Executive Summary

Introduction

"Making Orange County a safe, healthy, and fulfilling place to live, work, and play, today and for generations to come, by providing outstanding, cost-effective regional public services."

Through the 2010 Strategic Financial Planning process, the County of Orange (the County) continues to demonstrate a long-term commitment to due diligence, ensuring that demands for core services are met, critical opportunities are not missed, and sound financial principles are followed. The 2010 Strategic Financial Plan (the 2010 Plan, the Plan or SFP) was developed using Board developed guiding principles to establish priorities and vision.

The purpose of the Plan is to provide a long-term view of the County's fiscal position, including revenue sources and patterns, planned expenditures and other potential issues that could impact County resources and operations. The Plan, used in conjunction with the annual budget process and operating plans such as Departments' Business Plans and Balanced Scorecards, helps to ensure the County has developed the long-term financial position necessary to:

- Maintain services and programs at mandated and/or recommended levels
- Manage cash flows and maintain operational flexibility
- Protect and maintain infrastructure and other capital assets
- Ensure efficient use of resources
- Manage risk relating to debt and liabilities

The Plan establishes the framework for a five-year operating budget and prepares for the development of the next fiscal year budget with the caveat that assumptions used in developing the plan may change over time. Changes are addressed as early as possible, as part of the annual or quarterly budget process, or when timing is critical, presented directly to the Board as a separate agenda item. Even with known limitations, the five-year plan continues to be an excellent tool to enable the Board to act strategically and to forecast the financial impact of Board policy, actions taken by Departments, and external impacts such as Federal or State legislation, economic events, etc.

The 2010 Plan identifies the need to follow the process (begun in 2007) of trending down non-mandated spending and programs to continue on the path toward long-term financial stability. The County, along with other local governments, continues to experience significant impacts from the most recent recession and the prolonged recovery that appears to start, and then stall, only to pick up steam and sputter again. Even with the significant and targeted cuts that have been made since mid-2007, revenue growth has lagged growth in the cost of doing business. Since 2007, the County has balanced operating budgets using one-time sources.

Departments have been diligent during this period to reduce costs and maximize resources. Even so, the five year outlook is concerning as operating expense growth now outpaces revenue growth.

The incremental approach we have taken to glide down the County's budget will not be an effective strategy in the current environment. Long-term structural changes to achieve ongoing stability and flexibility is recommended.

The Process

"Looking ahead to ensure cost-effective and efficient methods while fostering a spirit of collaboration and partnership."

The primary focus of the SFP is on the portion of the General Fund, often referred to as the discretionary General Fund or Net County Cost (NCC), the funding source for those activities over which the Board has discretion. The non-discretionary portion of the budget contains mandated activities such as benefit payments to clients, which the County provides. Such activities are primarily funded with State and Federal revenues.

Preparation of the SFP involved compiling of various summaries and schedules including the Economic Forecast, General Assumptions related to costs, General Purpose Revenue Forecast, Fund Balance Available (FBA), Departmental Reserves, NCC Limits and Strategic Priorities. Departments provided input via their individual five-year SFP projections. Those projections included augmentations for service reductions ($304.8 million), requests to restore certain services ($299.5 million) and requests for service expansions ($22.7 million). Departments also submitted strategic priorities and capital project funding requests (NCC share) totaling $354.2 million and $52.9 million respectively, over the five plan years (see the Strategic Priority and Capital Project sections for further discussion).

Although the SFP focuses primarily on the General Fund, Non-General Funds require monitoring as well. The increasing costs of doing business will likely have significant impact on the long-term outlook for completing projects as well as claiming and billing for services rendered.

