Executive Summary

Introduction

The County of Orange is committed to long-term strategic financial planning to ensure its ability to respond to economic fluctuations and unanticipated events in a manner that allows the County to maintain the quality and range of services provided to the community. The year leading up to the 2016 Strategic Financial Plan process was marked by continued slow economic growth. While the growth after the Great Recession has allowed the County to re-baseline some department budgets and reprioritize one-time projects, the level of growth does not allow for increased levels of service. In addition, revenue reductions particularly to Public Safety Sales Tax (Prop 172) and Public Safety Realignment (AB109) mean that additional re-evaluation of department budgets and reprioritization of projects will be required. The County is committed to maintaining current levels of service to the extent possible while using fluctuations in revenue growth to prepare for or complete previously deferred projects.

As the economy appears set to continue along a path of prolonged slow to moderate growth, a disciplined approach to fiscal management of the County's limited resources will ensure alignment with countywide strategic priorities and values. Commitment to the Board of Supervisors' priorities of budget stabilization, preparation for contingencies, and funding of agency infrastructure, in addition to the VLFAA repayment to the State, emphasizes the need for long-term strategic planning including building a reserve balance that best positions the County to weather future economic variations with minimal impact on the community it serves.

Despite the continued slow economic growth, the County is committed to implementing key initiatives that will enrich the lives of Orange County residents and visitors including:

- **Homeless Initiatives:** The County has acquired property for a multi-service center in the City of Anaheim that will serve the homeless on a year-round basis. This is one of many initiatives the County is implementing to assist our homeless residents, which includes providing mental and physical health services and increased coordination of services across County departments.

- **OC Animal Care:** The County is moving forward with the construction of a new animal care center to be built on 10 acres of land at the former Tustin Marine base. The new facility will include a state-of-the-art design with outdoor areas, kennels and a training center.

- **Civic Center Master Plan:** The Civic Center Master Plan initiative will address the County's long-term occupancy in the Orange County Civic Center, improve delivery of services to the community, improve space usage and departmental adjacencies, address the aging portfolio of County facilities, and better manage long-term occupancy and maintenance costs.

- **Connection to Services for Older Adults and Veterans:** The County is addressing the demands of an increasing older adult population by dedicating resources to increase outreach, improve assessments, and engage and connect caregivers and those who would benefit from services. The Veterans Services Offices are helping the 130,000 Orange County veterans and their families receive the benefits earned through their service to our nation and have dedicated resources ensuring the veterans' needs are met through reduced wait times, increased outreach, and greater assistance with claims and other services.

- **Integrated Services:** Integrated Services is an umbrella concept that covers five Strategic Priories submitted for the 2016 SFP. These proposed initiatives focus on providing a host of services aimed at: mental health and substance abuse treatment, recidivism reduction, and post incarceration reentry to the community. An integrated approach in the implementation of these programs provides opportunities to leverage the overlap to more effectively and efficiently deliver these services.

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 and the annual budget process. It offers a means to gauge Departments' needs and resources to ensure the County's financial position is sufficient to support ongoing services and long-term needs while ensuring realistic sustainability within potential future economic constrictions. The Plan provides policy makers with a tool for evaluating the possible 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 development of the next fiscal year budget with the qualification that assumptions used in developing the plan may change over time. The Plan is developed with a goal of identifying any significant issues that must be addressed to achieve the County's mission, goals and long-term plan for financial sustainability. The County continues to focus on the following key fiscal goals:

- Budget stabilization and planning for contingencies
- Planning for and funding 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 streams. 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 chiefly funded with State and Federal revenues.

As in past years, the SFP focuses on General Fund gap analysis to highlight the continuing impact of projected slow General Fund revenue growth and the rising cost of doing business. The plan focuses on 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 2017-18 Annual Budget Process. Summary analyses of capital and IT project needs was also conducted. This year's SFP lays the groundwork for establishing budget priorities and funding solutions for FY 2017-18 prior to the normal timeframe of the annual budget process, allowing more time for collaboration and creative solutions.

