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September 16, 2014

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"*One thing about championship teams is that they're resilient.*
No matter what is thrown at them, no matter how deep the hole,
they find a way to bounce back and overcome adversity."
Nick Saban

Dear Supervisors,

I am pleased to present to you for your consideration the Recommended Final Budget for Fiscal Year 2014-2015. This recommended budget, totaling $1,092,658,111, represents a modest 4.8% increase over our 2013-2014 Adopted Final Budget, and reflects the gradual improvement we are beginning to see in our local economy.

The last several years have been particularly difficult for local government as our entire Country has weathered the "Great Recession." Reductions in programs, service levels and staff have created significant challenges in our entire organization, often resulting in a struggle just to get by and provide basic core levels of service. In addition, after three years of below average rainfall, a majority of the State, including Stanislaus County, is now classified as being in an "extreme drought" condition. It is indeed a "deep hole" that we have found ourselves in.

In spite of our challenges, I take heart in knowing that we have a championship caliber team in Stanislaus County and that they are finding ways to bounce back and overcome the adversity that has come our way.

This upcoming year will serve as a "turning point" for our organization based on several key issues which I will discuss. These issues played a significant role in the development of a financial strategy that will enable the organization to move forward during this period of slow to moderate economic growth. Our conservative and careful approach has served this organization well and should allow us to begin the gradual restoration of critical public safety services over the next several years. The recommended budget presented for your consideration is balanced and reflects the beginning of that gradual restoration.

Final Budget Financial Strategy

The 2014-2015 Final Budget was established with several key concepts in mind. The first goal was to ensure that departments are properly funded to meet their Board approved service levels while maintaining an incentive program that recognizes and rewards efficient government operations. As stated previously, this budget represents a turning point for some of our General Fund departments as they have exhausted past savings created as part of our Net County Cost Savings Program. Consequently, as part of this year's budget development, the Chief Executive Office worked closely with all General Fund departments to establish base funding levels using a zero-based budget approach that incorporates their current Board approved staffing and service levels less an imputed 5% vacancy rate. Departments that no longer have net county cost savings are recommended for funding at this new base funding level.

The second goal was to establish a financial framework that would balance the need for restoring salaries for our employees and rebuilding critical public services which suffered during the recession. Both of these areas need to be addressed in a sustainable manner so as to not throw our organization in a tail spin. The Final Budget presented for your consideration contains recommendations for the beginning of this restoration in the Auditor-Controller, District Attorney, Public Defender and Sheriff Departments.

The third goal was to begin creating capacity to address the staffing and operational costs that the organization will face when our Public Safety Center expansion is completed in late Fall of 2016. The costs of operating these new facilities are projected to exceed $13 million per year and will need to be borne through a combination of General Fund and Community Corrections Partnership funding. With this in mind, the Final Budget contains recommendations to pay down a portion of debt (approximately $15 million), associated with an internal borrowing, from one-time year-end General Fund savings. This debt buy-down, described further in the budget document, will free up approximately $2 million annually of General Fund dollars commencing with the 2017-2018 Budget Year.

Major Priorities

Finalizing Labor Agreements – A major priority for Fiscal Year 2014-2015 will be to complete new long-term labor and health agreements. Contracts for all 15 labor agreements expired in June 2014 and the County is working diligently with the respective bargaining units to create new long term agreements. County employees are the heartbeat of the organization and have made tremendous sacrifices over the past five years and our goal is to provide a complete restoration of salaries within the next twelve months.

Long-range Financial Model – The long-range financial model for the County is continually updated and the goal is to maintain a multi-year outlook in planning and budgeting. The long-range model has helped to provide a sustainable operations plan that maximizes benefit to the local community and minimizes program and service fluctuations. Focusing the organization's vision long-term will continue to promote organizational stability and the sound fiscal management of taxpayer funds. The County has used this information in its annual operating financial decisions.