The SFP also addresses the General Fund Reserves Policy. This Plan includes proposed modifications to current General Fund reserve policies for Board consideration. Reserve policies are intended to provide flexibility in the maintenance and use of reserves and to reflect the County's continued commitment to sound fiscal policy. Healthy reserves have allowed the County to react to the depressed economy and declining revenues in a controlled manner. This year, other local governments with declining reserve balances experienced restricted strategic options and lowered bond ratings. A continued decline in County General Fund reserve balances and cash position over the last few fiscal years indicate a need to begin restoring balances and to proactively address the continuing growth in the cost of doing business (see the Reserves section for further discussion).

The County Executive Office compiled relevant economic data for use in preparing the County's 2010 SFP including:

- General Purpose Revenue forecast developed in conjunction with forecasts by the Auditor-Controller, the 2010-11 Local Assessment Roll of Values and receipt trends.
- Various projections for capital and operating inflationary factors, as developed by governmental or industry experts in the related field.
- Continued monitoring of economic forecasts published by Chapman University, California State University Fullerton, University California Los Angeles, the State Legislative Analyst Office and other sources.

The economic data, compiled in August 2010, was included as part of the 2010 SFP instructions. As the economy continues to fluctuate, and new information is known, some projections may become dated. Most of the economic data will require update by the time we begin the annual budget process. This is common with each Plan and Departments were cautioned to use the projection data as a source, to be monitored over time when preparing their individual plans.

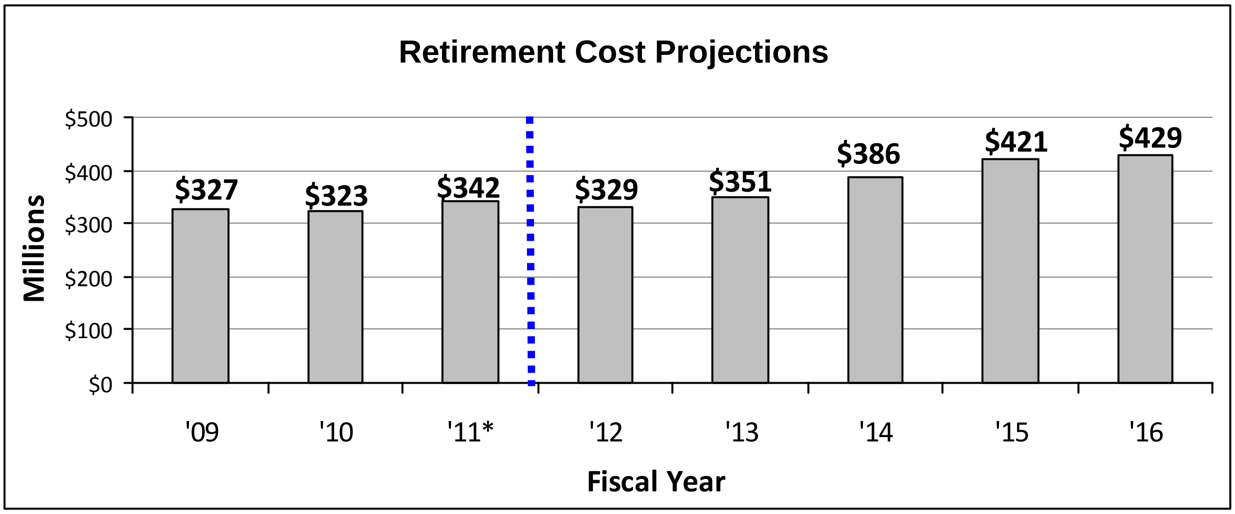
Departmental NCC limits are set for ongoing baseline operations (current level of services). FY 2011-12 NCC limits were calculated using the adopted FY 2010-11 limits ($686.2 million) as a starting point with amendments for technical adjustments, removal of one-time items, approved funding of augmentations and a **2% NCC reduction** to address ongoing economic challenges. Consequently, the FY 2011-12 NCC limits are set at $645.5 million. Departments have identified $37.2 million in reductions that would be required to meet the FY 2011-12 NCC limits. After factoring in NCC limit growth or 2% for years two through five of the Plan, Departments still identified cumulative, potential reductions of $304.8 million necessary to match baseline expenditures to available resources over the five plan years.

