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Date: October 29, 2008
To: Butte County Board of Supervisors
From: Greg Iturria, Chief Financial Officer
Subject: **Fiscal Year 2008-2009 First Quarter Financial Report**

Overview

Similar to the vast majority of public agencies and private enterprises around the globe, Butte County is steering through a "perfect storm" of financial crises involving swells of instability in the financial markets, significant delays of cash reimbursement from the State of California for services provided on their behalf, and a budget challenge deeper than anything this County has seen in decades.

The global financial crisis of 2008 is expected to cause a deep global economic recession in 2009 that will drive down revenues for years to come. All the while, the State of California appears to be unwilling or maybe unable to truly balance its own budget deficits.

Over recent weeks, upon the sudden economic downturn and recent posting of first quarter expenses and revenues, Butte County and other California counties have been carefully reviewing financial data and economic indicators in an effort to understand rapidly deteriorating financial positions. One week before preparation of this report, staff discussed initial findings with counterparts in other counties and determined that others are arriving at the same conclusions. Any county without a large general reserve needs to make significant budget reductions this fiscal year in light of recent events in the economy and unexpected State actions. However, even those counties with large general reserves are now finding themselves with major structural budget deficits in the forthcoming budget cycle that begins on July 1, 2009. In all California counties, significant impacts to services are expected that will not be quickly recovered.

Many long-term financial challenges are occurring concurrently and deepening suddenly. The State of California has been withholding over ten million dollars owed to Butte County for services rendered on the State's behalf. It has caused a cash crunch that is demanding extraordinary cash management efforts be performed by the Finance,

Treasurer and Auditor offices. Because of the global liquidity crisis in the financial markets, the State of California and others, including Butte County, do not have access to additional credit at affordable rates. This credit crunch requires staff to seek Board of Supervisors approval for short-term cash flow borrowing between county operating and internal service funds to ensure sufficient operating capital through the end of the fiscal year. And, last but not least concerning, the County is expecting a \$10 million budget shortfall in tax revenues, interest earnings, other revenues and unanticipated expenses this fiscal year.

Economy-driven impacts to County provided programs and services can be less severe with proactive management of the County's budget. A broad array of immediate actions can be taken to ensure sufficient liquidity, curtail spending, improve revenue collections, and adjust to a new economic condition. Actions may include increased advocacy, internal borrowing, extraordinary reviews of proposed hiring, purchasing and contracting, deferment of capital projects and required cost reductions.

Cash Crunch

When staff reported to the Board of Supervisors in February and June 2008, the State intended to hold funds owed to the County between April 2008 and September 2008 for services rendered to assist the State with its cash flow problems. The withholdings intensified this summer and continue now at a far greater extent than reported by the State. The late adoption of the State budget delayed additional revenue flow beyond expectations and, ultimately, the adopted State budget included trailer bills that authorized several other payments to the County to be held until later in the fiscal year. This cash shortage became critical to the County earlier this fall when the worldwide credit market collapse occurred and the State's cash flow problem worsened.

The County currently expects that the average daily cash balance in the County's General Fund this fiscal year to be about half of the amount of last fiscal year. There are a variety of reasons for this shortage. The results of staff analysis for first quarter (July 2008 – September 2008) cash flow are shown below.

The cash flow differences for the first quarter of fiscal year 2008-2009, compared to fiscal year 2007-2008, are as follows:

During the first quarter of fiscal year 2008-2009, the County's CalPERS pension obligation prepayment increased \$3 million, compared to the previous year. This increase is due to the County's classification and compensation study implementation finally being realized at CalPERS in their actuarial calculations.

During the first quarter of fiscal year 2008-2009, the County's General Fund advanced an additional \$6 million to the Behavioral Health Fund. The total advance as of September 2008 was \$11.5 million. These additional advances are due to the State delaying approximately \$2.5 million to \$3 million in Behavioral Health receipts per month. The department's cash flow problems are continuing and appear to be getting

worse. As of this writing the managed care allocation, administrative claims and EPSDT advances have not been received. Additionally, billings are not moving quickly through the payment process. Currently the State owes the County approximately \$11 million. The State Department of Mental Health is reporting that they have been granted an exception and have been allowed to hire back extra help to aid in the processing of Medi-Cal payments, and payments totaling \$6 million are expected in the first part of November.

Per a State ruling at the end of last year, the Department of Behavioral Health now has to pay contract agencies for Medi-Cal expenditures prior to receiving payment from the state. This further increases the County's cash flow problems because, in the past, payments were not made to the contractors until the County received the revenue from the state.

Other delayed State payments include \$8 million in Department of Employment and Social Services receipts being delayed two months during the first quarter of fiscal year 2008-2009.

Much of the Department of Public Health's revenue is based on invoices sent to the State. None of these billings were processed by State staff until the State adopted its budget, causing both a delay and now a backlog that could stretch to the end of the fiscal year. This issue is exacerbated because the State Department of Health Services used extra help (temporary employees) to process claims, and all extra help has been released in that department.

All of these factors have contributed to the County having to borrow \$14.6 million in July plus another \$10 million in August from the County's \$25 million Tax and Revenue Anticipation Note (TRAN). The TRAN is the County's short-term annual cash flow loan that helps to fund operations until property tax receipts arrive in December 2008 and April 2009. To put this in perspective, during fiscal year 2007-2008, the County only borrowed \$4.5 million of its \$17.2 million TRAN in July and August.

Local school districts and other agencies in the County Treasury are finding that they are in the same cash challenged position. The Treasurer-Tax Collector's Office is helping address this cash crunch by maintaining a higher liquidity position in the County Treasury than the historical norm. This is necessary for our immediate situation, but it is also expected to result in a further reduction of pool earnings. The Treasurer-Tax Collector is doing an excellent job helping the County and other local agencies manage through this cash flow challenge.

- ***What does all this mean?*** It means that with an average daily balance half that of last fiscal year's balance, the County will see a proportionate decrease in expected interest earnings.
- ***What can be done about this?*** The Board can increase advocacy efforts at the State level to push State agencies for a much quicker reimbursement timeframe.

