NAPA COUNTY
5-YEAR GENERAL FUND
FORECAST
PREPARED IN FISCAL YEAR 2021-22 FOR
FISCAL YEAR 2022-23 THROUGH 2026-27

Introduction:

Napa County has a long 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 fiscal prudence. The **5-Year Forecast** is updated annually and is used in with the County's adopted **Strategic Plan**, the five-year **Strategic Financial Plan**, and the annual **Budget Policies** to guide the annual Recommended 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 results of the Five-Year Forecast are used, along with the County's multi-year Strategic Financial Plans to guide how we prepare the annual Recommended Budget.

The 5-Year Forecast provides the Board with a representation of the General Fund outlook. The projections are based on continuing the existing level of service and known variables. The projections also include some of the Board's priorities such as Fire protection. The projection 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 an uncertain project. This is especially the case given recent inflation and the ongoing economic impacts of COVID-19. For the purposes of this report, future years' projections are based on the Adopted Budget for FY 2021-22 General Fund revenue and expenditures. In addition, several assumptions are made 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.

Regional Economy:

The economic impacts of the COVID-19 pandemic are ongoing while the North Bay economy has rebounded strongly. Visitors have begun returning to Napa County, although foreign travel and large conferences remain limited. Labor shortages continue to hamper business growth, particularly in the leisure and hospitality industries. The Napa County unemployment rate remains low (4.2%) though the labor force remains 2.7% below pre-pandemic levels. Local businesses are having difficulty hiring and retaining employees. Inflation has increased nationally, with the consumer price index climbing to 7% in 2021 which was the largest increase in over 30 years. This increase in inflation has temporarily eroded the purchasing power of households and was led by higher prices for housing, shortages of certain goods, and used vehicles.

The County of Napa has continued to see double digit percentage increases in the median price of homes. Meanwhile, the Federal Reserved has signaled it may increase interest rates multiple times in the calendar year 2022. This increased interest rate would increase the cost to borrow for households and firms. The higher borrowing costs could tamper consumer demand for higher cost items such as automobiles and real property, potentially impacting sales tax and property tax. Recent volatility in the stock market in early 2022 could, however, impact whether the Federal Reserve increases interest rates.

Finally, the State of California's budget has seen strong growth. Since State coffers are so strong, reductions in state programs are unlikely in the next fiscal year.

Baseline assumptions:

The baseline forecast assumes the existing level of service. This forecast assumes that the Board will continue to maintain the fiscal approach set forth in its Budget Policies.

The baseline forecast also assumes that most outside resources will increase at the current pace to continue to fund program services, and there is no incremental encroachment on the General Fund. The baseline includes a conservative revenue growth estimate and increases the additional annual operating costs for the replacement jail beginning in FY 2023-24 estimated at $1 million initially, then once it has been fully staffed for an entire year the cost is estimated at $4.89 million. Fire protection is included as an expense in this forecast.

The current calculations do not include a potential proposal to use $10 million dollars of the County's $26.8 million American Rescue Plan Act funds for general government services. If the county used a portion of this $10 million standard allowance for general government services, it could free up resources to address additional Board priorities.

Napa County's Budgeting Practices:

The basic categories of General Fund expenses in Napa County's budget: Salaries and Benefits, Services and Supplies, and Other Expenses.

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Napa County budgets positions 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 normal turnover and a hiring lag for those departments with over twenty employees. The difference between budgeted amounts for salaries and benefits and actual expenditures varies from year to year. The actual expenditures show that General Fund salary savings has averaged 3.75% annually over the last decade. Napa County enacted a selective hiring freeze in response to the COVID-19 Public Health Emergency, which has artificially inflated salary savings in Fiscal Years 2020-2021 and 2021-22. In Fiscal Year 2022-23 staff does not expect salary savings to be as high as it has been in previous fiscal years. The forecast assumes a 3-4% average of salary and benefits appropriations to be available each year as salary savings to fund the budget for the following year.