Outlook

"The pace of recovery since the recession ended in June 2009 and the growth that CBO projects for the next few years are anemic relative to the rate of recovery following previous deep recessions." **- Congressional Budget Office (CBO), September 28, 2010**

The five-year SFP forecasts that General Purpose Revenue growth will begin a steady pattern of growth by FY 2011-12; however that growth is anticipated to be much slower than the average growth experienced after previous recessions. This is consistent with National and State forecasts and predictions by local economists. General Purpose Revenue growth, in particular property tax receipts and sales and use taxes, reflect continued weakness driven by a mixed housing market and consumers who are replenishing savings rather than boosting spending. Recent growth in employment and earnings has not been significant, and has not offset the impact of the increase in the number of unemployed and the under employed. The good news is that there is growth, albeit slow growth, and that a "double dip" recession is not currently forecasted.

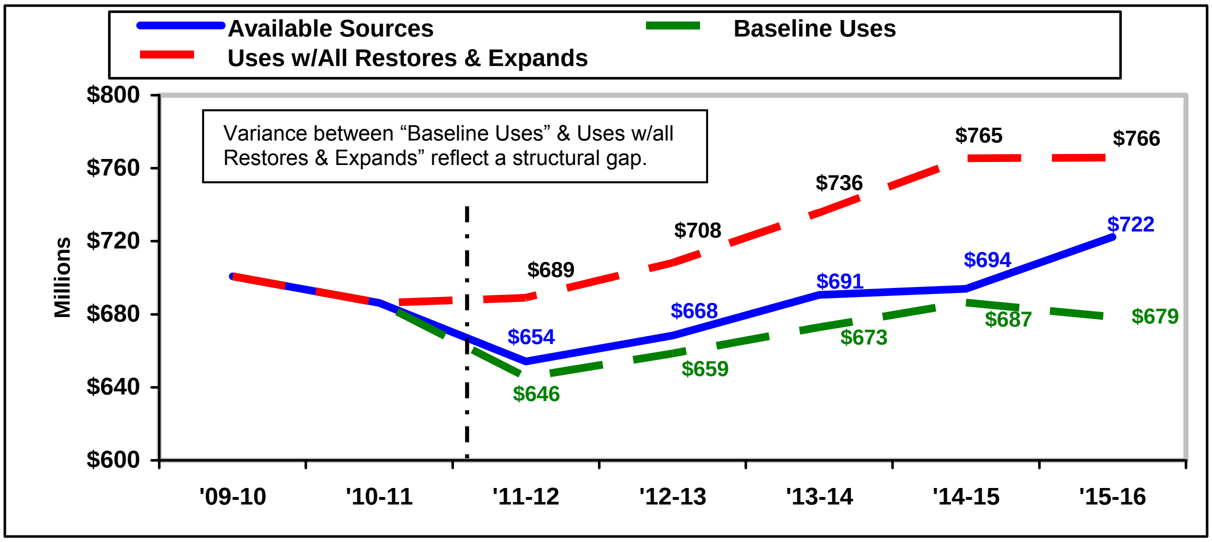
As stated in the introduction, over the long term, it is anticipated that expenditures will outpace revenue growth requiring Departments to continue trending down and evaluating the very real potential for further cuts. Retirement and benefits cost increases currently outpace revenue growth and are projected to continue to do so over the next five Plan years. Preliminary retirement cost projections by the Segal Company reflect annual costs growing from an actual cost of $342 million in FY 2009-10 to a projected $429 million by FY 2015-16 (see following chart):