Credit Crunch

The County increased the size of its TRAN significantly from \$17.3 million last fiscal year to \$25.2 million this fiscal year, partly in anticipation of a larger than usual delay in state funding. However, the magnitude of the size and timeframe of the State delays and deferments was unfathomable to local government throughout the State. Counties, cities and school districts, throughout the state, are looking for new means to maintain sufficient cash on hand for daily operations. Local governments that do not maintain general or other discretionary reserves are finding that additional cash flow loans are needed to get through the fiscal year.

California local government's are certainly not alone in the search for operating credit. The recently emerging global recession is accelerating, largely because of the diminished access to credit.

Staff in the Finance, Treasurer and Auditor's offices have been exploring all options to find the most cost-effective means to ensure sufficient operating capital in the General Fund and special revenue funds. Staff concluded that it would not be prudent for the County to borrow more cash flow funds from outside entities, and, indeed, it would be very difficult.

The County's \$25 million TRAN has already been fully utilized. It is secured by the property taxes the County will receive in December 2008 and April 2009. Half of the TRAN must be paid back to a trust fund by January 1, 2009 and the other half by April 30, 2009. Staff has concluded that issuing another TRAN is not practical, since it would only be available to us for May and June, and issuance cost is too expensive for such a short period.

Public and private enterprises sometimes look to a bank for an operating line of credit that is not secured by taxes or other revenue. Staff has thoroughly explored this option. While in normal financial times, the County could expect a reasonable price for an operating Line of Credit (LOC), staff found the pricing would be unaffordable at this time and/or that the amount available may be inadequate to fully meet our needs. In addition, outside borrowing may further hurt our credit rating and therefore increase the County's cost of next fiscal year's TRAN. Staff already believes the County's current low fund balances will cause deterioration of our credit rating and result in additional borrowing costs to be borne next fiscal year.

Staff has concluded that the only practical solution, to ensure sufficient operating capital for payment of bills and payroll through June 2009, is internal borrowing of cash under the control of the Board of Supervisors that is otherwise restricted in use. Such borrowed cash must be paid back by June 30, 2009 in order to comply with State law. Such cash may include Public Health realignment cash reserves, insurance claim reserves, and special revenue fund cash balances.

Staff is also learning, along with much of the world, that the whole business of borrowing cash and of selling government bonds is going to significantly change

because of recent events in the global financial market. There will certainly be a push to go back to basics with innovative lending practices not so highly valued. We also expect that it will take a longer time for County bonds to be issued in the bond market and certainly a more arduous process with much more time spent by staff to pre-market and get the deal done.

The liquidity crisis is one of the worst financial catastrophes in the history of our country and staff anticipates credit will be more expensive and relatively hard to come by in the next couple of years. We are not even sure who will be buying municipal bonds in the near future. Four of the top ten California municipal bond underwriters are gone (Merrill Lynch, UBS Securities, Lehman Brothers, and Bear Sterns). Staff expects global banks will focus on jumbo issuers (State of California, Metropolitan Water District, etc.) and specialty groups like healthcare, student loans, housing and higher education. Our financial advisors are predicting that the majority (by number of deals) of the market will be left to regional firms. Even the marketing of bonds is expected to change. For example, it appears a competitive sale of bonds would be more risky than a negotiated one since failed auctions may be commonplace for a while. Also, bond insurance and Letters of Credit, both historically used as tools to obtain more market participation and better pricing, are virtually unavailable.

Rating agencies are advising staff that they will start looking for quarterly reconciliation of budgets and a greater emphasis on cash flow analysis with well noted variations and documented assumptions. Therefore, it will take more effort by the County to submit and secure financing in the future. The agencies will start looking harder at budget management practices and take General Fund Reserves into greater consideration. If the County fails to adequately respond to new financial reporting and management demands from the credit rating agencies and underwriters, then we can expect much greater borrowing costs for our cash flow loans (TRAN) and any capital project loans.

- ***What does all this mean?*** It means that our normal cash flow loan secured by property tax receipts, is not sufficient and additional cash borrowing is needed. It also means that we will likely need to redirect staff working on other activities to work on new financial analysis and reporting to conform to new expectations in the financial industry.
- ***What can be done about this?*** The Board could authorize staff to borrow internally among otherwise restricted fund balances. The Board could ask their Finance Management Options Committee to re-evaluate the use of fiscal staff in light of new reporting and financial management demands. The Board can also direct staff to draft a reserve policy for their consideration.

Current Fiscal Year Budget Crunch

While analysis finds substantial department budget shortfalls, which will likely reduce the County General Fund contingency to near zero by the end of the fiscal year, the most concerning trend is the sharp drop in tax and other discretionary revenue trends.

Several key revenues are on track to be about \$6 million less than originally anticipated. The cause for the estimated \$6 million shortfall rests entirely on the recently sharpening downturn in the state and local economies. This report will address the current fiscal year budget crunch in three sections: 1) General Purpose Revenue and Realignment Revenue, 2) Summary of Department Budget Findings, and 3) Budgetary Impact of Fires.

1) General Purpose Revenue and Realignment Revenue The challenge began in the 4th quarter of the prior fiscal year when several tax sources started coming in with a lower trend due to statewide and national economic factors, while the County also had unanticipated costs due to the June wildfires. Because of these factors, the General Fund ending balance was less than previously expected, resulting in a very low General Fund contingency to start this fiscal year. The County targeted a General Fund contingency for this fiscal year to be funded at \$5.5 million but the actual beginning contingency amount is about \$3 million.

The County’s current fiscal year budget position deteriorated through the first quarter of this fiscal year due to the much sharper economic downturn. This is clearly going to decrease tax receipts for the rest of the fiscal year, and will be compounded by much lower interest earnings.

Total tax and interest revenue losses impacting the General Fund add up to an estimated \$6 million. The small contingency that remains (\$3 million) will be needed for other expenditure and revenue challenges in department budgets, due to a variety of factors including fire costs that won’t likely be reimbursed this fiscal year, a further decline in development activity, State funding reductions and deferments, and other revenue declines. Therefore, the County needs about \$6 million in additional budget solutions to get through June, so that we close the fiscal year in the black.