Investing in Prevention – Members of the Board of Supervisors and County staff have been researching the multiple challenges and issues facing our community. Chronic unemployment, lack of education, reliance on government assistance, substance abuse and criminal gang involvement are major challenges of our region. Leadership is attempting to draw attention to, and facilitate action, around identifying root causes of community issues and strategically investing in solutions that focus on the source of the problem and not just the symptoms. For this to be successful, it will need to be an effort of all sectors of our community, including our non-profits, faith-based, business, education, health, government, media, and arts and entertainment organizations. We envision the County's role as primarily that of a convener and facilitator in this effort. County departments like the Health Services Agency, Behavioral Health and Recovery Services and others have been looking at these issues for many years while engaging with community partners and may serve as a model and facilitator for this new focus.

Improving Customer Service – This coming year we are going to ask our departments to stand back and evaluate their service delivery models through the eyes of their consumers. This evaluation should include, among other criteria, ease of access for services, days and hours of operation and efficient use of technology. As our economy improves and brings new opportunities for restoring public services, departments will be asked to deploy current and future resources in a manner that reflects the needs of the public we serve. Departments utilizing creative solutions to improving service gaps to the public will receive priority in the allocation of available County funding.

Budget Outlook

The 2014-2015 Recommended Final Budget will mark the implementation of the *Funded Service Levels* budget model for the County. Prior to the Great Recession, Stanislaus County General Fund departments were funded based on what was called the *Issued Base* approach. This meant that the departments were issued a General Fund contribution amount which they would use in establishing their budget. In reality, based on how budget calculations were made, some years this was not sufficient to maintain a department's allocated positions and would require departments to request additional General Fund support for their basic service levels. During the recession, the County shifted to a *Net County Cost* model where departments became responsible for all cost increases with no additional General Fund support. This program incentivized departments to become more efficient and generate cost savings to cover any cost increases. Departments were then allowed to retain a specific percentage of their year-end cost savings going forward. The opportunity for savings has dwindled over time and many departments are running out of their cost savings to cover increases. Starting in 2014-2015, the County is recommending implementation of the *Funded Service Level* budget model. This model involved the departments and Chief Executive Office working collaboratively to determine the appropriate level of funding to meet Board-approved service levels and departments would only need to get Board authorization for any changes to these approved service levels. Staff have done extensive work to prepare these budgets that are included as part of the Recommended Final Budget.

Ordinarily, the Recommended Proposed Budget is a very detailed and extensive budget the Board of Supervisors uses for policy consideration. This year, the 2014-2015 Recommended Proposed Budget served as carry over budget until the Recommended Final Budget could be prepared to implement Phase II of the Net County Cost savings program. So, significant budget detail will now be presented in this document that ordinarily would have appeared in the Proposed Budget.

The 2014-2015 Recommended Final Budget reflects $1,092,658,111 in appropriations and $1,039,389,036 in revenue. This compares to the 2013-2014 Adopted Final Budget which totaled $1,042,987,731 in appropriations and $1,005,839,769 in revenue, meaning appropriations are up by $49.7 million over the 2013-2014 Adopted Final Budget and revenue is up by $33.5 million. There is $169,038,478 in Discretionary Revenue included in the Recommended Final Budget, which is a $12.9 million increase from the 2013-2014 Adopted Final Budget.

The General Fund appropriations are at approximately $271 million for the 2014-2015 Recommended Final Budget compared to last year's Adopted Final Budget of $256.6 million. Special Revenue appropriations are up 2.5% from $627.6 million to $643.3 million, the Capital Projects fund is up 66% from $731,898 to $1.2 million, Enterprise Funds are up 18% from $67.1 million to $79.2 million with Internal Service funds up 7.7% from $90.8 million to $97.9 million.

The County will be using net county cost savings, fund balance and retained earnings in several areas to balance the Final Budget. The $271 million General Fund portion of the Recommended Final Budget is balanced through the use of $12.3 million in net county cost savings and $17.1 million of unassigned fund balance. Special Revenue funds will be using $15.4 million of fund balance and Capital Projects will use $78,510 of fund balance. Enterprise Funds will be using $6.7 million of retained earnings and Internal Service Funds will use $1.6 million of retained earnings for balancing.

Issues & Budget Impacts

Water – The historic drought in California is greatly impacting Stanislaus County and the central valley. The economic impacts of this year's drought are projected to be up to 50% more severe than the drought of 2009. The water crisis is impacting different parts of the County in different ways depending on the source of water (federal, state, etc.). But, the bottom line is the water crisis is impacting everyone.