The SFP also provides an opportunity to review 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. Additionally, this Plan includes two new policies for Board consideration: (1) Debt Management Policy; and (2) Position Policy.

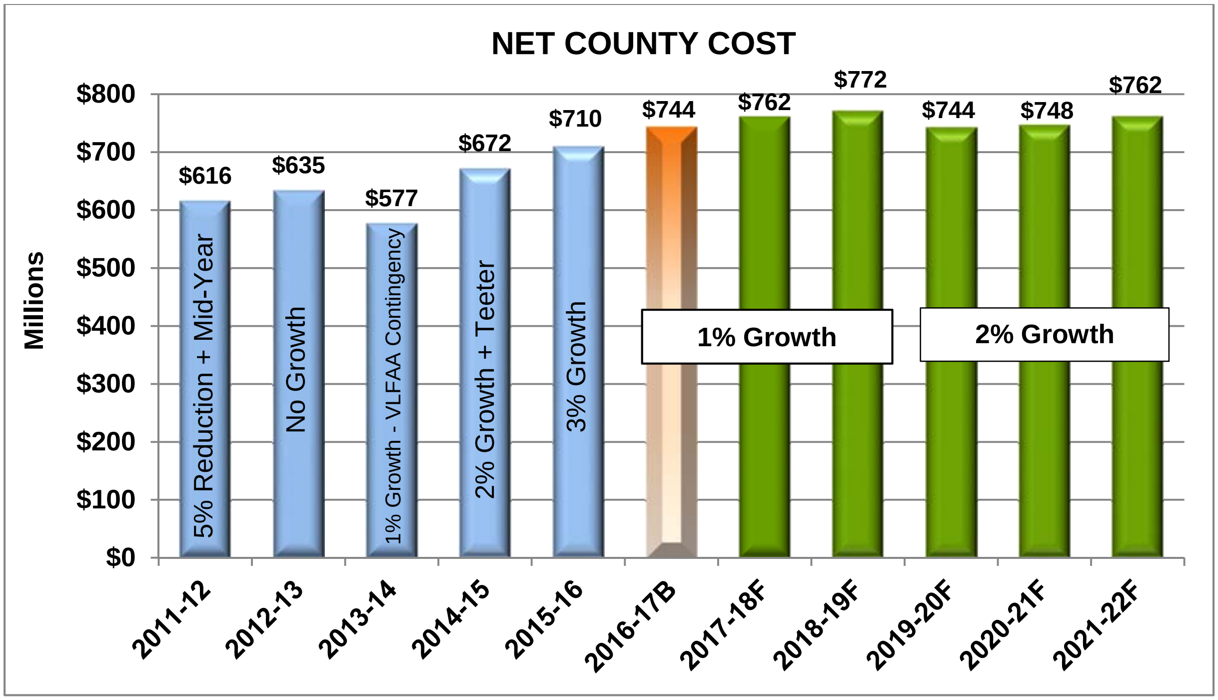
Relevant economic data was used in preparing the County's 2016 SFP including:

- General Purpose Revenue forecast developed in conjunction with forecasts by the Auditor-Controller, the 2016-17 Local Assessment Roll of Values, and revenue 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 of California, Los Angeles, the State Legislative Analyst Office and other various sources.

Economic data compiled in August 2016 was included as part of the 2016 SFP instructions. As changes occur in the economy, some projections may be updated during the FY 2017-18 annual budget process.

Key Assumptions:

- The total cost of salaries and benefits is expected to increase over the five plan years and includes the following assumptions:
  - Salary growth factors include general salary increases consistent with existing memorandum of understanding (MOU) terms. Assumptions for salary increases beyond the existing MOU terms include 2% growth for all five years of the plan. Salary projections are developed independently and not in consultation with Human Resource Services or the Board, and does not represent a commitment for bargaining purposes.
  - Retirement Rate Assumptions (Tier II) include the assumption where the market rate of return for calendar year 2016 is 0.00% and 7.25% for each year thereafter, which resulted in the following retirement rates:
    - Safety Rate from 62% to 67% (3@50; excludes retiree medical)
    - Non-Safety Rate of 29% to 33% (2.7@55; excludes retiree medical)
    - Retiree Medical for AOCDS at 4.6% (7.4% for Law Enforcement Managers)
    - Retiree Medical for General at 4%
  - Health Benefit Cost Assumptions
    - 5-Year Growth from $191M to $281M (46%)
- Consumer Price Index (CPI) Assumptions for Services & Supplies: 2.3% to 2.4%
- Departmental NCC limits were set for ongoing baseline operations (current levels of service). FY 2017-18 NCC limits were projected using the adopted FY 2016-17 limits ($744 million) as a starting point, with amendments for technical adjustments and removal of one-time items resulting in proposed baseline limits for FY 2017-18 of $762 million. Departments have identified $51 million in reductions that would be required to meet the FY 2017-18 NCC limits. After factoring in NCC limit growth of 1% in years one and two (2017-18 and 2018-19), and 2% growth in the last three years (FYs 2019-20 through 2021-22) of the five-year Plan and removing any one-time items, departments identified a 5-year cumulative budget gap of $363 million. The following table summarizes historical and forecasted NCC.



The following table summarizes NCC by program:

Program	13-14	14-15	15-16	16-17B	17-18F	18-19F	19-20F	20-21F	21-22F
Public Protection	$328.27	$358.50	$395.39	$413.37	$413.29	$417.01	$424.40	$431.92	$439.60
Community Services	108.36	132.34	125.56	127.23	128.48	129.75	132.31	134.93	137.59
Infrastructure	31.54	32.35	20.98	22.33	23.32	19.27	19.56	19.86	20.17
General Government	101.60	105.80	125.19	121.27	124.02	119.67	128.33	128.01	133.17
Capital Improvements	17.54	23.97	21.80	20.31	19.30	28.53	36.68	25.16	23.35
Debt Service	19.00	19.29	0.87	0.87	0.87	0.87	0.00	0.00	0.00
Insurance, Reserves & Misc.	(28.88)	(0.23)	20.36	38.87	52.27	57.27	2.28	7.64	8.56
GRAND TOTAL NCC	**$577.43**	**$672.02**	**$710.15**	**$744.25**	**$761.55**	**$772.37**	**$743.56**	**$747.52**	**$762.44**

Note: FY 16-17B NCC is the adopted budget. SFP years are forecasted (F).

Outlook and Opportunities

In general, trends in key economic indicators reflect continued slow economic growth now and into the near future. Although economic growth is still projected, it is not sufficient to offset Prop 172 and AB109 revenue reductions in combination with rising costs of salaries and benefits and other costs of doing business. Please see further discussion of economic impacts in the *Economic Forecast* section of this document.