GPR Adjustments	
Property Taxes	(2,600,000)
Local Sales Taxes	(200,000)
Public Safety Sales Taxes	(700,000)
Property Transfer Tax	(200,000)
Interest Earnings	(800,000)
Total Reduced GPR	(4,500,000)
GPR backfill - Decline in Social	(1,500,000)
Services Realignment (Vehicle/Sales Taxes)	
Total Expected Decline This Fiscal Year	(6,000,000)

Property Tax receipts are expected to be less based on a variety of data trends. Most prominently, the current budget anticipated \$2 million in prior year secured property taxes initially believed to be available for transfer from the Tax Resources Fund. However, due to anticipated tax payment delays and defaults, and the County's obligation through the Teeter Plan, the prior year secured property taxes will be needed to buyout such losses from cities and school districts until the County is able to collect them in a future year.

Additionally, current secured property taxes are expected at a lower amount than original projections, due to an increase in property value adjustments. Our forecast for current secured property taxes to be assessed and collected this year is adjusted downward by about \$600,000.

The outlook for the next two fiscal year property tax collections is more pessimistic based on what is occurring this year in valuations. So far this fiscal year 1,655 new Proposition 8 property tax adjustments have been made resulting in a decreased assessed valuation by \$88.5 million. Also, while it is difficult to forecast future market trends, staff is projecting 3,600 new Proposition 8 adjustments in 2009.

Sales tax receipts, from retail activity in the unincorporated area in the County and the County's share of the activity in the incorporated area of Chico, are continuing to decline at a faster rate than initially projected. First quarter sales tax receipts received by the County in July through September, representing activity for April through June, is 12.7% less than the same period in fiscal year 2007-2008. Since the County had a conservative estimate to begin with, this will only result in a budget shortfall of about \$200,000.

Much bigger sales tax concerns lie within our revised projections for Proposition 172 Public Safety Sales Tax. This tax revenue stream is tied to statewide sales tax receipts. The revenue source is currently trending less than expected and the collection rate is expected to further decline, based on the most recent collection information provided to us by the State Controller's Office. The revised estimate results in a budget shortfall of about \$700,000.

Property transfer activity and value of property transfers have continued to decline but at a sharper rate than originally projected. It is difficult to project this volatile revenue activity for the entire fiscal year based only on three months of data, but current trends lead staff to revise estimates downward by about \$200,000.

Interest earnings in the General Fund are also very difficult to project this early in the fiscal year, particularly in this very volatile financial market. However, due to the aforementioned cash and credit challenges earnings will be significantly less. At this juncture, staff is projecting about \$800,000 less in General Fund interest earnings.

Due to shortfalls in Social Services realignment (statewide sales taxes and vehicle license registration fees) and expected caseload-driven cost increases to mandated

social service programs, the required transfer of general purpose revenue to fund mandated social service programs is expected to increase by about \$1.5 million. More details on this aspect are found below in the Department Budget Findings section.

Several actions can be taken to address the current year general purpose revenue shortfall, primarily short-term and long-term expenditure cuts and deferrals, as described in further detail later in this report under the title "Suggested Actions."

2) Summary of Department Budget Findings A comprehensive analysis of department budgets was performed by staff in every department. There are a variety of trends including some department revenue declines, reductions in State allocations for local services, and unanticipated expenses. It is expected that adjustments will need to be made to department budgets at midyear to address these factors.

Health & Human Services

Behavioral Health

1. ***Expenditure Trends*** - Overall expenditures are slightly under budget for the 1st quarter.
2. ***Revenue Trends*** - There are a number of areas of concern for revenues.
 - Realignment revenue is anticipated to be \$150,000 less than budgeted. In fiscal year 2007-2008, Vehicle License Fee (VLF) realignment revenue was short of base by 1.1% and Sales Tax realignment was short of base by 1.8%. Due to continuing declines in the economy, VLF revenue is currently estimated to be 98.5% of base and Sales Tax will come in at 97% of base.
 - This estimate is a very early and a best guess with extremely limited information. Based on these assumptions Behavioral Health realignment will be \$150,000 less than budget. As additional Mental Health Services Act funds are brought into the budget they come with administrative funds that will be used to help offset the realignment shortfall.
 - The Managed Care Allocation came in \$160,000 greater than expected. This will be used to offset other shortfalls.
 - Current billing revenues are low. Current projections indicate that actual year-end revenues may be \$3.8 million less than budgeted revenues. This is due to reduced billings in September that could be the result of budget reduction implementation and the school year startup period which tends to delay youth service referrals. Staff will continue to closely monitor this revenue trend.

- The MIORC Program was eliminated. Previous Board action moved all staff to MHSA funded programs. However, the remaining program costs and interdepartmental MOU's still need to be adjusted out of the budget.
- The Mental Health and Substance Abuse CalWORKS allocation was reduced by \$60,000. A recent vacancy will be deleted to adjust for this cut.

3. *Estimated General Purpose Revenue Impact:*

- While staff does not anticipate a GPR impact at this time, staff will continue to closely monitor expenditure and revenue trends. Behavioral Health's fiscal status will be reevaluated following closure of the 2nd quarter.

Employment and Social Services

1. *Expenditure Trends:*

- General Assistance mandated aid payments are on an upward trend. Estimated caseload increases to the program will increase expenses \$200,000 more than original estimates.
- Costs for Severely Emotionally Disabled (SED) children assistance are also increasing due to increased caseload (which does not seem to be driven by economic factors). It is estimated that the County cost of this program will be \$190,000 more than original estimates.
- Additional costs, due to caseload, for KinGAP and Foster Care are up with a likely combined County cost increase of \$140,000.

2. *Revenue Trends:*

- By far the most significant concern for the Department's budget is lower than expected realignment revenues. Realignment is currently expected to be \$950,000 less than budgeted.
- The Department is still waiting for its state allocation letters. However, the Department is anticipating a reduction in Adult Protective Services allocations and will make necessary adjustments for this program and any others to stay within the state allocations and County Maintenance of Efforts (MOE) funding requirements. Adjustments will be brought forward to the Board once allocation letters have been received. In the mean time vacancies are being held.

3. *Estimated General Purpose Revenue Impact:*

- Based on current estimates the Department will likely require an additional \$1.5 million in County general purpose revenues. Due to legal mandates to provide

services and required MOEs there are little to no places to make cuts in the Department to mitigate the need for an additional transfer.