Water is the life blood of the nearly $3.7 billion Stanislaus County agricultural industry. There are increasing reports of residential domestic wells going dry at the same time farmers are drilling new wells in record numbers in response to a market opportunity for nut crops and other commodities. There have been more than 30,000 acres of almond trees (approximately 3.75 million trees) planted on grazing land on the east side of the County since 2001. 7,000 of those acres were planted in 2013. On the other hand, over the past several years, more than 9,000 acres of land in Stanislaus have been fallowed due to lack of water for crops and other financial reasons. Facts such as these have prompted significant debate over water rights and responsibilities.

Lack of scientific data has made it challenging to pinpoint where root issues are. The County hired a Water Resources Manager in 2013 to lead its efforts in recommending sound water policies to the Board of Supervisors. The County will continue to fund this position in the 2014-2015 budget as well as a water consultant. In late 2013, the County established a Water Advisory Committee to advise the Board of Supervisors in matters related to groundwater. The Committee was tasked to produce a needs assessment, prioritize issues, and develop draft policies and directives. The Committee developed a 19-point action plan in its first 100 days that was approved by the Board of Supervisors, and continues to work on water issues in preparation of a second next 100 days report.

The Governor declared a drought State of Emergency in January and the State Water Board has also implemented mandatory water conservation regulations. Political pressure has mounted from the State to address water issues quickly at a local level, increasing the need to take action and additional State action is anticipated. Significant battles over water rights are expected as homeowners, special interest groups, water purveyors, well drillers, government entities and more explore how to respond to the water crisis. The issue is very challenging from many angles including economic, social justice and political.

Public Safety Facility Construction – Public safety construction projects for the County are progressing. Work is moving forward on the AB 900 Phase II Public Safety Jail Expansion project which includes 480 new maximum security beds, a 72 bed Medical Mental Health Facility, an Intake Release and Transportation Facility and a Day Reporting Center. Ground was broken on the Jail Expansion project on August 15 and the new facility will be completed in fall 2016 with phased occupancy beginning in spring 2017. Construction is planned to begin this year on a new $6 million Coroner's facility that would be a re-use of an existing facility on the County Center III campus – the site of the old postal encoding center.

Public Safety Services – As a result of public safety realignment and the upturn in the economy, there are a number of projects and changes underway. The County will be looking at some specific actions in the Mid-Year 2014-2015 Budget to restore public safety services. Beyond that, this fiscal year the County will be pursuing reopening the Ray Simon Criminal Justice Training Center which was temporarily closed in 2010. The training center will be restructured to produce qualified trainees in a shorter training period and getting them on the streets faster. Probation will pursue grant funding of several hundred thousand dollars to reduce racial and ethnic disparities in the juvenile justice system. While grant funding has not been secured yet, this project is an important priority and would potentially involve multiple partner organizations. The District Attorney's Office will be working on connectivity with Modesto Police Department (MPD) after MPD implements software upgrades. The DA will also work with the Superior Court on data integration of the Integrated Criminal Justice Information System (ICJIS) for minute orders.

Roads & Bridges – The County will continue with normal road maintenance during 2014-2015 and looks to complete 80 miles of resurfacing. Also, the two major projects in construction - the Kiernan Interchange and Claribel Road Widening Projects – continue to move forward. The budget for the Kiernan Interchange in 2014-2015 is $23 million and the budget for the Claribel Road project is $6.1 million. For the Kiernan project, in 2014-2015 we look to complete two stages of bridge construction and the remaining on and off ramp work. Total project completion is slated for spring 2016. The Claribel Road project is scheduled for spring 2015 completion after remaining roadway and bridge widening and all traffic signal improvements.

Appropriations for Contingencies – The County will be increasing its budget for appropriations for contingencies from $4.4 million to a little over $11 million in order to fund anticipated termination cash outs, anticipated labor increases, public safety restoration efforts and prevention services. Historically, over the past five years the County has used a little over $1 million per year for contingencies, so this will be a significant change.