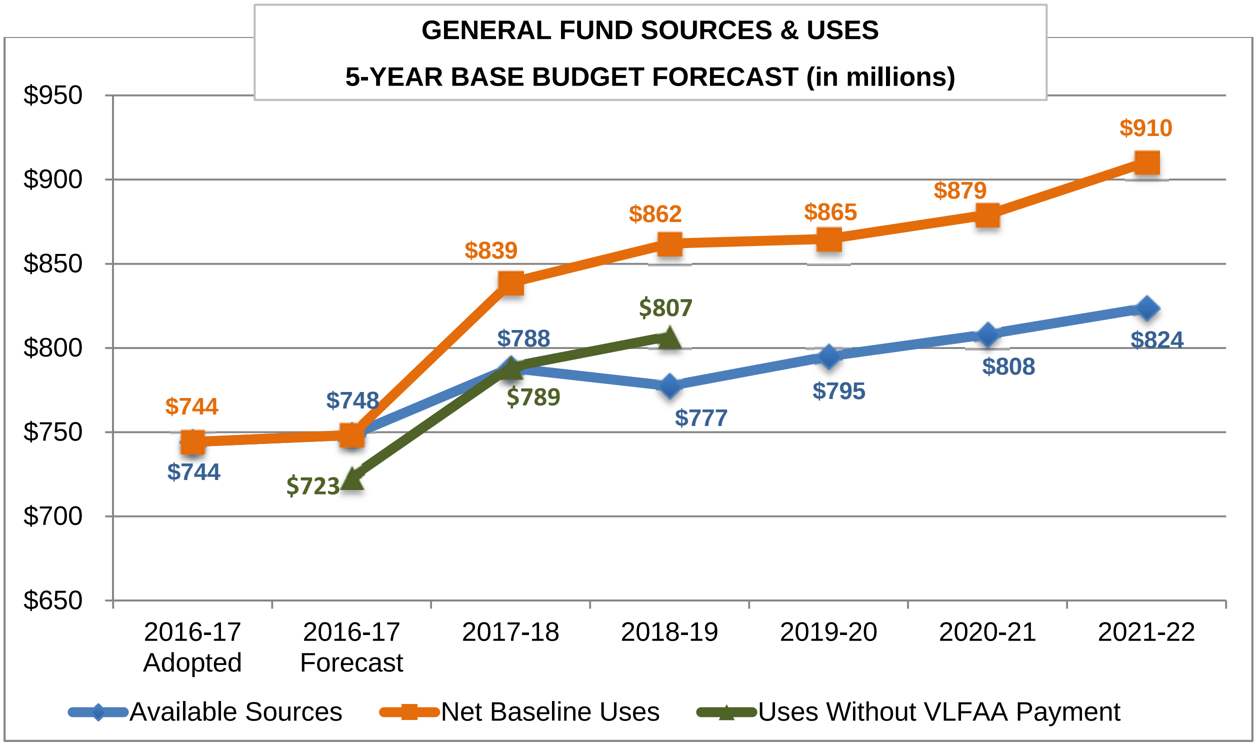
This SFP has been conservatively developed and includes modest growth consistent with current economic conditions. The County continues to follow fiscal policies that will stabilize department budgets, prepare for contingencies, and address and fund agency infrastructure.

Expenditures

Key Issues –

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

The following table illustrates the projected General Fund Sources and Uses. The Net Baseline Uses encompasses department NCC requests including restore and expand augmentations. The Baseline Uses assumes payment of the remaining $130 million in VLFAA payments to the State within available baseline sources rather than use of reserves previously set aside for the payments, contributing to the large gap between sources and uses in FYs 2017-18 and 2018-19. This gap continues and widens into future fiscal years even after the final payment is made. The County will attempt to make the VLFAA payments from the baseline budget to preserve reserve balances, but may draw on reserves if needed to ensure no impact on mandated levels of service.

