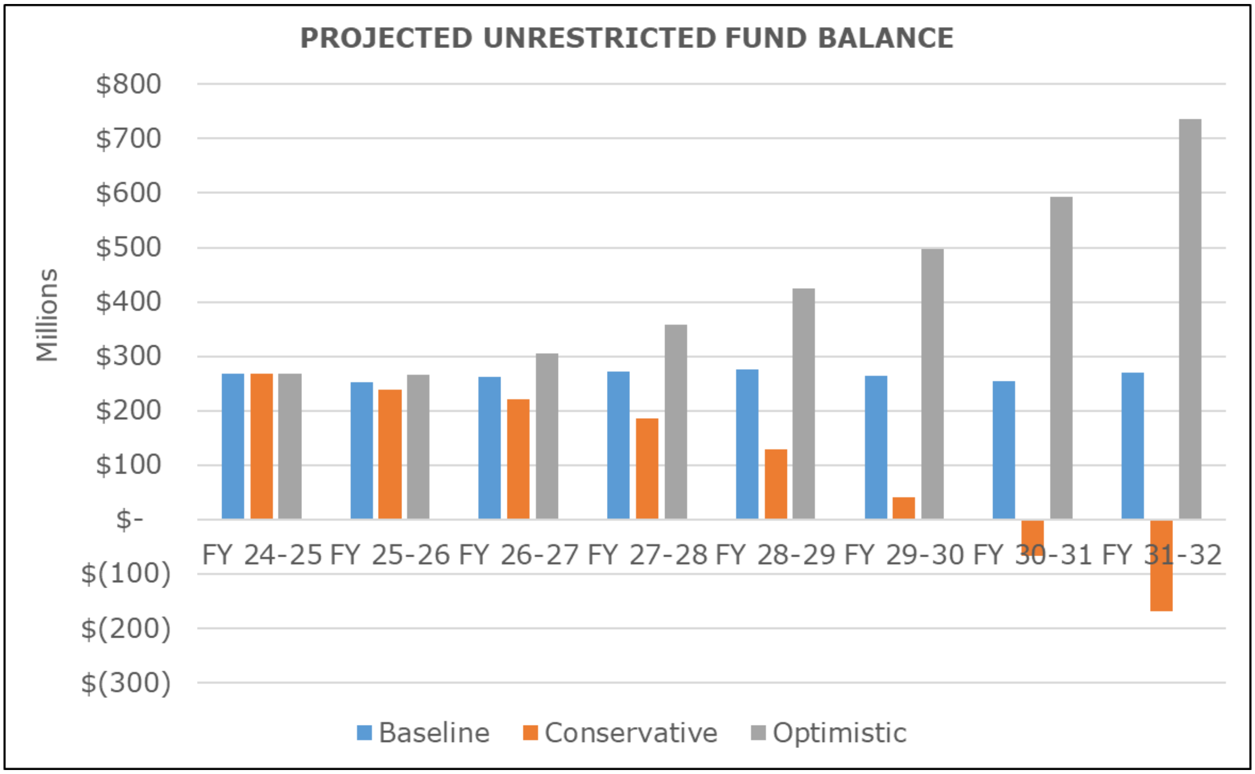
The annual difference between projected discretionary revenues and Net County Cost for each of the three scenarios is displayed on the chart below. Projected results are shown through FY 2031-32, the first full fiscal year after the Pension Obligation Bonds are fully paid off.



The Baseline Scenario shows projected Net County Cost exceeding discretionary revenues until FY 2026-27 and then again in FY 2029-30 and FY 2030-31. In the Optimistic Scenario, discretionary revenues are projected to exceed Net County Cost beginning in FY 2026-27 through the end of the forecast period. In the Conservative Scenario, Net County Cost is projected to exceed discretionary revenues throughout the forecast period.

In all three scenarios, Net County Cost is projected to exceed discretionary revenues in FY 2025-26, reflecting a continued structural deficit in the County's budget.

Projected annual differences between discretionary revenues and Net County Cost either contribute to or reduce the projected unrestricted fund balance in the General Fund, as shown in the chart on the following page.



Under the Baseline Scenario, the General Fund's unrestricted fund balance is projected to remain between $250 million and $275 million throughout the forecast period. In the Optimistic Scenario, the FY 2031-32 projected unrestricted fund balance reaches approximately $700 million. In the Conservative Scenario, the projected unrestricted fund balance continues to decline during the forecast period, with a negative fund balance beginning in FY 2030-31. As a practical matter, budget reductions would need to be made if the projected assumptions in this scenario were to occur in order to achieve a balanced budget and avoid a negative fund balance.

The wide range of projected results in these three scenarios illustrates the sensitivity of the projections to the assumptions used in developing them. Additionally, future circumstances may vary widely from these assumptions for a variety of reasons, with actual results falling outside the projection range. With those limitations in mind, the following conclusions can be drawn from this sensitivity analysis:

- Without adjustment to the current course, it is not likely that the General Fund will be in structural balance in the near future, with the Baseline Scenario showing annual revenue/Net County Cost deficits in several years, ranging from $9 to $15 million. This means that without further reductions: (1) the County will likely need to continue to rely on the use of fund balance to balance the General Fund budget and (2) the unrestricted fund balance is not likely to grow significantly over the forecast period and may decline.

- While many things are largely outside the County's control, including future growth in discretionary revenue, changes could be made to bring the General Fund into structural balance more quickly than shown in the Baseline Scenario. For example, limiting future year growth to $5 million per year instead of $10 million and reducing the annual increase in underlying Net County Cost from 3% to 2.5% would produce results approximating the Optimistic Scenario under the Baseline Scenario revenue assumptions.
- Although none of these scenarios assumes an economic downturn during the projection period, achieving structural balance by aligning ongoing Net County Cost with ongoing discretionary revenues would not only help ensure the sustainability of budgeted service levels into the future, it would also preserve unrestricted fund balance as an available resource to be used to lessen the need for expenditure and service reductions during future economic downturns.