Public Health

1. ***Expenditure Trends:*** Expenditures are slightly under budget for the 1st quarter.

2. ***Revenue Trends:***

- Public Health realignment revenues are currently expected to be \$750,000 less than budget. While there are sufficient funds in the realignment restricted cash account to cover any needs beyond current year receipts, the County also relies on these funds for transfers to social services and for a planned land purchase in north County for a future health services building. Additionally, the County may need to consider the potential use of this fund as a source of internal borrowing this fiscal year. Public Health's current year budget includes approximately \$350,000 in one-time costs.
- Teen Smart Outreach, a teen pregnancy prevention program was eliminated in the budget. The department has now eliminated the program, but nonetheless has first quarter expenses estimated at \$22,000 that must be absorbed by realignment revenues.
- The California Children's Services (CCS) program, previously an uncapped program was capped and restricted in the State budget. The state is currently determining the allocation methodology. Staff estimates the cut to be between \$100,000 and \$300,000.
- Animal License Fee revenues are down from budget estimates by approximately \$50,000 annualized. The budget assumed fee increases that were not adopted. It is recommended that expenditures in this area are carefully monitored to determine if adjustments should be considered midyear.
- Mandate Claim – Animal Control. Due to continuing delays in reimbursement of claims it is estimated that only \$60,000 of the \$125,000 budgeted amount will be received.
- The department has continued to experience reduced revenues in its lab and clinics. They are currently working with a consultant to reduce costs and increase revenues in the clinics which will likely positively impact the lab as well. Additionally, the lab fees haven't been adjusted in many years and are part of the user fee study. At the current rate a \$60,000 shortfall could be expected. It is recommended that this area is watched carefully to determine if needed adjustments are successful.

3. *Estimated General Purpose Revenue Impact:*

- Ultimately any expenditure that exceed revenues will be paid with realignment reserves, however given the possible impacts to the realignment restricted cash account the situation should be monitored with cuts made as necessary.

Public Safety

District Attorney

1. *Expenditure Trends:*

- Expenditures for the 1st quarter fiscal year 2008-2009 are in line with the same period last fiscal year. It is anticipated that the Department's expenditures will stay within its appropriations for fiscal year 2008-2009.

2. *Revenue Trends:*

- Revenues will be approximately \$302,000 lower than the budgeted amount. This is the result of the reductions due to the elimination of the Mentally Ill Offender Crime Reduction program (\$26,000), the elimination of a grant from the Department of Justice to prosecute spousal abuse (\$54,000), and the lack of SB 90 payments for the mandated child abduction services (\$222,000).
- The department will receive additional grant revenues for the Auto Insurance Fraud Grant (\$67,000) and Worker's Compensation Insurance Fraud Grant (\$45,000). The department is recommending budget adjustments (increased appropriations) for these increases on the November 4th Board meeting. There is no net impact to the General Fund.

3. ***Estimated General Purpose Revenue Impact:*** \$80,000 (excluding SB 90 revenue loss)

Probation

1. *Expenditure Trends:*

- Expenditures for the 1st quarter fiscal year 2008-2009 are in line with the same period last fiscal year. It is anticipated that the department's expenditures will stay within its appropriations for fiscal year 2008-2009.

2. *Revenue Trends:*

- Revenues will be approximately \$254,000 lower than the budgeted amount due to a 10% reduction in the Juvenile Probation and Camp Funding and the elimination of the Mentally Ill Offender Crime Reduction program.

3. *Estimated General Purpose Revenue Impact:*

- The department has made adjustments to deal with the reductions in the Juvenile Probation and Camp Funding and the elimination of the Mentally Ill Offender Crime Reduction program. Primarily, the department had eliminated vacant positions and shifted some other positions to ensure that there is no net impact to the General Fund.

Public Defender: It is anticipated that \$25,000 from contingencies will be required by the end of the fiscal year to balance this budget unit. Most of the appropriations in this budget unit are tied up through contracts, and there are no options for reductions.

Sheriff

1. *Expenditure Trends:*

- Expenditures for the 1st quarter fiscal year 2008-2009 are in line with the same period last fiscal year except for the overtime costs (\$200,000) incurred during the recent fires.

2. *Revenue Trends:*

- Revenues will be approximately \$220,000 lower than the budgeted amount. This is the result of 10% reduction in booking fee subvention (\$12,000), elimination of MIOCR funding (\$15,000), elimination of State marijuana suppression grant (\$166,000), the reduction of federal marijuana suppression grant (\$27,000), and the lack of SB 90 payments (\$44,000).
- The State fully funded the Rural County Supplemental Funding. In the budget a 10% cut was anticipated. Therefore, additional \$50,000 is available in the 360.007 budget unit.

3. ***Estimated General Purpose Revenue Impact:*** \$220,000 (excludes SB 90 revenue loss and \$200,000 of unbudgeted overtime costs related to the fire events.)

Development Services

1. *Expenditure Trends:*

- Expenditures for the 1st Quarter of fiscal year 2008-09 are in line with the same period last fiscal year. It is anticipated that the Department's overall expenditures will be below budgeted at the end of the year, with anticipated savings of at least \$750,000. It is possible to obtain further savings through additional layoffs, a

reduction in other major Departmental expenses, or increased cost recovery in fees for services that benefit individuals or businesses.

2. Revenue Trends:

- CDBG Grant for Code Enforcement – The County was not selected to receive a \$100,000 CDBG Grant for Code Enforcement activities in communities of Chapman-Mulberry, Magalia, Stirling City, Southside Oroville, Palermo, Honcut, and Bangor. The anticipated revenue would have funded two (2) Code Enforcement Officers for the period October 2008 – June 2009.
- Nuisance Abatement Liens– Lien revenue received in any given fiscal year is based upon the amount of liens levied by the County between March 1st and the last day in February of the previous fiscal year. Revenues are anticipated to come in \$90,000 below anticipated due to Code Enforcement staff being pulled away from regular Nuisance Abatement activities to work on Debris Removal and Cleanup activities related to the summer fires, as well as reduced staffing due to budget reductions.
- Construction Permits – Building permit applications continue to decrease, and more people are choosing to remodel instead of building new homes, which brings in a much lower amount of fee revenue than new construction. In addition, cost recovery under Construction Permit fees is currently well below 100% and General Fund resources are unable to backfill the full gap between the cost of providing services and the revenue received. The Department anticipates that revenues will be approximately \$700,000 below budgeted.
- Planning Permits – Planning permit applications continue to decrease with a corresponding reduction of approximately \$400,000 in anticipated revenue. Similar to construction fees, the County charges below full cost recovery without General Fund available to backfill the gap between the cost for services and revenue received. Other issues that impact revenues include the large amount of time spent by staff on the General Plan update process, which is not recoverable through fees under our current fee structure, and staff time spent on planning applications that were submitted in a prior fiscal year and charged a flat fee, in which case the revenue was realized in a previous fiscal year but the work is still being done.

