Executive Summary

Introduction

The County is committed to financial sustainability through long-term planning which enhances the ability to respond to financial uncertainty in a manner that minimizes the impact to the quality and range of services provided to the community. The year leading up to the 2013 Strategic Financial Plan process presented challenges, including moderate economic growth and significantly reduced revenues as a result of the State sweeping the County's Vehicle License Fee (VLF) revenue. While the County has experienced slow economic growth since the Great Recession, it was on a road to recovery prior to the loss of the VLF revenue. This loss of revenue reemphasizes the need for long-term strategic planning including building a reserve balance that allows the County to manage through such downturns with minimal impact on the community it serves.

In FY 2007-08, the County began to proactively address impacts of the recession. Early action allowed the County to phase in reduction plans over time, minimizing the amount of funding reductions and long-term service impacts. Looking forward, continuing growth in the demand for services and related costs will affect the County's ability to sustain service levels and establishes a need to ensure that resources and programs are aligned to countywide strategic priorities and values.

In light of the challenges of the last five fiscal years, the County maintained key services and programs and implemented new programs including:

- County Website Re-launch – The County of Orange received the Center for Digital Government's 2013 Best of the Web Award for the innovation, functionality, productivity, and performance of the recently re-launched website.
- OC Clerk-Recorder Extended Hours – OC Clerk-Recorder has implemented extended hours on one Saturday each month at the Old County Courthouse and the Fullerton and Laguna Hills branch offices to improve customer service and make it easier for families and those who work during the week to obtain services usually offered only on weekdays.
- OC Public Libraries' Book Talk Blog – The OC Public Libraries' Book Talk is a readers' advisory blog written and maintained by OC Public Libraries' staff. The purpose of the blog is to extend the Readers' Advisory service provided in the branches and helps patrons find books they want to read in an online environment.

The Process

The Strategic Financial Plan (the Plan or SFP) is a financial component of the County's Strategic Plan that provides short and long-term operational linkage between the County's Strategic Plan, the annual budget process, and department operating plans. It offers a means to focus on Departments' needs and resources to ensure the County's financial position is adequate to support ongoing services and long-term needs while ensuring realistic sustainability considering projected future economies. The plan identifies for policy makers the potential financial impact of policy decisions related to General Fund operations, capital requirements and strategic priorities.

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. The Plan is developed with a goal of identifying significant issues that must be addressed to achieve the County's mission, goals and long-term plan for financial sustainability. Key fiscal goals warranting attention this year include:

- Stabilize the budget and prepare for contingencies.
- Address and fund agency infrastructure.

The primary focus of the SFP is the portion of the General Fund often referred to as discretionary funding or Net County Cost (NCC). This is the funding source allocated to departments and approved by the Board for programs and activities which are not funded by specific revenue sources. The non-discretionary portion of the budget contains mandated activities such as benefit payments to clients, which the County provides on behalf of the State and Federal governments. Such activities are primarily funded with State and Federal revenues.

This year's plan focuses on General Fund gap analysis in an effort to highlight the significant impacts of State budget actions, the continuing impact of subdued General Fund revenue growth, and the rising cost of doing business. The plan focuses on the identification of General Fund fiscal gaps (comprised of Departmental planned expenditures net of Departmental revenues and NCC) and imbalances that will need to be addressed during the FY 2014-15 Annual Budget Process. A summary analysis of capital needs was also conducted. This year's SFP lays the groundwork for establishing budget priorities and funding solutions for FY 2014-15 prior to the normal timeframe of the annual budget process, allowing more time for collaboration and creative solutions.

The SFP also addresses the General Fund Reserves Policy which is developed to provide flexibility in the maintenance and use of reserves and to reflect the County's continued commitment to sound fiscal policy. There are no recommended changes to reserve policies proposed in this year's SFP.