Staffing – Budget staffing recommendations include an overall increase in the Staffing allocation count of 28 positions to 3,978. A total of 24 new positions are recommended in the Auditor-Controller (3), Community Services Agency (5), Behavioral Health & Recovery Services (5), Cooperative Extension (1), General Services Agency (1), Health Services Agency (2), Planning & Community Development (1), Probation (1) and Sheriff's Department (5). In addition, a total of 11 previously unfunded positions are recommended to be restored in the Auditor-Controller (2), District Attorney (1), General Services Agency (1), Health Services Agency (4), Public Defender (1) and Treasurer-Tax Collector (2). Seven positions are being unfunded or deleted in the District Attorney (1), Health Services Agency (1) and Probation Department (5).

Employee Benefits – If the County retains its current health benefit plan configuration in 2015, medical self-insurance total costs will increase about $5.8 million over 2014-2015 to approximately $57 million. An estimated $1.5 to $2 million revenue surplus is expected to be generated in plan year 2014 through employer and employee contributions, which will create plan stability and partially offset the accumulated retained earnings deficit from plan years 2012 and 2013. Staff continues to evaluate a variety of health benefit plan configuration options for 2015 and subsequent years that focus on local availability of services, quality of care, and cost containment.

Retirement Costs – The County's retirement plan is funded at 79.4%. It is projected that retirement costs will continue to be a significant cost driver for the organization into the future. Total County retirement costs increased by nearly 13% ($5.4 million) in the 2014-2015 budget and are projected for a 6% ($2.8 million) increase in the 2015-2016 budget. The last payment of around $10.8 million for the Pension Obligation Bond was made in 2013-2014 offsetting recent increases in retirement costs.

Debt Service – The County continues with tight controls on the use of debt to limit its financial leverage. Maintaining low debt to total asset ratios has been a core strategy for the organization over recent years. The County uses internal borrowing where possible, the strategic use of Public Facility Fees, and leverages third party funding when possible. The County refinanced $20 million of debt in 2013, speeding up the payback period from calendar year 2025 down to calendar year 2017 to plan for the need to fund operations of the new jail expansion project. Interest payments were reduced from a high of 4.375% down to 1.5%. The strategy will save the County nearly $5 million over the life of the loan, but the accelerated payback will increase annual payments by approximately $2 million over the next few years. The final payment of $10.8 million was made on the Pension Obligation Bond at the end of Fiscal Year 2013-2014, eliminating this obligation. Also, $15 million in unassigned fund balance is being recommended in the 2014-2015 Recommended Final Budget to pay down a portion of the Health Services Agency debt, and a $6.2 million assignment will be made towards the Coroner construction project.

Financial Reserves – As the organization moves forward with financial recovery, the goal of building back financial reserves continues to be important. Having sufficient reserves and replenishing fund balances is important to maintain fiscal strength during economic fluctuations. The Recommended Final Budget will continue the Board of Supervisors policy of maintaining a Contingency Reserve equal to 8% of the three-year average of Discretionary Revenue.

External Assessment/Issues

Economic Outlook:

Regional economists projected employment rates and income levels would rise steadily in Stanislaus County during 2014 and continue that direction over the next few years. Total employment growth in the Valley increased 2.5% and growth is projected at a faster pace in 2014 and 2015, reflecting some of the strongest job growth in nearly a decade.

Unemployment has decreased dramatically in 2014 ahead of projections. It was initially estimated that Stanislaus County would have unemployment levels of 11.6% by 2015; instead, that has occurred a year early, with unemployment already below 2015 estimates. However, while the outlook has improved, the County's unemployment rate remains well above the National Average

2014	Stanislaus County Unemployment Rate	National Unemployment Rate
June	11.1%	6.1%
May	11.1%	6.3%
April	12.2%	6.3%
March	13.5%	6.7%

Home values increased by nearly 25% between May 2013-May 2014 and are projected to rise 16.5% within the next year. Single family building permits experienced a 37% increase in 2013 helping to increase construction employment. However, rising mortgage costs caused a slowdown in mortgage operations, while on a positive note, foreclosure starts reverted back to pre-recession levels in 2013. There were 170 foreclosures in Stanislaus County in April through June of this year compared to 2,800 foreclosures in three months during the summer of 2008 at the peak of the crisis.