Napa County budgets and encumbers the maximum cost of all executed contracts. When the total amount allowed to be spent in a contract is not used, it creates some savings. When comparing the budget to actual activity, the percentage difference has averaged 11% annually in unspent appropriations since 2012-13 and varied significantly. We are using a more conservative 7% assumption of services and supplies savings.

Revenue projections:

Taking what economists are projecting for the economic recovery, the current state of the local housing market, and State and Federal budgets into consideration, we assume that revenue will grow during Fiscal Year 2022-23.

- Secured Property Tax revenues are based on the 2021-22 extended tax roll with a 3% growth assumption for all 5 years. These projections are supported by data provided by the County Assessor.
- Unsecured Property Tax revenues are based on the 2021-22 extended tax roll with a 2% growth for all 5 years. These projections are supported by data provided by the County Assessor.
- Property Taxes-Vehicle License Fee Swap (VLF) revenue projections are based on the 2021-22 adopted budget with a growth rate that mirrors Secured Property Taxes. We anticipate that the County's only remaining non-basic aid school district will turn basic aid in Fiscal Year 2023-24. Pending any legislative change, this will eliminate the only remaining statutorily defined funding source and will significantly impact the County, as well as our cities and town.
  If the state follows its past practice, the anticipated result is a sudden two-year lag in receiving these revenues, which is reflected in the forecast as a loss of $24M in Fiscal Year 2023-24 and $25M in 2024-25.
- Supplemental Property Tax revenue projections are based on the 2021-22 adopted budget with a 3% assumption for years 1 through year 5. This is supported by data provided by the County Assessor.

- Sales Tax revenue is based on projections provided by the County's independent tax consultant. Sales tax across the state has grown significantly with average annual growth projected around 4%.
- Transient Occupancy Tax revenues are estimated to be higher than 2021-22 budgeted figures. The current projection is based on data from Visit Napa Valley assumes that this revenue will be similar to the revenue seen in FY2015-16. This revenue is then projected to increase by 2% each year. This projection is, however, conservative because Transient Occupancy Tax is one of the more volatile revenue sources for the County.
- Other discretionary revenues are based on 2021-22 adopted budget with a flat or 2-3% growth assumed per year.

Expenditure projections:

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

- Salary and Benefits assumes growth of 4% per year due to salary inflation based on a five-year average Bay-Area Consumer Price Index for Urban consumers. This CPI generally incorporates basic economic expenses to map out increases to the cost of doing business in the local Bay-Area. Economists, such as Dr. Robert Eyler, expect that inflation will begin to moderate in the coming years with a growth of roughly 3% in calendar year 2023. An on-going County expense is its retirement benefits to employees. The County's Fiscal Year 2020-21 actual share of pension contributions was $30.8 million which makes up close to 6% of the County's overall budget. The General Fund portion of this cost is approximately $17.8 million which is 14.5% of the General Fund's Salary and Benefits. The amount the County pays into its retirement plan is partly influenced by changes in the California Public Employees Retirement System discount rate.
- Services and Supplies assumes growth of 4% per year. This projection is based on Consumer Price Index for Urban Consumers to cover increased costs for doing business through our internal service costs, contracted services, and supplies. Some of our contracted services have built in CPI inflators but not all. Although we expect that Services and Supplies will be lower than Salary and Benefits, we are projecting this expense higher to provide a more conservative forecast.
- Other Expenses – assumes growth of 1.5% per year, to cover increased operating costs consistent with the budget policies related to contributions to other agencies. This does not assume any transfers to Accumulated Capital Outlay because these transfers vary widely from year to year. This projection assumes that in Fiscal Year 2022-23, $2.2 million will be removed due to a 2012 refunding debt issuance being defeased. Additionally, in year three, $1.8 million will be removed when a 2014 debt issuance is paid off.

