

**NAPA COUNTY
5-YEAR GENERAL FUND
FORECAST
PREPARED IN FISCAL YEAR 2023-24 FOR
FISCAL YEAR 2024-25 THROUGH 2028-29**

Introduction:

Napa County has a history of financial stability and fiscal prudence, which results in services that are provided consistently. The **5-year General Fund Forecast** (5-year Forecast) is one of the tools to support prudent fiscal planning. The **5-Year Forecast** is updated annually and is used with the County's **Annual Budget Policy Guidelines** to develop the annual Recommended Budget. The 5-Year Forecast is not a preliminary budget.

Each year, as part of the annual budget process, staff provides the Board with a forecast of what the General Fund's financial condition could look like over the next five years. This is important because revenue and expenditure decisions that are made in the budget year can have a significant impact on future year General Fund resources and obligations.

The 5-Year Forecast provides the Board with a representation of the General Fund outlook. The projections assume that the county will maintain the existing levels of service. The projection also assumes there will not be legislative changes that will affect revenues or programs and our adopted policy structure will remain constant during these five years. The figures provided in the 5-Year Forecast are based on high-level assumptions. Projected amounts are intended to show general trends and are not preliminary budget figures.

Forecasting Methodology:

Forecasting revenues and expenditures is always uncertain. The economy appears to be strong. Staff does not expect a recession to occur in the next twelve months. For the purposes of this report, future years' projections are based on the Adopted Budget for FY 2023-24 General Fund revenue and expenditures. In addition, the report makes several assumptions about what will happen over the next five years including inflation rates, state budgets, and economic conditions. This forecasting methodology does not include any capital improvement projects, Federal Emergency Management Agency (FEMA) reimbursements or insurance proceeds. The report does, however, include the estimated cost of previously identified board priorities such as general fund contributions to fire protection, climate action and groundwater.

Economic Conditions:

Inflation rates have cooled over the previous year. Prices in the San Francisco Bay area, as measured by the Consumer Price Index (CPI), were up 2.8 percent over the previous year,

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according to data from the US Bureau of Labor Statistics. Nationally, the CPI was up 3.1% over the previous year. Surveys of consumers also show inflation expectations to moderate in the coming year. Inflation expectation is a major indication of future inflation. The Federal Reserve has signaled it may reduce interest rates from its current decades-long high. The increase in interest rates have slowed the housing market and discouraged firms from undertaking major investments due to increased borrowing costs. Household spending and low unemployment, combined with positive jobs numbers have continued to keep the US economy out of a recession. Real Gross Domestic Product (GDP) growth has remained positive as of the last quarter of 2023 at an annual rate of 3.3%. Real GDP growth is largely driven by consumer spending. There are no major “bubbles” on the horizon, which could lead to a recession. The national economy also appears to be stronger than the state economy.

A potential area of concern is the states’ fiscal condition. Due to significant revenue decline in Fiscal Year 2022-23, the state expects a budget deficit of approximately \$68 billion dollars. Increased interest rates have resulted in higher borrowing costs. This has resulted in less investment in California startups and technology companies—which have an outsized role in the state’s budget. In recent years there has been a significant decrease in the number of California companies’ initial public offerings. Since the state heavily relies on high wealth households, anything that reduces the wealth among these households also reduces the state’s budget.

The state legislature may seek to reduce one-time expenditures to respond to the budget shortfall. Napa County’s General Fund, however, is mostly protected from changes in the state’s budget. Napa County’s General Fund largely relies on Property Tax, which is not impacted by the state’s budget woes. Despite this, the state budget shortfall may still impact the General Fund. With a budget shortfall, the State Department of Finance and state legislature may be less likely to support a legislative fix to the Vehicle License Fee issue. Should this happen, the county will lose approximately \$29 million in revenue annually.

Local sales tax receipts are mostly stagnated, despite increases in inflation. The local hotel industry saw a decline in average daily room rates and occupancy rates in 2023. The industry forecasts modest recovery into 2024. The wine grape pricing for Napa County remains strong and above neighboring counties. Like the state, Napa County’s population continues to decline. The tight labor market locally continues to hamper business expansion. Although a declining population does not directly impact the General Fund, it does impact recruitment and retention of county staff. Other impacts include Napa volunteer fire companies struggling to find able bodied volunteers, school closures, and departments struggling to fill vacancies. Younger, lower educated and lower income residents continue to leave Napa at higher rates, while the older and higher educated remain or move into Napa.¹

¹ Beacon Economics, November 2023

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Baseline assumptions:

The baseline forecast assumes a sustained, existing level of service. General Fund contributions for fire protection, climate action and groundwater are in the projection. This forecast assumes its Annual Budget Policy Guidelines. The baseline forecast also assumes that most outside resources will increase at the current pace to continue to fund program services. The baseline includes a conservative revenue growth estimate. Particularly, staff expects both sales tax and transient occupancy tax grow little, or not at all, for the coming two years before modestly recovering.