As in prior years' plans, the County Executive Office compiled relevant economic data for use in preparing the County's 2013 SFP including:

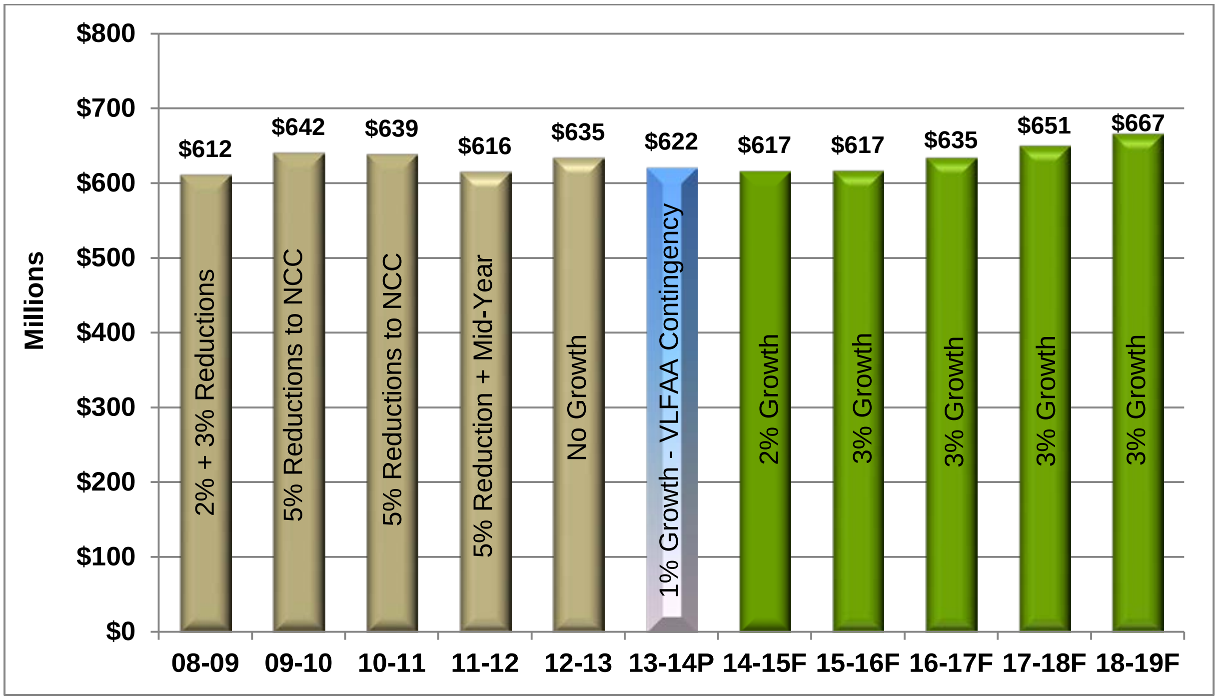
- General Purpose Revenue forecast developed in conjunction with forecasts by the Auditor-Controller, the 2013-14 Local Assessment Roll of Values, and receipt trends.
- Various projections for capital and operating inflationary factors, as developed by governmental or industry experts in the related field.
- Continued monitoring of economic forecasts published by Chapman University, University California Los Angeles, the State Legislative Analyst Office and other sources.

Economic data compiled in August 2013 was included as part of the 2013 SFP instructions. As changes occur in the economy, some projections may be updated during the FY 2014-15 annual budget process.

Key Assumptions:

- The total cost of salaries and benefits is expected to increase by 12% over the five plan years and includes the following assumptions:
  - Salaries (growth projection developed independently and not in consultation with Human Resource Services or the Board, and does not represent a commitment for bargaining purposes)
    - Year 1: 0%
    - Year 2: 1.0%
    - Years 3 through 5: 2.0%
  - Retirement Rate Assumptions (Tier II)
    - Safety Rate from 68% to 69% (excludes retiree medical)
    - Non-Safety Rate begins and ends at 30% (excludes retiree medical)
    - Retiree Medical for AOCDS at 2.94% (5.30% for Law Enforcement Managers)
    - Retiree Medical for General at 3.96%
  - Health Benefit Cost Assumptions
    - 5-Year Growth from $182M to $270M (48.4%)
- Consumer Price Index (CPI) Assumptions for Services & Supplies: 2.1% to 2.5%
- Departmental NCC limits were set for ongoing baseline operations (current levels of service). FY 2014-15 NCC limits were projected using the adopted FY 2013-14 limits ($621.9 million) as a starting point, with amendments for technical adjustments and removal of one-time items resulting in proposed baseline limits for FY 2014-15

of $617.2 million (2% growth was proposed for FY 2014-15 limits). Departments have identified $61.6 million in reductions that would be required to meet the FY 2014-15 NCC limits. After factoring in NCC limit growth of 2% in year one, and 3% in years two through five of the Plan, Departments still identified a 5-year cumulative budget gap of $366.5 million. The following table summarizes historical and forecasted NCC limits. The FY 15-16 amount includes removal of $18M no longer required for the bankruptcy debt payment.