  - Operating cost increases for replacement jail – these are expected beginning in early FY 2023-24 at $1 million. Once the replacement jail is fully operating, the fiscal year cost is estimated at an additional cost of $4.89 million with growth of 4% per year assumed.
  - The forecasts include $2.5M in FY 2022-23, increasing to $4.2M in FY 2026-27 to start addressing high priorities, including implementation of the American with Disabilities Act (ADA) Transition Plan for accessible services, cyber security, homelessness, and the County's participation in regional climate action planning.
- Fire prevention – the current forecast includes the cost to implement the Community Wildfire Protection Plan (CWPP). This forecast assumes that no additional revenue will be received to meet this board priority. Without additional revenue for fire prevention, the Board may need to provide significant additional General Fund support for fire protection which will begin to erode core county services. The projection estimates an annual cost of $8.5—9.6 million, based on the Board adopted CWPP.

After accounting for all these assumptions, the forecast shows that the General Fund is structurally sound. This means that over the next 5 years the General Fund does not project long term expenses that will outpace the likely revenue growth.

Over the next 5 years, the General Fund will recover from the COVID-19 Public Health Emergency where revenues are expected to grow faster than expenses. However, this recovery is impacted by the potential two-year loss in VLF Swap revenues beginning in Fiscal Year 2023-24. Additionally increases in inflation, particularly for employee Salary and Wages might increase expenses faster than revenues in the coming fiscal years. The additional costs of operating the replacement jail and the costs to fire protection are additional significant expenses in the coming years. Without new dedicated revenue, the costs of fire protection may begin to significantly erode core county functions.

The below chart shows the forecast's potential surplus or deficit in each fiscal year. This forecast assumes the County will not receive VLF revenues for two fiscal years and will pay the cost of the Community Wildfire Protection Plan entirely from the General Fund. These two costs alone are roughly $34 million dollars annually. This projection estimates modest revenue growth with no recession.

	22-23	23-24	24-25	25-26	26-27
Potential Surplus or Deficit	$14,258,000	($21,980,000)	($18,763,000)	$9,334,000	$14,392,000

The forecasts reflect that if the VLF issue does not have a legislative fix, the County's General Fund would take a significant hit beginning in 2023-24.