Source: The Segal Company

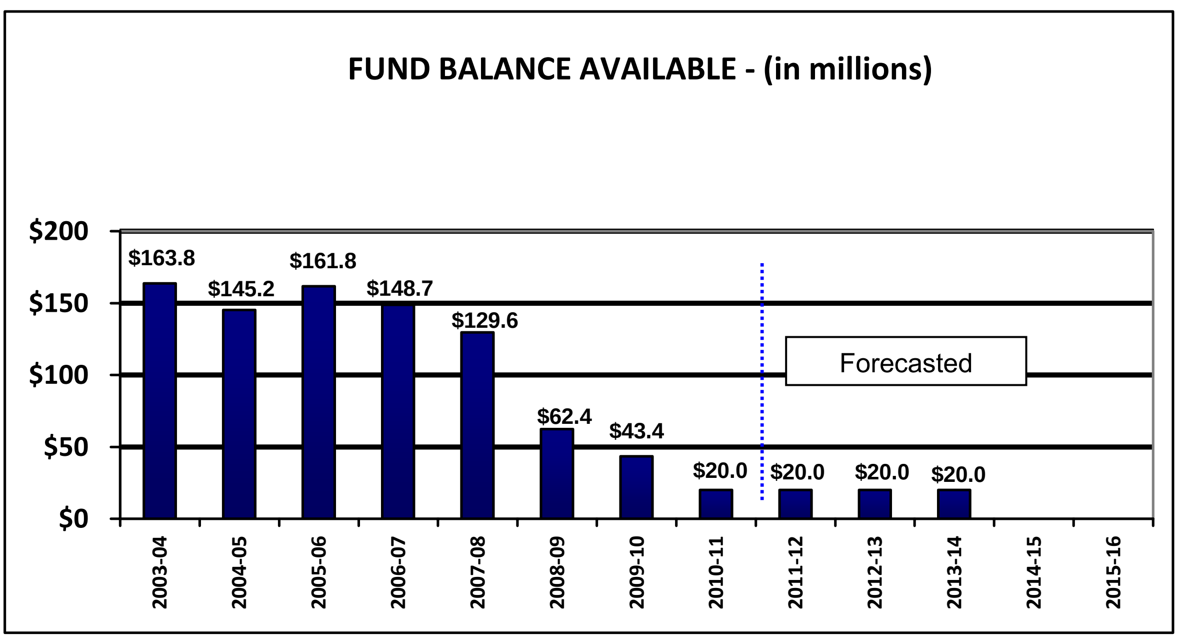
Sources are forecast to grow, rising slightly above baseline uses (or Net County Cost). In addition, baseline uses reflect a drop in FY 2015-16 primarily attributed to the close out of the debt on the County's Bankruptcy Bonds. These positive factors have minimal impact in reducing the gap when the requests for service restorations and program expansions are considered. Growth in property taxes due to funding from Senate Bill 8 (Correa) is allocated within the existing NCC Budget.

As the following chart indicates, even with projected revenue growth, there is an ongoing structural imbalance requiring continued prioritization of resources and service reductions.



Sources include forecasted revenue sources, one-time revenues and estimates of annual carryover of Fund Balance Available (FBA). While the SFP forecasts a moderate increase in General Purpose Revenue growth, one-time sources have been or are near exhausted. Departments continue to experience lagging growth in other General Fund key revenue sources such as Public Safety Sales Tax and Health and Welfare Realignment.

FBA is considered one-time funding and fiscal year-end balances have been declining since FY 2006-07 (see chart below). FBA balances are projected to decrease to $20 million beginning in FY 2011-12 four when it is projected that there will be no significant balance available for balancing. The Plan eliminates FBA as a funding source, a significant step toward reducing structural reliance on one-time funds.



Uses represent known impacts, programs and projects that the County optimally would fund, including current level of operations. Baseline uses represent current costs less any reductions required to meet NCC limits and maintain structural balance. Reductions create challenges and potential issues when service reductions exceed amounts that can be restored and restoration requests compete with critical expansion requests and strategic priorities.