- The following table summarizes NCC by program:

Program	10-11	11-12	12-13	13-14P	14-15F	15-16F	16-17F	17-18F	18-19F
Public Protection	$370.7	$311.2	$337.5	$335.7	$320.1	$328.5	$337.2	$346.2	$355.5
Community Services	145.1	136.2	137.3	129.8	130.4	134.2	138.2	142.4	146.7
Infrastructure	31.0	30.7	32.1	32.6	33.2	34.2	35.2	36.3	37.4
General Government	95.8	98.6	97.3	101.8	96.8	100.4	103.4	106.5	109.4
Capital Improvements.	10.8	39.7	6.0	15.7	20.4	22.1	22.5	21.4	20.0
Debt Service	20.4	23.1	19.3	19.3	19.3	0.9	0.9	0.9	0.9
Insurance, Reserves. & Misc.	-34.7	-23.3	5.2	-13.0	-3.0	-2.9	-2.9	-2.9	-2.9
GRAND TOTAL NCC	**$639.1**	**$616.2**	**$634.7**	**$621.9**	**$617.2**	**$617.4**	**$634.5**	**$650.8**	**$667.0**

- *Note: FY 13-14 NCC is projected (P) based upon balances at mid-year. SFP years are forecasted (F).

Outlook and Challenges

In general, trends in key economic indicators reflect continued modest economic growth now and into the near future. Although economic growth is predicted to be better than in the past four years, it is not sufficient to offset the Great Recession as far as income and employment are concerned. Please see further discussion of economic impacts in the *Economic Forecast Summary* section of this document.

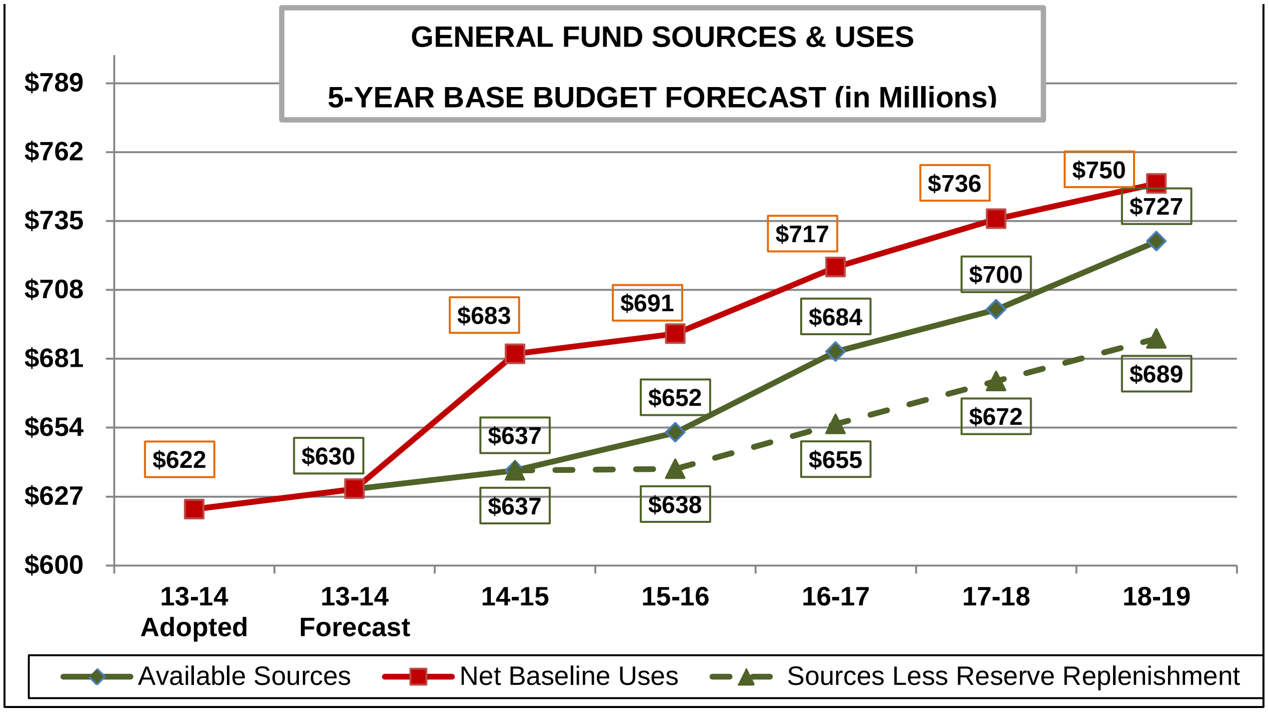
This SFP has been conservatively developed and includes modest growth consistent with current economic conditions. The County continues to follow fiscal policies that will stabilize department budgets, prepare for contingencies, and address and fund agency infrastructure.