Napa County's Budgeting Practices:

The General Fund Budget mostly consists of Salaries and Benefits, Services and Supplies, and Other Expenses. Napa County budgets assuming that all positions will be filled for the entire year with the full weight of their benefit costs. Then a vacancy factor is calculated to account for turnover and hiring lags. The difference between budgeted amounts for salaries and benefits and actual expenditures varies from year to year. Napa County budgets and encumbers the maximum cost of executed contracts. When the total amount allowed to be spent in a contract is not used, it creates savings. Napa County budgets a conservative savings to ensure that actual savings are higher than what we projected.

Revenue projections:

Below are Napa County's primary General Fund revenue sources:

- Secured Property Tax revenues are expected to grow 3-4% during the forecast. This is by far the largest and most important General Fund revenue source. This revenue source is also exceptionally stable.²
- Unsecured Property Tax revenues are expected to grow at 2% for each year of the forecast.
- Property Taxes-Vehicle License Fee Swap (VLF) is projected at \$27 million in Fiscal Year 2023-24 and \$29 million in Fiscal Year 2024-25. Pending any legislative change, county staff anticipates that Fiscal Year 2024-25 could be the final year that Napa receives Property Tax-Vehicle License Fee Swap. No legislative fix has been achieved to date and the state's budget challenges make backfilling the loss less likely.
- Supplemental Property Tax revenue is projected to grow at 4% each year of the forecast.
- Sales Tax revenue is based on projections provided by the County's independent tax consultant. Sales tax is expected to remain relatively flat in Fiscal Year 2024-25 and

² For a description of secured and unsecured property taxes see: <https://www.countyofnapa.org/1206/Secured-Unsecured-Taxes>

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Fiscal Year 2025-26. Modest increases in sales tax are anticipated beginning in Fiscal Year 2026-27.

- Transient Occupancy Tax revenues are expected to slightly decline in Fiscal Year 2023-24 and Fiscal Year 2024-25. Modest increases in Transient Occupancy Tax revenues are expected after Fiscal Year 2025-26.
- Other discretionary revenues are based on Fiscal Year 2022-23 adopted budget with a 2-3% growth assumed per year. This includes items such as Franchise Fees for Public Utilities.

Napa County's primary revenues are Property Tax, Sales Tax and Transient Occupancy Tax. Sales Tax and Transient Occupancy Tax are each roughly \$15 million in revenue annually. Property Tax Secured, however is three times larger than Sales Tax and Transient Occupancy Tax, combined. Property Tax Secured is projected at over \$90 million through the 5 years of this forecast and is an exceptionally stable revenue source. Sales Tax and Transient Occupancy Tax, which the county relies on less, is significantly more volatile. Fiscally, the Napa County General Fund's primary strength is the size and stability of its Property Tax Secured revenue.

Expenditure projections:

The projections assume existing levels of service (including staffing and program costs) and assume that expenses will grow.

- Salary and Benefits are projected to increase at 3% in Fiscal Year 2024-25, which is roughly in line with inflation. Salary and Benefits are the largest General Fund expense. Salary and benefits costs spiked in Fiscal Year 2021-22, Fiscal Year 2022-23 and Fiscal Year 2023-24 due to equity pay increases, wage inflation and adding new employees to the county. Staff expects that the pace of this increase in salary and benefit costs will moderate in Fiscal Year 2024-25 as inflation cools.
- Services and Supplies assumes growth of 3% for the first few fiscal years, then staff expects this expense to decline with inflation.
- Other Expenses
 - Operating cost increases for the new jail – these are expected to start this fiscal year at \$707,000. Once the new jail is fully operational, the annual cost are estimated at \$2.8 million with growth of 4% per year assumed. This cost is higher than inflation due to increased General Liability expenses.
 - The forecast includes costs to start addressing high priorities, including implementing the American with Disabilities Act (ADA) Transition Plan for accessible services, cyber security, groundwater, and the county's participation in regional climate action planning. These four costs amount to approximately \$3.2 annually and estimated to grow steadily in subsequent years.
 - General Liability expenses continue to grow each year without a clear signal when these costs may ease. This is due to market factors that are impacting all

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jurisdictions. General Liability costs to the General Fund from Fiscal Year 2023-24 to Fiscal Year 2024-25 have increased by over a million dollars.