The significance of rising retirement and health and benefits costs, coupled with the potential risks associated with continued deferral of capital maintenance projects related to an aging infrastructure, make it necessary to place a higher emphasis on cost reduction. Beginning in FY 2008-09, NCC limits have been reduced by a total of 15%, with 5% reductions in each of the last three fiscal years. The SFP plans for an additional 2% decrease in FY 2011-12. Even with the 2% reduction, the structural deficit is too large to fund more than a minimal amount of restoration requests. As such, the plan does not currently recommend funding of restoration requests; but, instead defers funding recommendations to the Budget process. The table below summarizes the "reduce level of service" augmentations submitted by Departments to meet NCC limits and summarizes the significance of the imbalance by program.

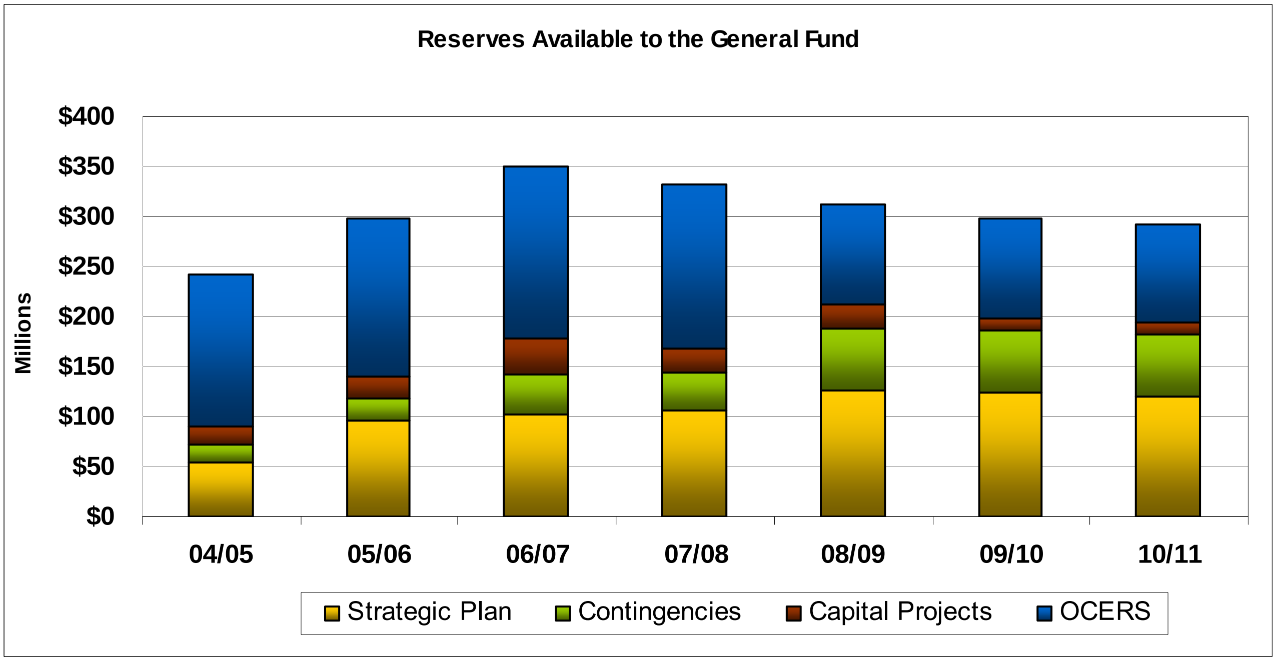
Reduce Level of Service Augmentations – 2010 SFP						
Program	**FY 11-12**	**FY 12-13**	**FY 13-14**	**FY 14-15**	**FY 15-16**	**5-Yr Total**
I-Public Protection	($19,992,588)	($29,099,539)	($38,114,446)	($47,041,584)	($50,445,456)	($184,693,613)
II-Community Services	(14,063,778)	(13,227,911)	(17,242,585)	(23,418,464)	(27,796,351)	(95,749,089)
IV-General Government Services	(3,154,964)	(3,500,637)	(4,830,698)	(6,316,578)	(6,586,173)	(24,389,050)
Total NCC Reductions	($37,211,330)	($45,828,087)	($60,187,729)	($76,776,626)	($84,827,980)	($304,831,752)
Total position deletes projected is 399 for all Departments other than District Attorney who is still analyzing impacts of reductions.						