<u>Expenditures</u>

Key Issues –

- Cost of doing business continues to grow and outpaces General Purpose Revenue growth.
- Competing needs exist for General Funds, including the need to fund deferred capital and information technology projects and ongoing strategic priority requests.

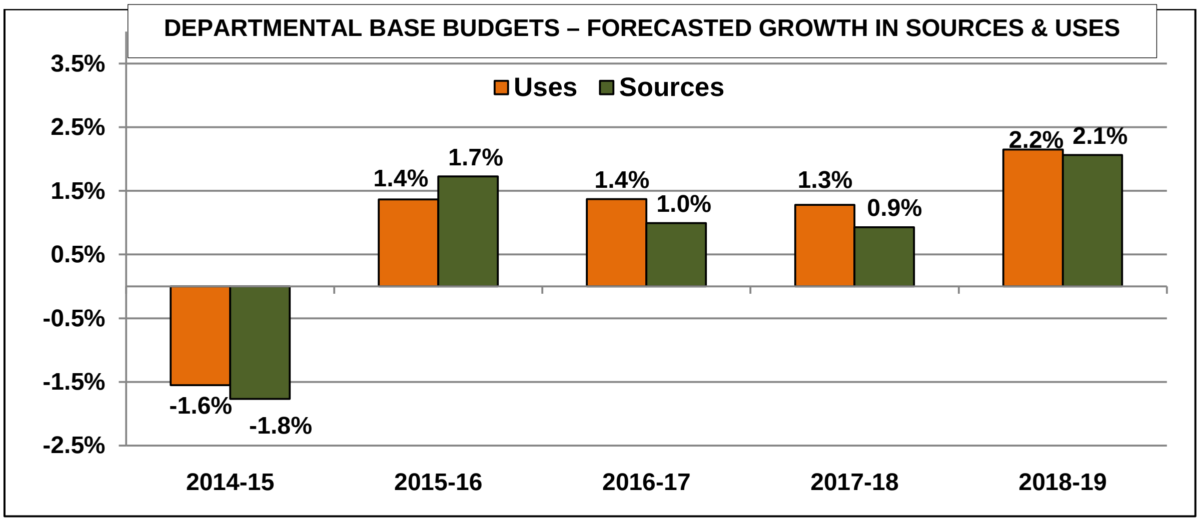
General Fund departments submitted baseline requests plus restoration requests that exceed available sources by $177 million over the five-year Plan period. If partial reserve replenishment is considered, the gap widens to $286 million over the five years. The County will make the final payment of remaining bankruptcy-related debt in FY 2014-15 (annual cost of approximately $18.4 million). The payments, which formerly required NCC allocations, are not included in the calculated NCC limits for FY 2015-16 through 2018-19. The following table illustrates the projected General Fund Sources and Uses:



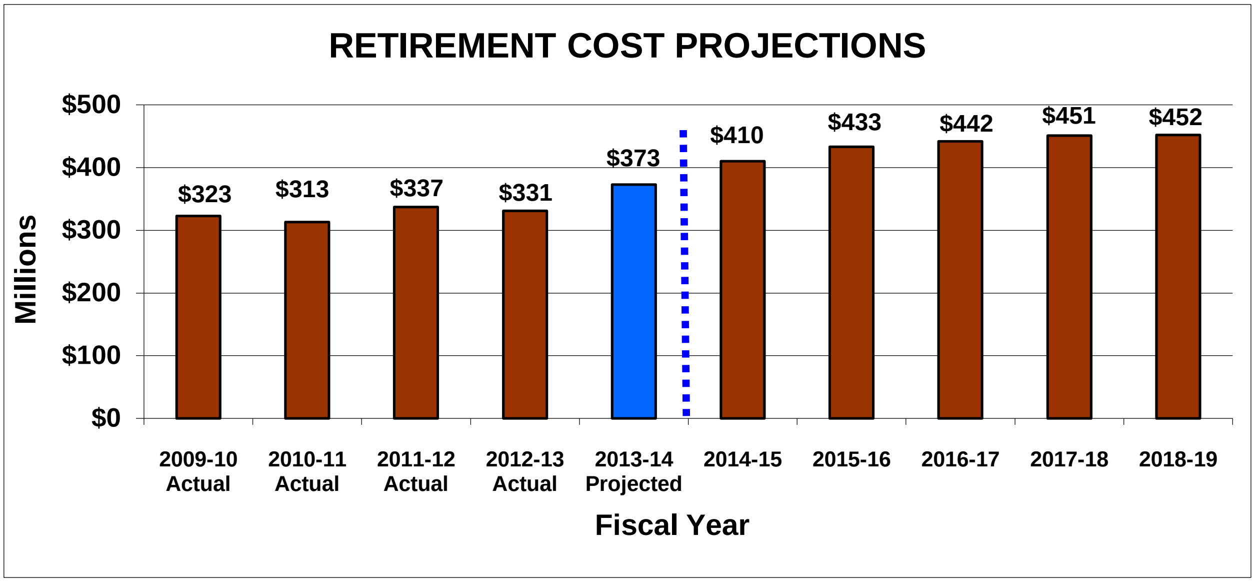
* Sources Less Reserve Replenishment assumes partial reserve replenishment of State repayment draws

It is important to note that the gap between available sources and net baseline uses is primarily attributable to General Fund Sources projections which no longer include: property tax in lieu of vehicle license fee revenue of $73.5 million annually as was included in the County's budget for fiscal years 2011-12 and 2012-13; and, Senate Bill 8 X3 annual revenues of $50 million. However, on September 27, 2013, Assembly Bill (AB) 701 was signed by the Governor to resolve disputed revenue between the State and the County and provides for $53 million in annual Vehicle License Fee Adjustment Amount (VLFAA), including growth. AB 701 provides stability for the County by securing the property tax revenues. AB 701 also allows for repayment of $150 million in disputed revenue to the State over the five years of the Plan.

The following chart summarizes variances in Departments' forecasted base sources and uses, inclusive of technical and reduction augmentations, and before application of any General Fund contribution (e.g. NCC):

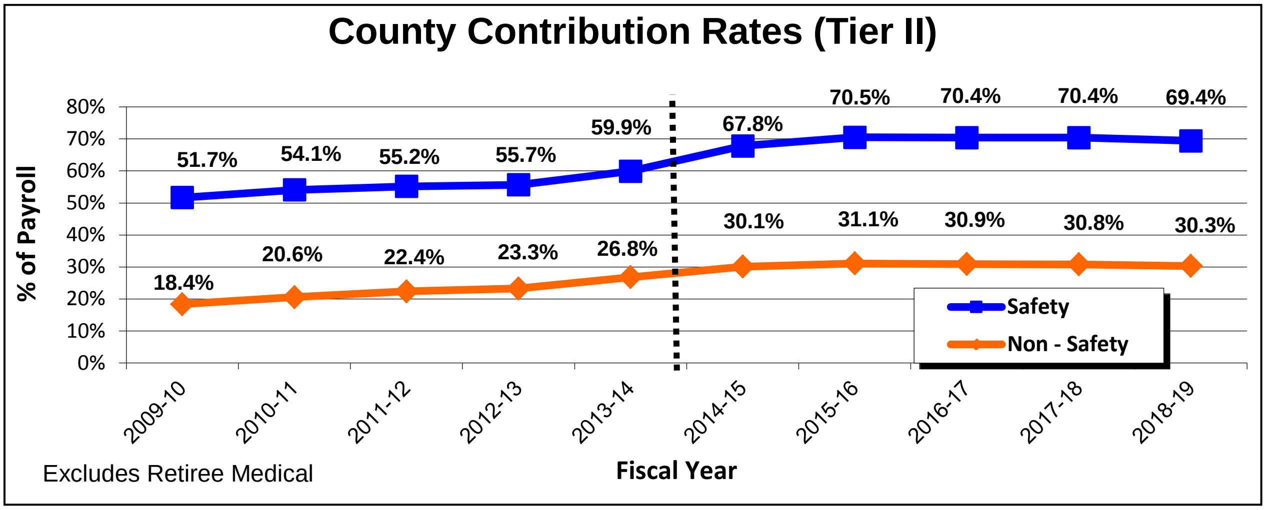


Retirement and health benefit cost increases continue to outpace revenue growth and are projected to continue to do so over the next five Plan years. As illustrated in the following chart, preliminary forecasts for retirement reflect annual costs growing from FY 2013-14 budgeted $373 million to a forecast of $452 million by FY 2018-19, an average annual increase of 3.3%. It is worth noting again that potential changes in the Orange County Employee Retirement System (OCERS) actuarial assumptions and amortization periods could result in retirement cost changes.