Property Tax Revenue increased by about 6% in Fiscal Year 2013-2014 and this revenue is expected to increase by another 9.3% in Fiscal Year 2014-2015. The Property Tax Assessed Roll for valuation increased 11.5% for 2014-2015 up to more than $39 billion, following nearly a 5% increase in 2013-2014. Sales tax revenues have continued increasing annually since 2009 and are projected to continue with modest growth. Property tax and sales tax are two of the biggest discretionary revenue sources available to the County to support organizational priorities. While these revenue trends are encouraging, it is important to note that combined Property Tax and Sales and Use Tax revenue are still 8.5% below their previous highs.

State Impacts:
The State budget has experienced significant recovery and stability over the past two fiscal cycles. The voter passed Proposition 30 initiative increased sales taxes and personal income taxes and coupled with the economic recovery has stabilized the State budget. The State is now decreasing its short-term debt which had built up to nearly $35 billion. There appears to be no current, significant fiscal threats to counties as the result of State action.

Realignment:
The public safety realignment revenue formula was favorable for some counties and not for others when it was implemented. Stanislaus County landed on the low-end of the reimbursement scale. Attempts to increase the reimbursement for the County have not been successful and we continue to closely watch this issue. Appropriate realignment funding is critical for implementation of programs that target recidivism of people in the criminal justice system, thus resulting in fewer crimes and decreased cost.

Health and Human Services:
As a result of health reform, more people in Stanislaus County have access to healthcare. It is estimated that one in 2.3 people now have access. There are also a decreasing number of people receiving cash aid in the County from a high of one in 16.3 persons receiving services in Fiscal Year 2010-2011, to one in 18.6 persons receiving services in Fiscal Year 2013-2014.

Looking Forward

County leadership continues to use a multi-year budget strategy to guide the organization. Strategies such as refinancing and early pay-down of debt, controlling total debt to total asset ratios, use of internal borrowing when possible, investment in reserves, tight controls on staffing changes and cost containment have all been successfully used to manage tax payer funds. The County will continue to use multiple strategies as appropriate to maintain fiscal viability for the organization into the future.

Cost drivers for the organization will continue to be employee salaries and benefits. The County is seeking to negotiate long-term salary agreements for the next several years, which will promote financial stability. However, employee health insurance costs and retirement costs are projected for continued growth. The County's self-insured health plan has slowed cost increases relative to industry inflation rates, but health costs will continue to rise. Even with the reforms in the retirement system implemented by the County, costs will increase. As noted earlier, the County's retirement plan is 82% funded, which is the third highest in the State of California, and we thank the leadership of StanCERA, the County's retirement system, for their vision, commitment to financial stability and their outstanding stewardship of retirement funds.

The County continues to plan for the operational costs of the opening of the new jail expansion project in 2017 and began setting aside funds in the Fiscal Year 2013-2014 Budget as well as early pay down of County debt to create financial capacity for this and other exposures.

As County finances have stabilized, leadership is looking at appropriate restoration of staffing levels, restoration of salaries as appropriate and targeted investment of tax payer funding to implement the Board of Supervisor's priorities. We will also continue to focus on our vision, mission and values in how we conduct the public's business and as we strive to become the best county in America.

Conclusion

I consider it a privilege to work with such a great Board of Supervisors. You are an intelligent, dedicated and hardworking Board and have demonstrated that you are willing to roll up your sleeves and provide leadership and guidance in the challenging issues we face. Thank you for your dedication to our community and this organization.

Our team is also led by an extremely talented and dedicated group of Department Heads, managers and senior leaders. They are resilient and work together well as a team. You can sense the positive energy in the room when this team comes together and I am excited about what we can accomplish together in the coming years.

Just as the key to success for any football team lies in its front line, I am grateful for all of our employees, as they are truly the heart of our organization. Their sacrifices have helped this organization weather this Great Recession. Their resiliency and commitment to providing a way to ensure the delivery of critical services, despite fewer resources, has helped minimize impacts to our community. Their attitudes and performance are what will drive our continued journey to becoming "…a county that is respected for its service in the community and is known as the best in America."

Ours is a journey of striving for excellence – championship caliber teams know no less!

Respectfully,

Stan Risen
Chief Executive Officer