Three Hypotheticals: Base Projections, Better Case, and Worse Case Scenario

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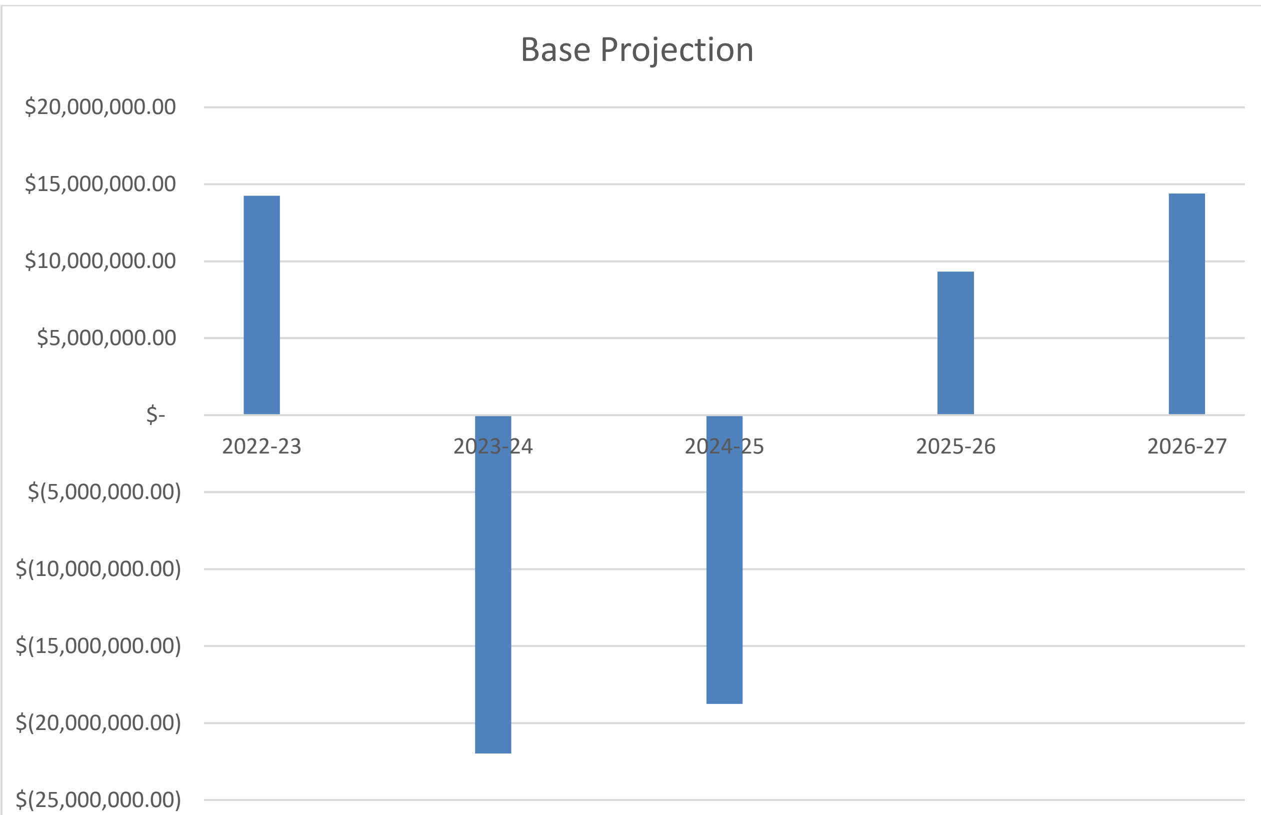
Base Projection:
The below base projection follows the assumptions described above. This projection assumes conservative but realistic revenue growth with no major recession over the next 5 years. This projection also assumes that there will be no legislative fix to the VLF. The projection furthermore assumes that there will be no dedicated new revenue for Fire protection and that the replacement jail will initially cost an additional $1 million, then will be $4.89 million once it is fully operational for a full year and that this additional cost will grow at 4% each year after that.



The deficit shown in FY2023-24 and FY2024-25 is due to no legislative fix from the VLF.

Better Case Scenario:

The better-case scenario makes similar assumptions throughout the base forecast with some major exceptions. This projection assumes similar conservative but realistic growth in revenue and expected growth in expenses. This projection also assumes no major recession in the coming 5 years. This projection, however, assumes that the VLF issue will have a legislative fix and that the County identifies a new dedicated revenue source for Fire protection. Finally, this projection continues to assume that the replacement jail operating costs would begin in Fiscal