In the 2009 SFP, Departments submitted proposed service reductions over five years of $909 million. This Plan reflects a significant decline in proposed reductions, down to $305 million which is attributable to Departments' proactive efforts since 2007 to bring budgets down to a sustainable level and to enhance revenues where possible. However, the annual increase in proposed reductions as summarized above indicates that continued diligence and control is necessary to maintain balance and realize continued results from the difficult actions Departments have already taken. The difficult reality is that service cuts have been made and further reductions and/or new revenues will be necessary to achieve an operating plan that is sustainable over the long-term.

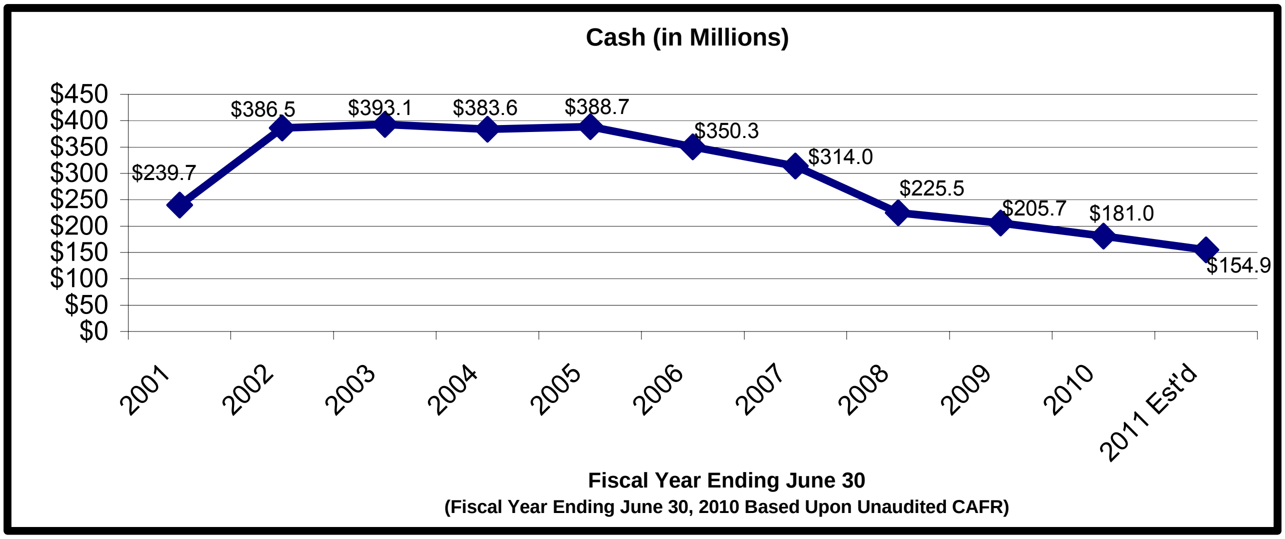
Reserve balances and cash flow trends highlight the importance of maintaining fiscal conservatism.

The use of reserves over the last three years to fund ongoing operations has been useful to allow Departments to trend down slowly and reduce the severity of impacts that may have been realized if cuts were initiated as one action and not over time.

Reserves are established to mitigate cash flow impacts, maintain best debt ratings and borrowing position and to provide liquidity in the event there is a catastrophic event. Further discussion of reserves, reserve policy and balances is provided in the *General Fund Reserves* section of this document. The chart below reflects the trends in reserves over the last five years and the current fiscal year projection for year-end:



Timing and level of expenditures versus receipts, as well as continued State deferrals of claims payments, continue to have an impact on cash balances and fiscal monitoring of cash. Cash balance trends beginning with Fiscal Year 2000-01 through Fiscal Year 2010-11 as of October 31, 2010 is reflected in the chart below:



Beginning in FY 2008-09, to augment average monthly operating cash flow requirements, the County began issuing Tax and Revenue Anticipate Notes (TRANs).