- The General Fund contribution to fire protection is projected at \$6 million annually and staff expects that this will increase by roughly \$500,000 each year. This is due to the Property Tax revenue dedicated for Fire not keeping pace with the cost of the CalFire contract. The General Fund contribution to Fire also includes funding for mitigation and vegetation management. Not included in this projection are the costs due the Federal Emergency Management Agency (FEMA) Building Resilient Infrastructure and Communities (BRIC) Grant. FEMA will reimburse the county at 75% for all eligible BRIC expenses. The \$6 million annual General Fund contribution to Fire includes the county's cost share of the BRIC and any other FEMA grants. The county will not be able to use its reimbursements until after the grant has expired in Fiscal Year 2026-27. This will create a cashflow issue but does not represent a structural challenge to the General Fund. This will not be a structural challenge to the General Fund because it will be a one-time infusion of resources to support the BRIC grant, and not an ongoing obligation.
- Debt payments for county facilities is included in this forecast. Debt payments to construct or rehabilitate county facilities, such as the Administration Building, are projected at \$9 million annually through the 5-years of the forecast. This cost will extend beyond the 5-year scope of this forecast and is estimated to last for 30 years.

The Condition of the General Fund:

After accounting for all these assumptions, the forecast shows that the General Fund is structurally sound. However, this is based on certain assumptions. Fiscal Year 2024-25 will likely be the last year that the county receives Vehicle License Fee (VLF) revenue. That year, 2024-25, VLF revenue is projected at \$29 million. Excess ERAF is projected at \$40 million. The following year 2025-26, VLF will be \$0 and Excess ERAF is projected to increase to \$50 million. Past County practice has treated Excess ERAF as one-time revenue. The recently adopted Annual Budget Policy Guidelines allow revenues which have been received for multiple consecutive years to be treated as ongoing revenues. It also allows the General Fund flexibility to support certain board priorities as a short-term mitigation measure while the county works with its State legislative delegation on a permanent legislative fix to the VLF issue.

Inflation has cooled which has slowed some of the impetus that was driving the cost of salary and benefits. In recent years, salary and benefits growth was outpacing revenue growth. Assuming salary and benefits remain within an annual inflation rate of 3%, staff projects that this cost will be within the General Fund revenues' ability to absorb. Significant expenses to the General Fund include fire protection, debt payments for county facilities, operating the new jail, climate action and groundwater.

The chart below shows the forecast's potential surplus or deficit in each fiscal year. This forecast assumes the County will not receive VLF revenues starting in Fiscal Year 2025-26, will