3. Estimated General Purpose Revenue Impact: \$540,000

All Other Departments

- Expenditure and revenue trends in all other departments seem in line with the budget and consistent with this period of last fiscal year. Further analysis will be ongoing and any concerns will be addressed and reported in a subsequent financial review.
- The Elections budget contains a revenue gap of \$1,274,636 caused by budgetary timing and evolving State policy of reimbursing the County for the FY

07-08 special election costs. Reimbursements for the elections were believed to be received in FY 08-09, so \$1,274,636 was budgeted as a revenue. However, the State provided the reimbursement in time to book it as a receivable in FY 07-08, therefore the amount budgeted for FY 08-09 will not be realized, as it has already been received for FY 07-08.

Other State Mandate Reimbursement Implications

The final State budget appropriated funds for any outstanding fiscal year 2005-2006 and fiscal year 2006-2007 claims, but it did not appropriate funds for any fiscal year 2007-2008 claims. Therefore, we will not receive any of the 2007-2008 claim reimbursements presumed by our current county budget. Departments are aware of this change and the impacts are factored into the department analysis above. At this juncture, staff is expecting to receive the fiscal year 2007-2008 claim reimbursements next fiscal year unless we learn otherwise from the State.

Summary of Estimated Shortfalls for County Department

Department Budget Shortfalls ¹	
SB 90 / Elections Revenue (Fund 10)	(1,735,000)
Public Safety	(325,000)
Development Services	(540,000)
Estimated Budget Shortfall	(\$2,600,000)

Footnotes

¹ Represents revenue reductions or increased cost not already addressed in the budget

3) Budgetary Impact of Fires

Between June 10 and July 29, 2008, Butte County was ravaged by a series of fires unprecedented in County history. During the 49-day siege, thousands of residents were evacuated, hundreds lost their homes, and entire communities were transformed. Butte County mobilized an unmatched response to the suffering caused by the fires.

Total estimated costs may exceed \$6.2 million. However, due to FEMA's denial of a Major Disaster Declaration, the County will likely only receive approximately \$2 million in reimbursement from this source, of which \$1.1 million is expected to be received in fiscal year 2008-09. The balance of the funds, if not recouped by some other legislative or federal administrative means, will have a serious impact on local services, at a time when the County is still vulnerable to other disasters.

Butte County may be burdened with an unreimbursed balance of over \$4.2 million in related fire costs. Most of these costs have already been accounted for in our analysis

of department budgets but some costs are not yet fully realized and/or not yet budgeted. The following summary ledger displays our most current accounting.

Butte County Fire Siege – Summer 2008

Estimated Total Cost Summary

Salaries and Benefits ¹	\$ 1,349,222
Overtime ¹	536,073
Shelter/Food/Mutual Aid/etc. ²	576,348
Debris Removal	818,100
Disaster Recovery Coord.	170,000
Additional Mutual Aid/ Req Res.	548,685
Infrastructure Replacement	1,368,000
Related Costs	844,491
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	\$ 6,210,919

Footnotes

¹ Salaries, overtime, and benefits are based on Kronos time entry which is dependent on staff entries.

² Shelter/Food/etc. amount is received from procurement.

Estimated Impact to FY 2008-09 Budget:

Unbudgeted Costs:

Salaries and Benefits	\$ -
Overtime ¹	-
Shelter/Food/Mutual Aid/etc.	577,000
Debris Removal	818,100
Disaster Recovery Coord.	170,000
Additional Mutual Aid/ Req Res.	548,685
Infrastructure Replacement	368,000
Related Costs	-
Reimbursement to CSS	29,596
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Total Unbudgeted Costs:	\$ 2,511,381

Expected Reimbursement (08-09)

FEMA	993,671
State	310,362
Other	34,356
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Expected Reimbursement	\$ 1,338,389

Net Impact to Budget (08-09):

\$ 1,172,992

Footnotes

¹ Excludes \$200,000 of unbudgeted overtime costs incurred by the Sheriff's office.

The Administrative Office will continue to work closely with the Sheriff's Office to determine if future budgetary adjustments need to be considered.

Fire Storm - Summary Statistics

- 110,000 acres burned
- 3,300 firefighters assigned
- 308 dwellings destroyed
- 10,000 residents evacuated
- 7,800 total shelter stays
- \$6.2 million will be spent by the County
- \$2.0 million anticipated federal/state reimbursement over several years
- \$4.2 million unfunded burden on County General Fund
- \$2.5 million of current fiscal year's costs are not budgeted
- \$1.3 million estimated reimbursement to arrive this fiscal year
- \$1.2 million budget shortfall estimated this fiscal year

Current Fiscal Year General Fund Contingency

The impending midyear adjustments to department budgets, including the fire related costs described above, will eventually deplete most, if not all, of the remaining General Fund contingency from its current balance of about \$3 million, unless additional expense reduction actions are taken. These needed actions are in addition to the \$6 million in necessary budget solutions required because of economic impacts to the County's tax and interest earnings shortages.

- ***What does all this mean?*** It means that the County won't have the means to pay bills and make payroll in May and June of next calendar year, unless the County takes some actions to change expense and revenue trends.
- ***What can be done about this?*** The Board can direct staff to reduce costs, including the actions described in the "Suggested Actions" section of this report. The Board will also have an opportunity this winter to adjust fees to improve cost recovery of services that benefit individuals and business.