In FY 2008-09, TRANs in the amount of $100 million were issued. In FY 2009-10 and FY 2010-11, TRANs issued increased to $150 million in each year to address the continued downward trend of cash flows. This trend indicates that it's time to take early action, to ensure cash and debt policies are balanced and to ensure cash balances are:

- Sufficient to manage the timing of cash inflows and outflows, matching where possible
- Sufficient to reduce operational, credit and market risk
- Available to support other financial policies and unplanned needs

Actions and Next Steps

"He that will not sail till all dangers are over must never put to sea." **- Thomas Fuller**

Risks - There continues to be potential for cost and cash flow impacts related to existing Federal legislation (e.g. Health Care Reform) and State budget actions (e.g. deferred claims payments, reductions in revenue sharing, etc.). Deferral of capital and maintenance projects has reached a point on the time continuum where projects can no longer be deferred if safety and liability requirements are to be met.

Strategies - The County has always followed prudent fiscal policy, adopting a "Living within Our Limits" strategy. Identification of imbalances and early action taken to mitigate recessionary impacts have allowed the County to continue to provide mandated, quality services that constituents are accustomed to. In order to maintain financial stability and close the forecasted, long-term structural gap, the following actions are recommended for implementation or continuation:

- The 2010 SFP projects implementation of a 2% reduction in the FY 2011-12 NCC limits. This is in addition to the 5% across-the-board reductions made in each of the three preceding fiscal years and deeper cuts made in targeted areas such as capital projects and information technology.
- Positive variances in FBA are added to Strategic Reserves, consistent with Board policy, and necessary to improve cash position.
- Modifications to reserve policies in order to strengthen reserve positions are being brought forward for Board consideration.
- Deletion of long-term vacant positions and the hard hiring freeze continues as one method to control salaries and benefits costs.
- Continued deferral of projects where costs of deferring do not exceed the benefits.
- Continued collaboration with Departments to monitor programs and finances, and working together to find ways to enhance revenues and reduce costs.

This plan establishes initial structure for the FY 2011-12 Proposed Budget which will be presented to the Board of Supervisors in June 2011. The County Executive Office and Departments will continue to monitor programs, review growth and cost assumptions, and reprioritize when warranted to ensure that FY 2011-12 budgets, when presented, are structurally balanced and developed to ensure long-term fiscal stability is a priority.

SUMMARY

"About the time we can make the ends meet, somebody moves the ends." **– Herbert Hoover**

In 2007 the County made a choice, a choice of action to follow a path of fiscal prudence during lean economic times. The commitment to structural balance supports the philosophy that *"the ends will meet*."

The good news is that Orange County tends to rebound from declining economies earlier than other localities and the State. Our housing markets tend to be more resilient, employment rebounds earlier and our overall demographics are favorable. The County has managed cash well and does not have the debt burden of other governments; however, there are similar escalations in costs, including significant increases in liabilities related to pension and benefit obligations. The growth in pension and benefits liabilities makes the achievement of structural balance a moving target. Ongoing fiscal health requires long-term planning and commitment.

The Board of Supervisors will be apprised of fiscal status on an ongoing basis via the annual and quarterly Budget Reporting process and other methods as appropriate. We realize that carrying out of vital services and assurance of responsible management requires:

- We evaluate and communicate impacts and opportunities timely
- We apply continued discipline to financial management
- We strive toward structural balance focused on values and core priorities
- We continue to apply full cost recovery considering long-term impacts, not just short-term
- We proactively seek to establish creative alternatives and partnerships

The Board has demonstrated commitment to fiscal health. Their action has ensured that government core priorities and services are maintained while maintaining fiscal sustainability.