Note: All years exclude Pension Prepayment. FY 2011-12 forward excludes Retiree Medical.

The following summary of estimated County Contribution Rates for Tier II employees mirrors the trend of increasing costs and highlights the impacts of lower investment returns and changes in plan assumptions:



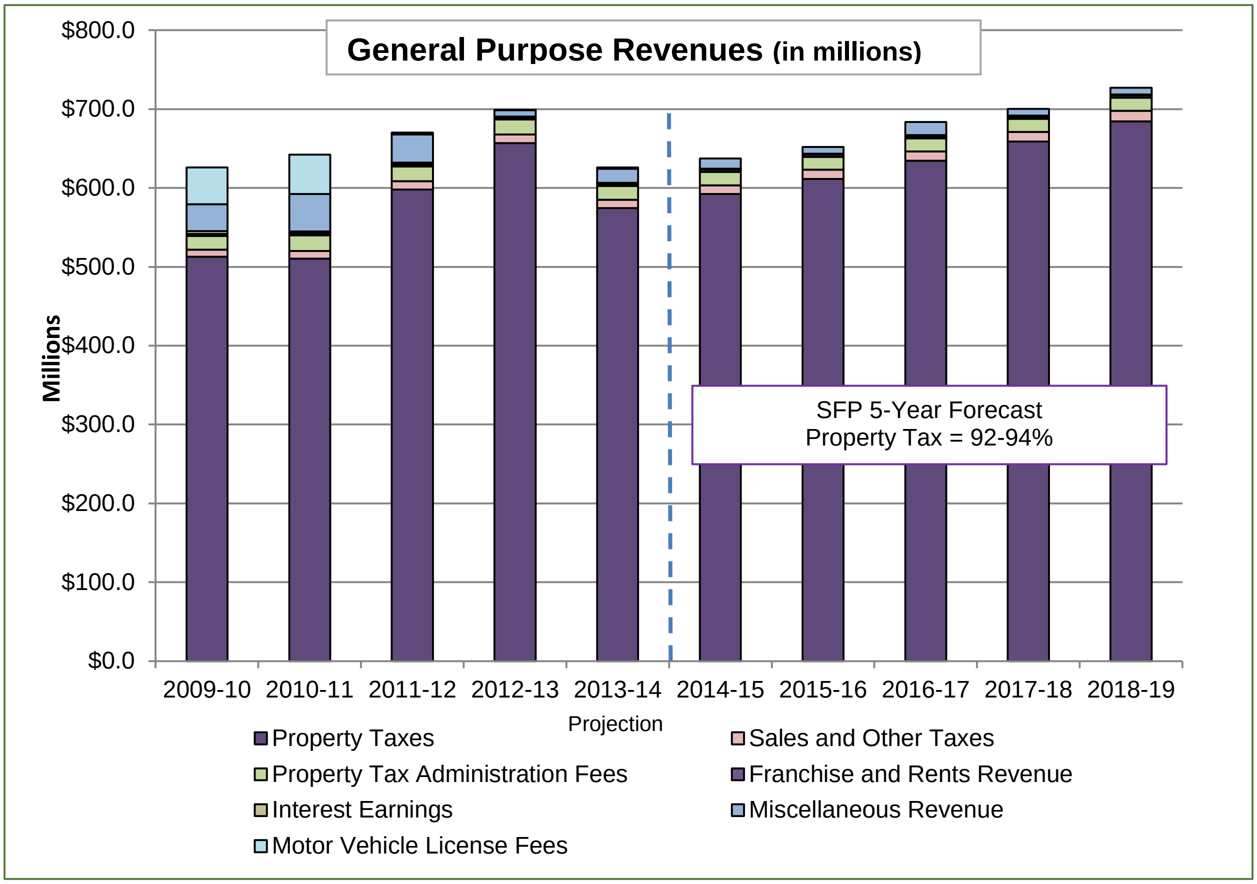
Revenues

Key Issues –

- User fees are not always at full cost recovery.
- Reimbursements – Timing and matching to costs unpredictable (e.g. State AB109, health and welfare reimbursements, etc.)
- Net loss of $70.5 million in revenue (property tax in lieu of vehicle license fee revenue of $73.5 million and Senate Bill 8 X3 annual revenues of $50 million offset by vehicle license fee adjustment allocation of $53 million)