Next Fiscal Year Budget Crunch and Outlook

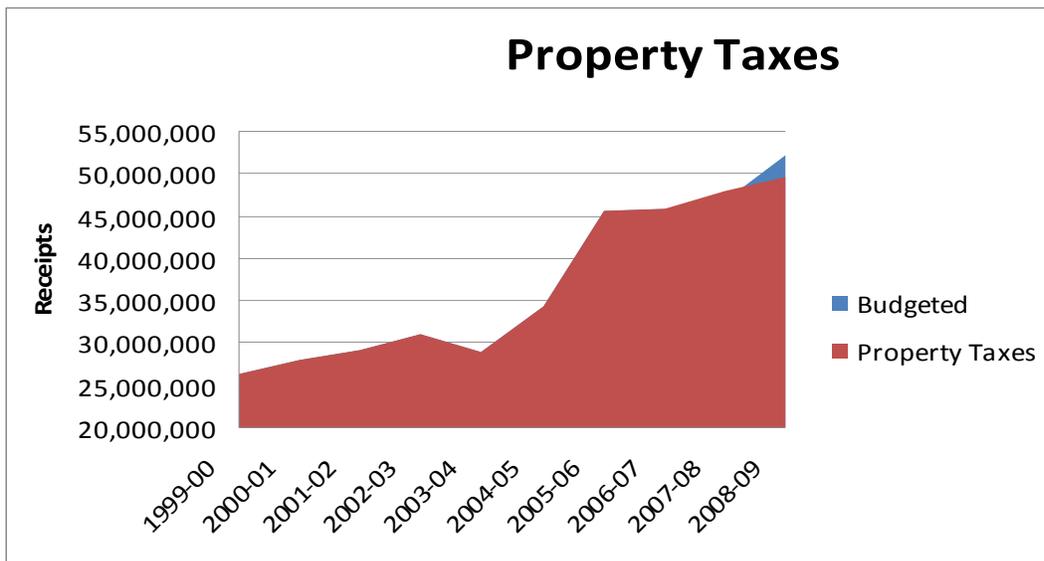
As discussed last June, staff forecasted that fiscal year 2009-2010 would be very difficult, if the County didn't see a strong upswing in the local and state economies. Unfortunately, just the opposite occurred. The state, national and global economies have fallen sharply and the general prognosis, among economists at all levels, is that we are entering into a deepening and prolonged global recession.

County tax receipts always lag behind the economy, ranging from 6 months for sales taxes to more than a year for property taxes. Economic activity is expected to be worse

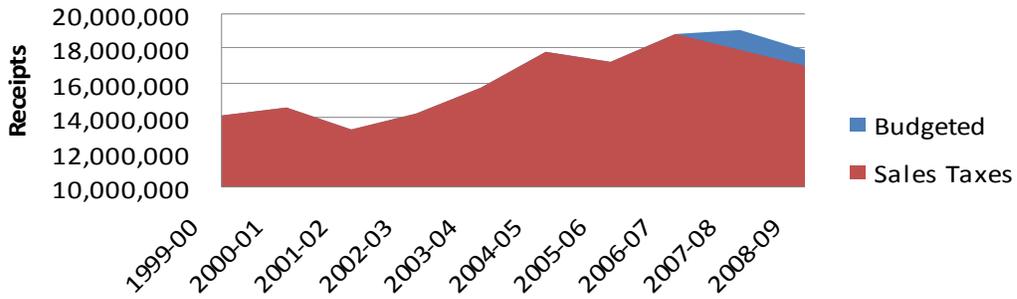
in 2009 than in 2008. Therefore, staff is forecasting further declines in revenues next fiscal year than we are experiencing this fiscal year. The following fiscal year looks equally bleak or worse, due to the property tax collections lag following re-evaluations, and recent news from CalPERS that the County can expect a 4% of payroll cost increase to the County's pension obligations beginning July 1, 2010, if CalPERS' current 21% asset loss holds up through the balance of the fiscal year.

Ten-Year Trends of these Important Funding Sources

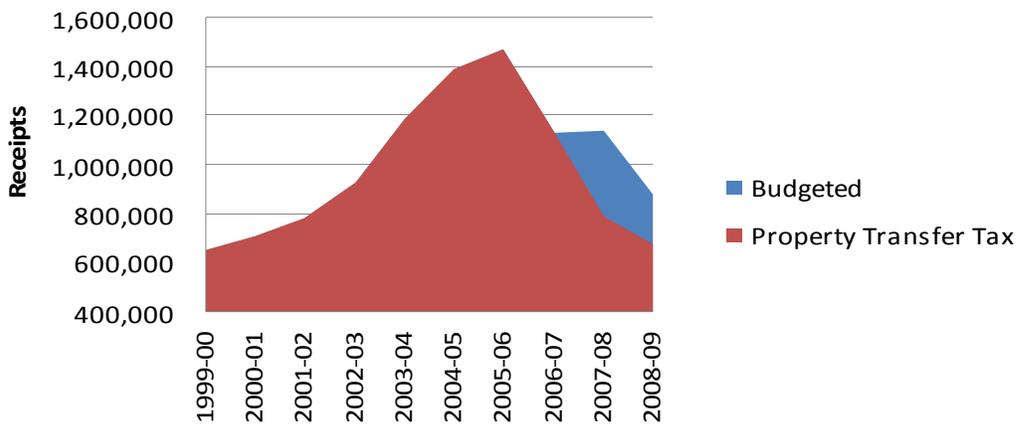
The following graphs illustrate the ten year trend of the aforementioned revenue sources. It should be noted that some revenues were impacted by the economic downturns following the dot.com bubble bust in 2000 and then the subsequent downturn that followed in 2002 after the attacks of September 11, 2001. It should also be noted how the County didn't fully feel the impacts of those downturns due to the rise of the housing and property value bubble and the increased growth in property tax revenues realized over a relatively short period of time. Everyone is just now starting to see an even deeper downturn in the economy. The housing value bubble has burst and there are no indications of any other economic growth to benefit the County's finances in the near future. Therefore, the County should expect the declines in the graphs to continue downward through the next couple of fiscal years.