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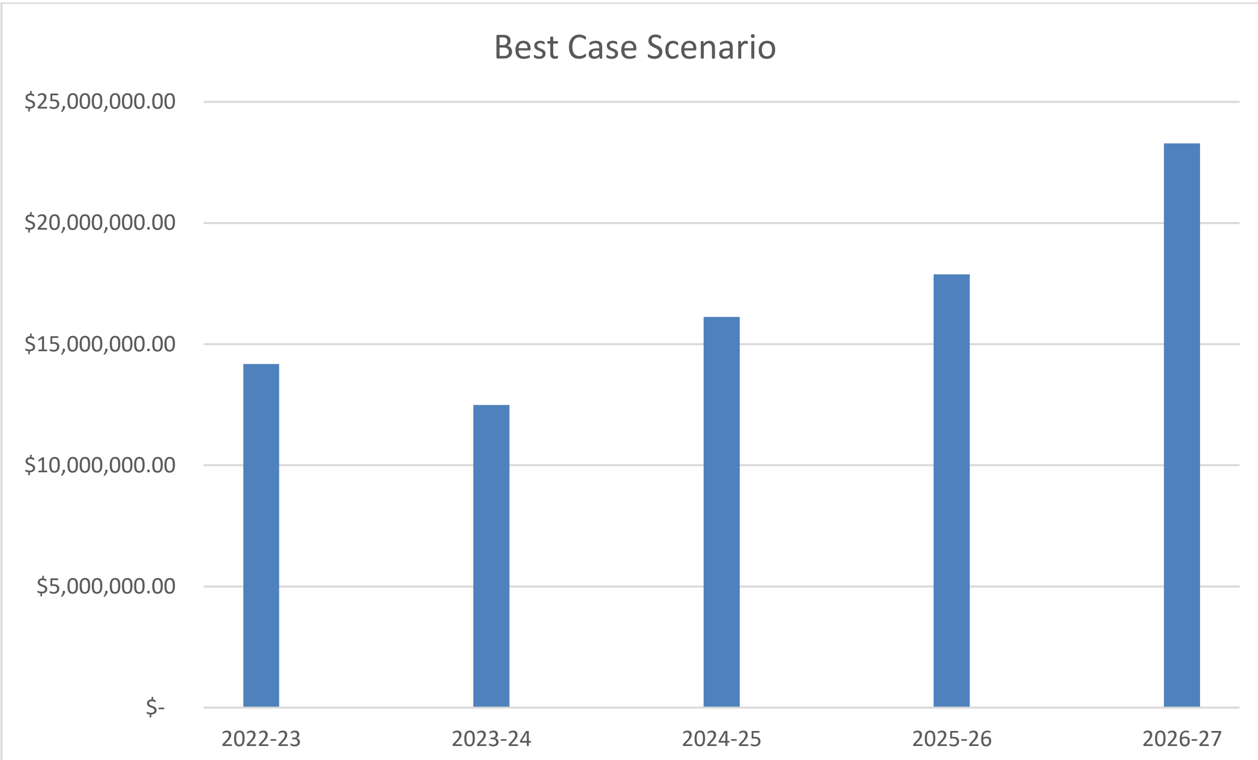
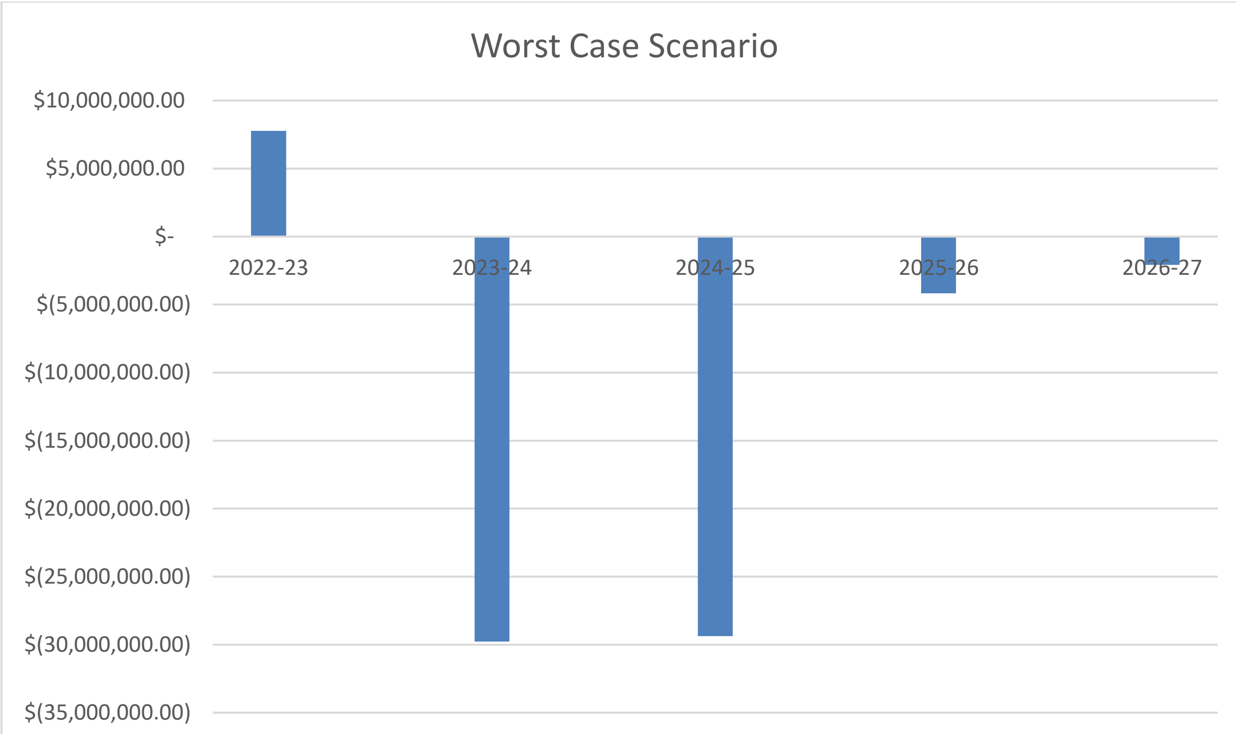
Year 2023-24 and once the jail is fulling operational will cost an additional $4.89 million annually and growing at 4% each year after that.