As previously illustrated, departmental base revenues (sources) are growing slowly, and in all but one year are projected to be below growth in departmental base expenditures (uses). The Plan forecasts a moderate increase in GPR and key departmental revenue sources such as Public Safety Sales Tax. While intended to reimburse dollar for dollar actual expenditures, 2011 Public Safety Realignment funding has not kept pace with program expenses and is projected flat over the five-year Plan.

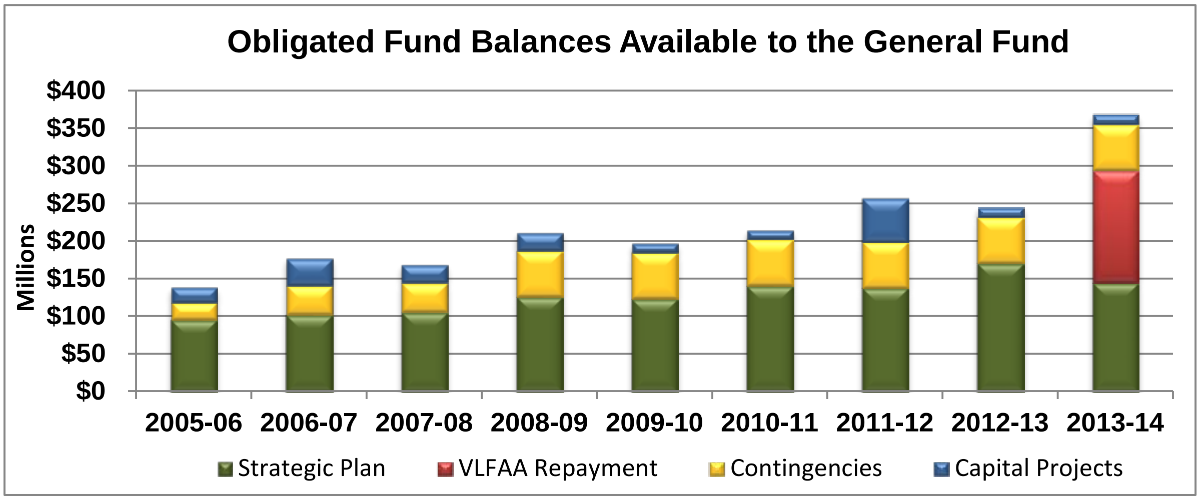
The following chart summarizes historical and forecasted growth in GPR. Detailed analysis of each component of GPR and Fund Balance Unassigned is provided in the *Revenue Forecast Summary* section of this document.



Note: Miscellaneous Revenue includes transfers in from other funds.

Obligated Fund Balances and Cash

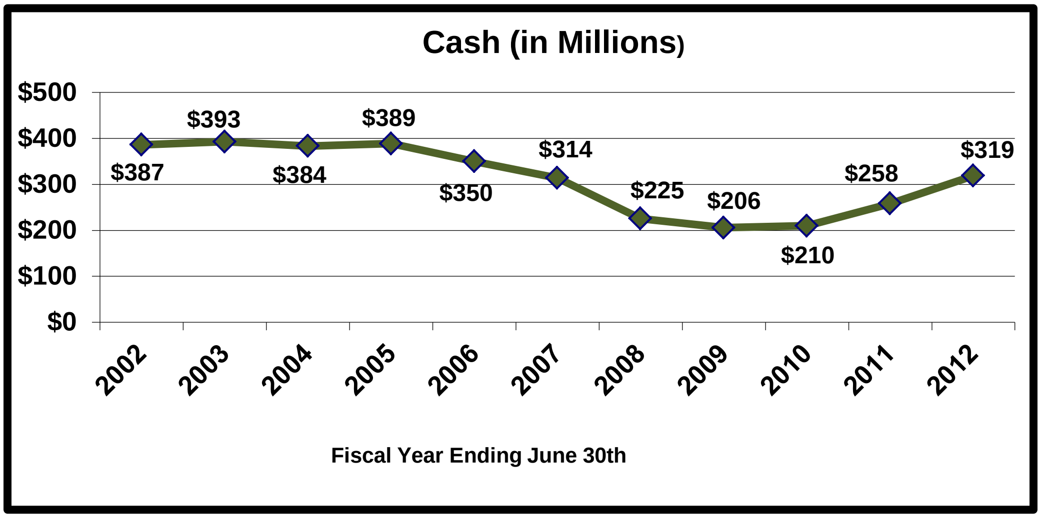
The County maintains an established reserves policy (please see the *General Fund Reserves* section of this document) to mitigate cash flow impacts, maintain best debt ratings and positive borrowing position, and to provide liquidity in the event of a catastrophic event.