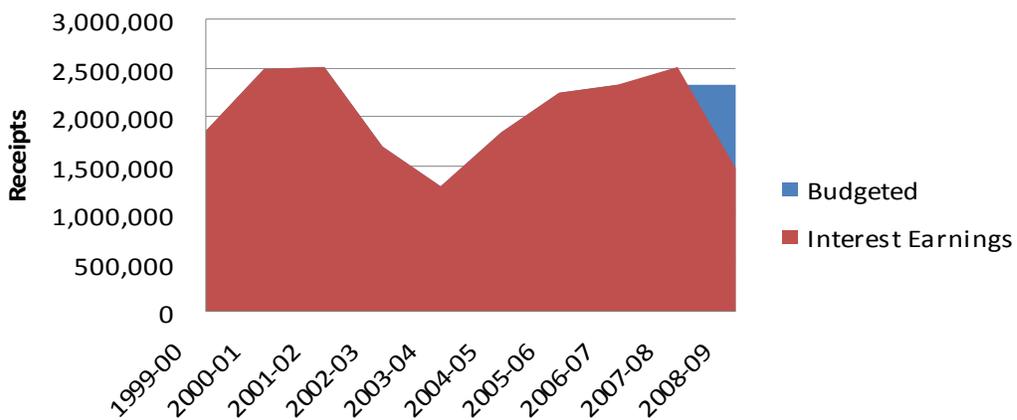
Sales Taxes



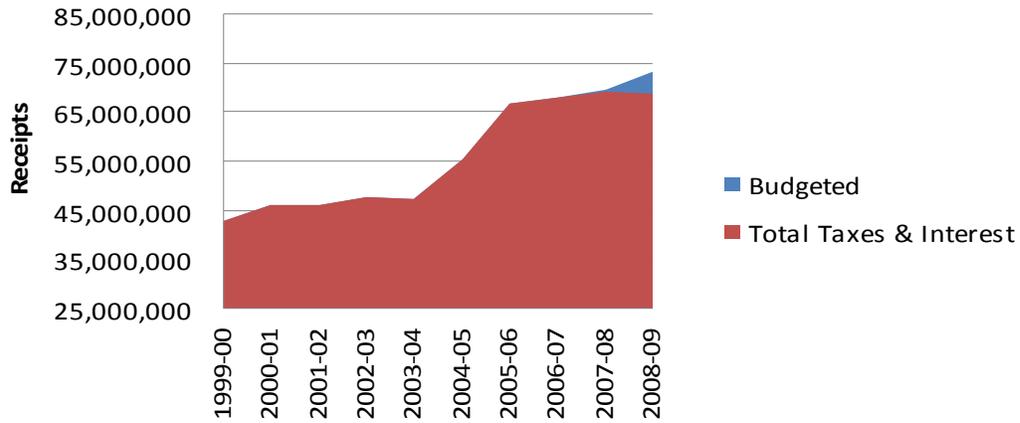
Property Transfer Taxes



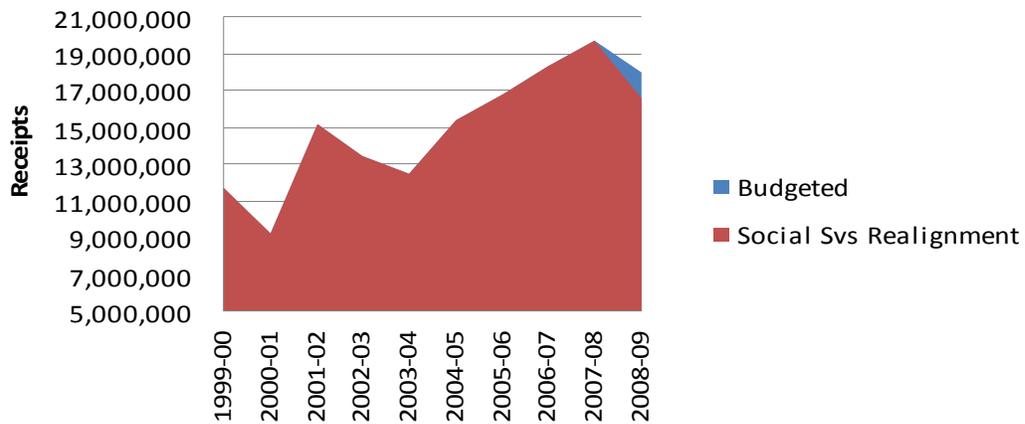
Interest Earnings



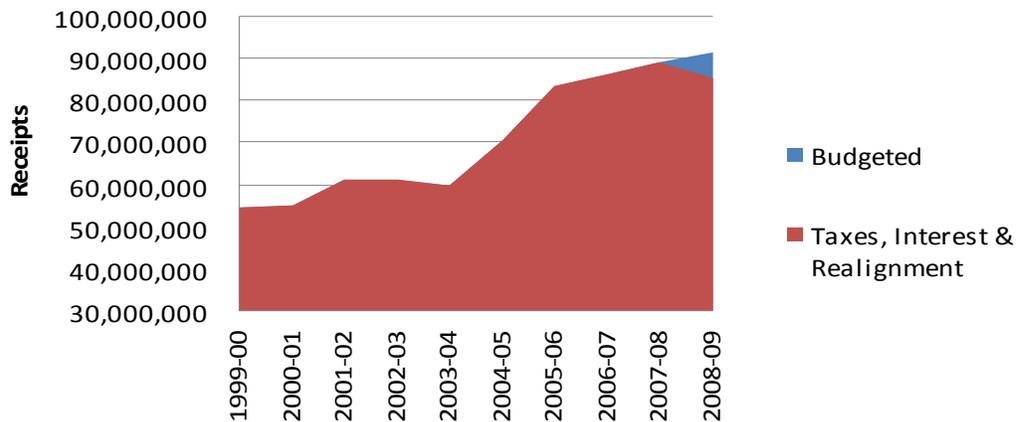
Total Taxes and Interest Earnings



Social Services Realignment



Taxes, Interest & Realignment



Given the drop in discretionary revenues that began at the end of last fiscal year, compounded by the additional expected loss of about \$6 million this fiscal year, and the expected further decline next fiscal year, we are forecasting a fiscal year 2009-2010 structural deficit of discretionary revenues in the neighborhood of \$10 million. To put this range in perspective, the County relied on \$86 million of general purpose revenue to pay for expenses last fiscal year with 72% of that amount spent on public safety and most of the rest going towards state mandates and popular community services such as libraries and veterans services.