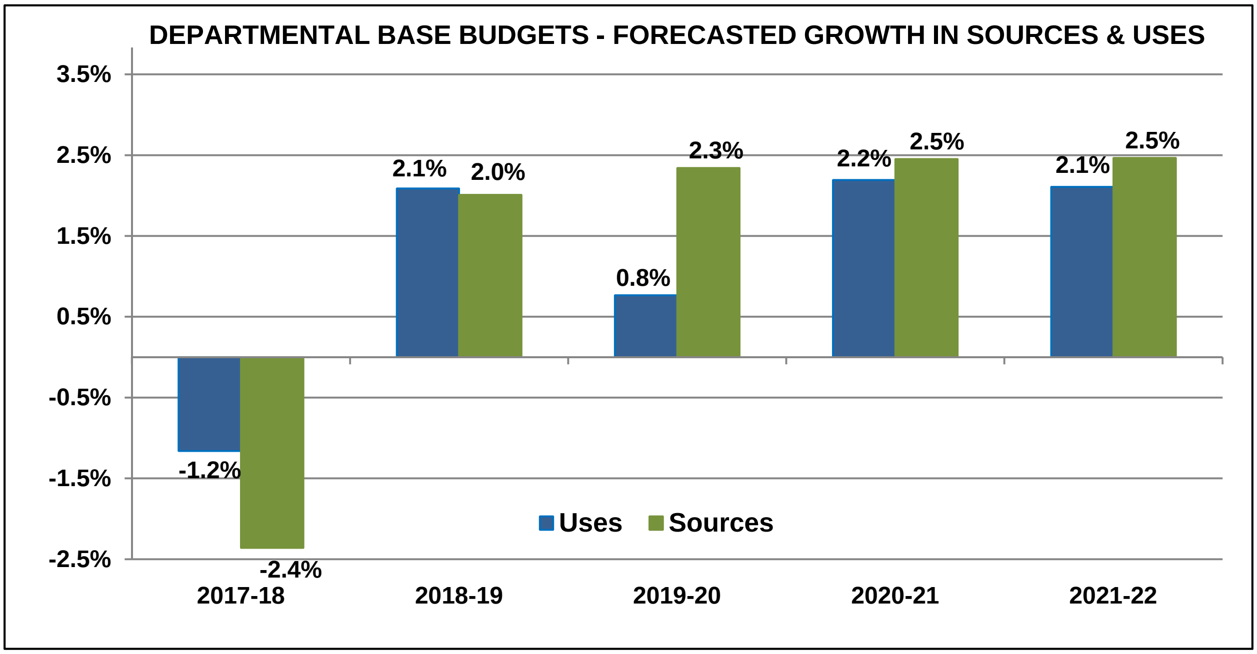


<u>Notes</u>:
[1] Available Sources includes use of one-time revenue, and reserves
[2] Net Baseline Uses is NCC limits plus restore and expand augmentations, and includes the remaining $130M in VLFAA payments in FYs 2016-17 through 2018-19

It is important to note that the gap between available sources and net baseline uses is attributable to a combination of loss of the property tax in lieu of vehicle license fee revenue of $73.5 million annually, reductions in Prop 172 and AB109 funding streams, and increases in salaries and benefits.