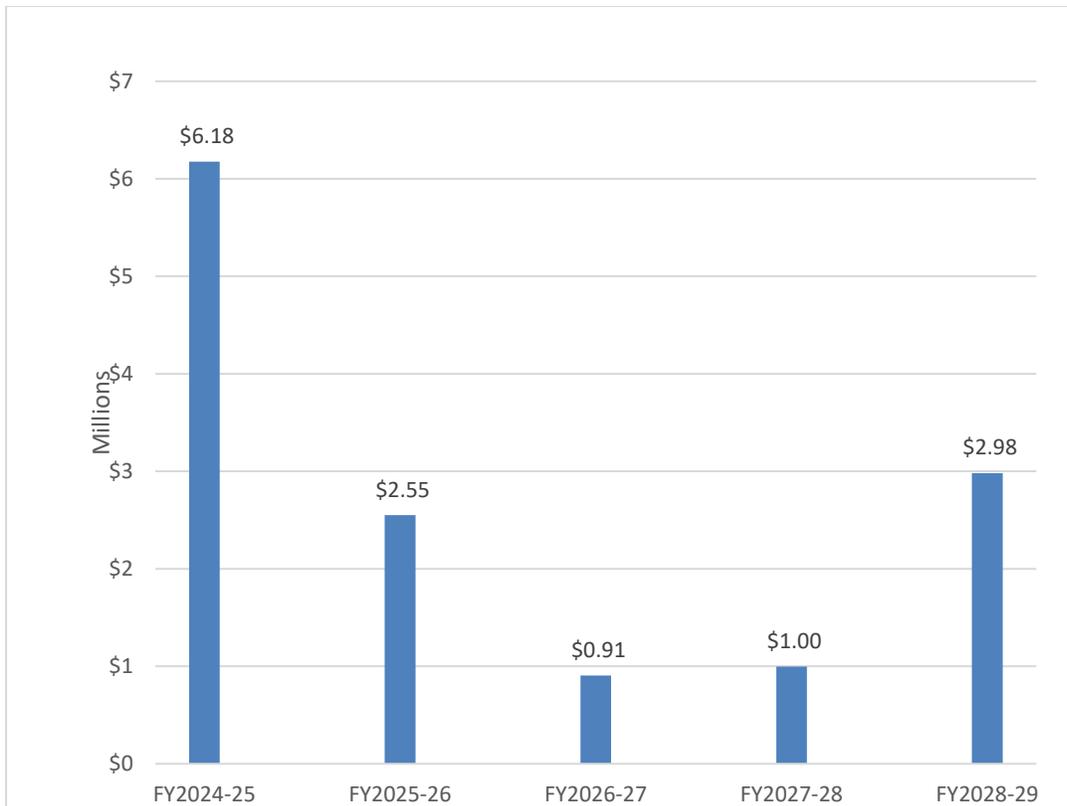
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treat Excess ERAF as an ongoing revenue, adds the cost of operating the replacement jail, assumes a large General Fund contribution to fire, debt payments for county facilities, among other costs mentioned above. This projection estimates modest growth, but no major recession.

Chart 1: Potential Surplus or Deficit of the General Fund

	2023-24	2024-25	2025-26	2026-27	2027-28
Potential Surplus or Deficit	\$6,177,000	\$2,549,000	\$905,000	\$996,000	\$2,982,000

Graph 1: Potential Surplus or Deficit of the General Fund



The forecast shows a dip in Fiscal Year 2025-26 attributed to anticipated debt payments for county facilities. Staff has estimated that this expense could be approximately \$9,000,000 annually. This forecast has intentionally not included a recession. The current US economy does not appear to have any major “bubbles” which could tip the economy into a recession. Were a recession to occur, Napa County’s General Fund would not be heavily exposed to the slowdown. The reason is that, on the revenue side, a recession would mostly impact Sales Tax and Transient Occupancy Tax which are more volatile. Property Tax Supplemental, meanwhile, would not likely decline. Median home sale prices did fall from 2022 to 2023, this did not

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tamper the county's revenue from Property Tax Supplemental. The significant housing shortage has kept the base value of property values high. Additionally, a recession would moderate the growth in major county expenses, specifically labor costs.

Identified unmet needs:

Throughout the year, the Board identifies unmet needs. These are included in the 5-Year Forecast so that the list can be reviewed and updated annually. Some of these priorities may have potential revenue sources beyond the General Fund, which would be used to meet these ongoing funding needs.

Board identified priorities:

- Fire Protection and Resilience
- Affordable housing, including family farmworker housing and homeless services
- Americans with Disabilities Act Transition Plan implementation
 - Facilities improvements
 - Website accessibility
- Cyber security
- Capital Improvement Projects
 - Road improvements
 - Major maintenance of Napa County facilities
 - Culvert and bridge maintenance
 - New County Administration Building
- General Plan update
- Preparing and implementing Climate Action and Resiliency strategies
- Groundwater

Conclusion:

While the General Fund is currently structurally sound, the anticipated loss of VLF revenue, beginning as early as FY 2024-25, will pose long-term challenges to future County operations unless addressed by the State Legislature. In preparation for the loss of this revenue, the Board has recently approved changes to the Annual Budget Policy Guidelines to provide greater flexibility in the use of General Fund resources for County priorities as a short-term mitigation measure for the VLF loss while the County works with its State legislative delegation on a permanent legislative fix. The General Fund has capacity to address some of the board's priorities and significant county expenses. Among these priorities are fire protection, climate action, groundwater, increased operating costs of the new jail, Americans with Disabilities Act implementation, cyber security, and debt payments for county facilities. The General Fund

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does not have capacity to absorb significant costs beyond these identified priorities, or to significantly expand existing service levels.