It is important to note that the County receives many government grants and allocations for non-mandated programs, with local matches of general purpose revenue required to obtain the allocations. Therefore, a reduction of \$10 million in general purpose revenue will likely result in the loss of other revenues which may be of an equal or greater amount. Since the County is a service organization, dependent upon many revenue sources affected by the economy, the County can expect significant impacts to important services for the foreseeable future.

Several difficult actions will be needed to address the impending structural deficit the County is facing in the next budget cycle. To get started on it, we recommend that the Board begin and conclude its budget process early, so that we minimize long-term impacts on County services and employees.

- ***What does all this mean?*** It means that the County will need to take several difficult actions to address the impending structural deficit we are facing in the next budget cycle.
- ***What can be done about this?*** The Board can begin and conclude its fiscal year 2009-2010 budget process early, to minimize long-term impacts on County services and employees.

Suggested Actions

A broad array of immediate actions may be taken to ensure sufficient liquidity in the County's operating funds, curtail current year spending, improve revenue collections, and adjust to a new economic condition. Suggested actions for the Board of Supervisors include:

- Direct staff to increase advocacy efforts at the State Capitol to push State agencies for a much quicker reimbursement timeframe.
- Authorize staff to borrow internally among otherwise restricted fund balances with direction to make repayment by June 30, 2009.

- Ask the Board's Finance Management Options Committee to re-evaluate the use of fiscal and other County staff in light of new reporting and financial management demands.
- Implement a hiring review wherein County Administrative Officer approval is required before any recruitment or offer of employment is made to ensure it does not further deteriorate the County's financial condition.
- Implement an overtime review, wherein the County Administrative Officer or his designee must review and concur in advance of any overtime usage, to ensure it does not further deteriorate the County's financial condition.
- Implement an extra help review, wherein the County Administrative Officer or his designee must review and concur in advance of any use of temporary extra help, to ensure it does not further deteriorate the County's financial condition.
- Implement a fixed asset purchase review, wherein the County Administrative Officer or his designee must review and concur in advance of any fixed asset purchase, to ensure it does not further deteriorate the County's financial condition.
- Implement an extraordinary contract review, wherein the County Administrative Officer or his designee must review and concur in advance of any contract execution exceeding \$600, to ensure it does not further deteriorate the County's financial condition.
- Direct staff to consider deferment of capital improvements and vehicle purchases that involve discretionary dollars and bring specific recommendations to the Board for approval.
- Direct the County Administrative Officer to prepare a recommended allocation of "Required Expenditure Savings" to each department receiving discretionary revenue, beyond mandated Maintenance of Effort levels, and to bring specific recommendations to the Board for approval.
- Direct staff to change the calendar for adoption of the fiscal year 2009-2010 budget, to allow for staffing changes to take effect in July 2009 for a full twelve months of expected cost savings.
- Direct staff to explore midyear staffing reductions, tied to current revenue declines, and bring specific recommendations to the Board prior to or concurrent with the midyear budget review.
- Transfer \$29,596 from the General Fund (Contingencies) to the Child Support Services Fund to reimburse the department for expenses related to staff time dedicated to the summer fire responses.

- Transfer \$25,000 from the General Fund (Contingencies) to the Public Defender cost center in the Non-Departmental budget unit for unanticipated costs incurred to date.
- Transfer \$1.2 million from the General Fund (Contingencies) to the Butte Lightning Fire cost center of the Non-Departmental budget unit for unbudgeted costs incurred from fire response and recovery activities.

Other Risks This Fiscal Year

The State of California has recently revised their current budget deficit from \$3 billion to \$10 billion, and the Governor is calling the State Legislature into a special legislative session beginning November 5, 2008. State financial forecasters are clearly responding to similar revenue decline trends and economic data that the County and other California agencies are observing. Since the County relies heavily on State subventions for most of its budget, staff expects additional risk and potentially additional budgetary impacts this fiscal year if and when the State comes to terms with its increasing budget deficit.

One action that the State Legislature may feel pressured to take to suspend Proposition 1A, and subsequently, transfer County property tax revenues away from the County this fiscal year. The impact to the County certainly depends on the prescribed methodology, but based on past methods the impact would probably be about \$3 million additional general purpose revenue loss this fiscal year.

Summary

The Administrative, Finance, Treasurer and Auditor offices were joined by fiscal staff in all County departments to conduct a thorough review of the County's financial condition, including current year budgetary status, cash situation, credit position, and its outlook for the new budget year commencing July 1, 2009. The County is not alone in facing these unprecedented challenges on three tough financial fronts. Governments and businesses, at all levels worldwide, are facing these same challenges. The review of all three fiscal arenas concludes with the following findings:

- The County needs to conduct internal short-term cash borrowing to ensure sufficient cash for daily operations through June 30, 2009.
- The County, and other municipalities, will have new challenges when seeking cash flow loans and selling bonds for capital, pension, and/or other obligations. Staff efforts will need to be redirected to minimize new credit costs.
- The remaining \$3 million of General Fund contingency will be needed to offset unanticipated department expenses and under-realized department revenues.

Much of these adjustments are due to the summer fire responses and recovery efforts.

- The County needs to find an additional \$6 million in General Fund budgetary solutions this fiscal year, due to the sharp economic downturn's impact on tax and other discretionary revenues. Since the County is a service organization that must maintain a balanced budget, these solutions are expected to significantly impact important services, County residents, other customers and County employees.
- Total budget deficit for this fiscal year adds up to \$10 million.
- The County is facing a structural budget deficit next fiscal year that is currently pegged at \$10 million. This estimate will be revised after the first installment of property taxes is collected in December and another three months of sales tax data is received.

The County is fortunate to have an experienced Board of Supervisors and professional staff to lead our community through these very difficult financial challenges. Collectively, we will fully and comprehensively respond to the economic downturn, while minimizing short and long-term impacts. We will need to wrestle with the State over their delays in reimbursements. We will need to contemplate all ideas for solutions, leaving no rock unturned. We will maintain a balanced budget this fiscal year and next. Thereafter, when we are through this storm, the County organization will be lean, but in a position to strengthen its financial condition when the economy eventually turns around.