This projection sees revenue growth keeping pace and exceeding expenses over the coming 5 years. Much of this revenue could be used to address significant capital improvement needs to public facilities.

Worse Case Scenario:

The worse-case scenario makes similar assumptions throughout the base forecast with some additional major differences. This scenario assumes an economic slowdown in Fiscal Year 2023-24 which would see major County revenues (Property Tax, Sales Tax and Transient Occupancy Tax) declining by 3% in the first year, then declining or stagnating, while expenses would increase, over the next 5 years. This scenario also assumes that there is no legislative fix to the VLF issue and that there is no new dedicated revenue source for Fire protection.



This worst-case scenario is not intended to be a realistic projection. Economists do not expect a recession in the coming year. Nor do we expect a recession, were one to occur, to negatively impact County tax revenues this significantly. The purpose of this worse-case scenario projection is to show how resilient the General Fund may be to a confluence of negative impacts.

With the County not receiving over $50 million in VLF revenue, seeing major General Fund tax revenue declining by over 2%, while paying for the full cost of the Community Wildfire Protection Plan, the General Fund would experience major declines for years. This could require reductions in discretionary core county services and use of the Assignment for Fiscal Uncertainty.

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.

- One-time funding needs
  - The Alert and Warning program
  - Homeless services

- Affordable housing, including family farmworker housing
- Americans with Disabilities Act Transition Plan implementation
  - Facilities improvements
  - Website accessibility
- Cyber security
- Capital Improvement Projects
  - Major maintenance of Napa County facilities
  - Culvert and bridge maintenance
  - Road maintenance and repairs
  - New County Administration Building
- Circulation Element update
- Housing Element update
- Implementation of Climate Action and Resiliency strategies
- Childcare
- Fire Prevention and Water

Conclusion:

The General Fund is currently structurally sound. A cause for concern that is the significant, but potentially short-term impact of losing the Vehicle License Fee. Besides this, the need to provide General Fund support to fund the Community Wildfire Protection Plan would make the General Fund less resilient and could over time begin to erode core county services. Although the worse-case scenario is unlikely, if the County did lose VLF revenues, it could require use of the Assignment for Fiscal Uncertainty or making reductions to core county services.

County revenues have begun to recover strongly from the first year of the pandemic. However, inflationary pressures on employee Salary and Wages may grow faster than revenues in the coming years. It is, however, unlikely that County revenues would decline without similar declines in major County expenses. Inflationary pressures push County revenues, such as Sales Tax and Property Taxes high, but also push employee Salary and Benefits costs up. Similarly, if economic conditions depressed county revenues, there would be no upward market pressures on major county expenses such as Salary and Benefits.

It remains imperative that staff continue constant vigilance in implementing the Board's budget policies and that all requests for use of discretionary revenue, especially for on-going uses, be analyzed and carefully considered. It is also imperative that one-time resources continue to be used to address priorities that protect future service delivery, such as paying down the pension liability and investing in major maintenance projects to prevent costly system failures and increasing costs in the future.