(Note: Balances exclude accounts held by other authorities/agencies such as balances held by the Orange County Employees' Retirement System [OCERS]).

During the economic downturn, reserves were used to reduce the severity of impacts to clients and Departments that might have been realized. Since that time, the County has taken a path to build reserves back to a level that provides the flexibility to maintain service levels and protects the County's cash position in order to meet its obligations. And, although the obligated fund balances available to the General Fund in FY 2013-14 reflect a healthier reserve position, the Strategic Plan balance is inclusive of $150 million owed to the State over the next five Plan years. As payments are made to the State, it is anticipated that even with prudent reserve replenishment, the reserve position in FY 2018-19 will be 10% less than projected for FY 2013-14; without replenishment, the reserve position will be 40% lower than the FY 2013-14 projection. Further discussion of reserves, reserve policy, and balances is provided in the *General Fund Reserves* section of this document.

The County is diligent in maintaining an adequate balance of General Fund cash to address timing variances that occur throughout the year between expense and revenue transactions. Cash balances experienced a steady decline since FY 2004-05, but in recent years, the County has been able to reverse this trend as a result of improvements to General Fund Reserve balance. Based on the current cash management plan, it is anticipated that cash balances will remain stable throughout the financial planning period, although on a cautionary note, cash may decline in years four and five when the two largest VLFAA payments are due to the State, unless steps are taken to replenish reserves over the five-year Plan. The following chart reflects historical cash balances through June 30, 2012.



Note: Cash balances are as of June 30 of each year as reported in the Comprehensive Annual Financial Report (CAFR). The FY 2012-13 CAFR has not yet been completed.

Infrastructure & Capital Expenditures

Economic conditions and competing priorities for General Funds have impacted how the County has addressed capital spending. Beginning in FY 2007-08, like other peer counties, Orange County began deferring necessary investments in plant and equipment to balance already strained budgets and mitigate potential cuts to ongoing operations. This policy has helped sustain funding for critical services; however, it is not viable long-term and should be considered a short term policy. Deferral of project funding for critical infrastructure repairs and maintenance increases the risk of further deterioration and increases the probability that costs will be greater in the future (e.g. construction, purchasing and design costs are typical of costs that generally increase with the passage of time). Deferral of projects impacts the County's asset base and could have an impact on future economic development. The added cost of continued deferral continues to be evaluated to ensure that adequate project funding is preserved and that project timelines are viable to maintain a reasonable level of risk and capital cost. (See further discussion in the *Capital Improvement Plan* section of this plan).

Strategies

It is critical that departments continue reviewing programs and operations to determine how best to continue to size programs for potential future impacts and to ensure critical services are carried out and performance goals continue to be met within the confines of available resources. Departments and the County Executive Office are currently planning for the FY 2014-15 budget process with a goal to maintain the ability to provide quality services to stakeholders, including external clients and employees.

Summary

The years since the Great Recession have been difficult; however, the County's long-term commitment to a balanced budget and early action has been successful in maintaining core services with minimum impact to end users. Through their commitment to fiscal prudence, the Board of Supervisors developed a vision for the County and enabled the County to adapt to a dramatically changing environment. This commitment to fiscal prudence will continue to be required as the County attempts to balance the funding of identified needs.

The Board of Supervisors will be apprised of the County's fiscal status on an ongoing basis via the annual and quarterly budget reporting processes and other methods as appropriate. Carrying out vital services and assurance of responsible management requires:

- That impacts continue to be evaluated and communicated timely;
- That the County continue to apply discipline to financial management;
- That structural balance focused on values and core services continues to be a priority;
- That the County continues to seek creative alternatives and partnerships.

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

"Economy is the method by which we prepare today to afford the improvements of tomorrow." ~ Calvin Coolidge