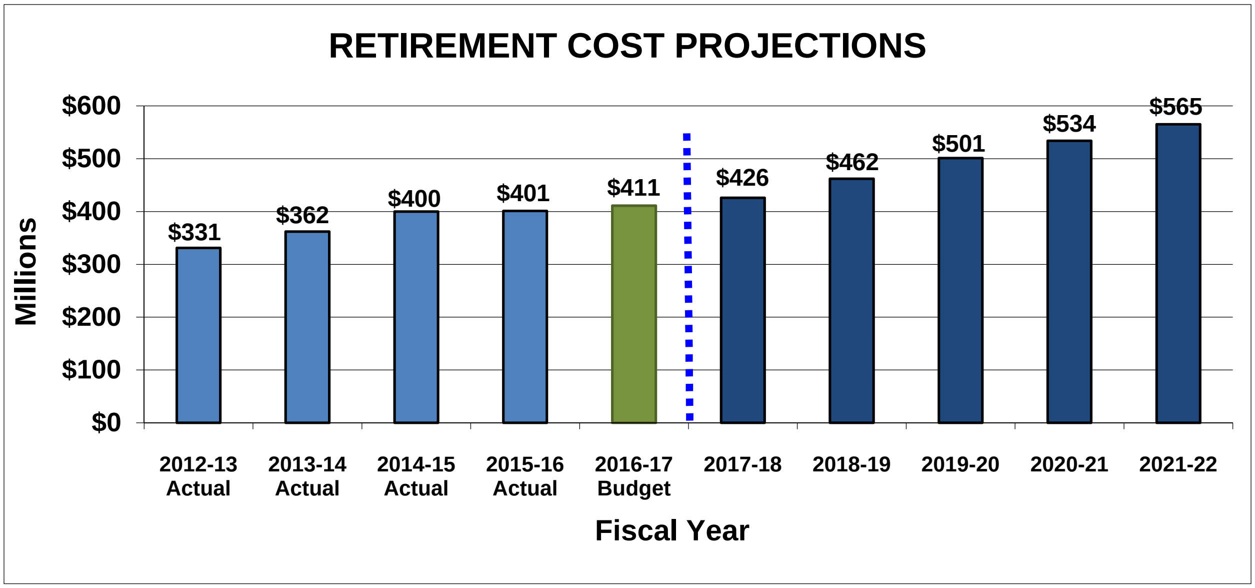
Base Budget Sources & Uses

The following chart summarizes variances in General Fund Departments' forecasted base sources and uses, inclusive of technical and reduction augmentations, and before application of any General Fund contribution (NCC). The reductions to base budgets that General Fund departments employed in each fiscal year to meet the NCC Limits were: FY 2017-18 - $67.9 million; FY 2018-19 - $101.1 million; FY 2019-20 - $132.6 million; FY 2020-21 - $145.0 million; and FY 2021-22 - $160.8 million.



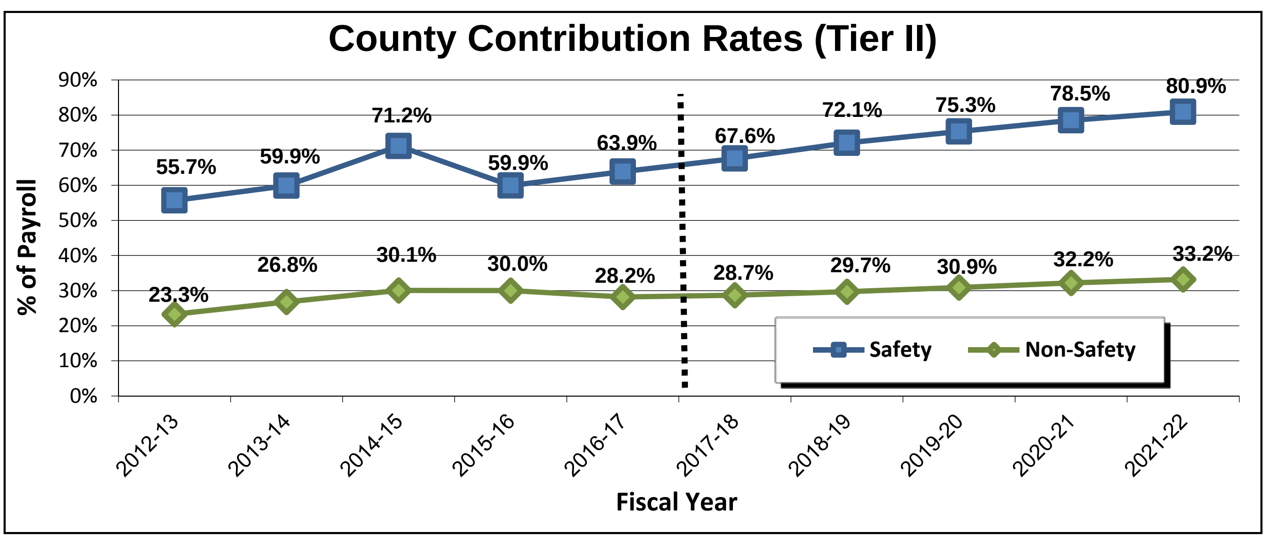
Retirement

The County's projected cost of retirement shows a significant increase over the 2015 SFP primarily due to: a) increases in regular salaries resulting from contract negotiations during the last round of bargaining; b) a retirement market rate of return of 0.00% assumed for calendar year 2016; c) increases in the number of budgeted positions; and d) impacts of retirement cost increases from a three-year phase-in of the decrease in mortality rates for Safety employees. As illustrated in the following chart, preliminary forecasts for retirement reflect annual costs growing from $411 million budgeted in FY 2016-17 to a forecast of $565 million in FY 2021-22, an average annual increase of 5.9%.



Note: All years exclude Pension Prepayment and Retiree Medical.

The following summary of estimated County Contribution Rates for Tier II employees reflects, in addition to changes in various actuarial assumptions, increased retirement rates for Safety employees beginning in FY 2016-17 related to the impact of the three-year phase-in of a decrease in mortality rates for Safety employees, and the overall impact to Safety and Non-safety rates resulting from the retirement market rate of return of 0.00% assumption for calendar year 2016.

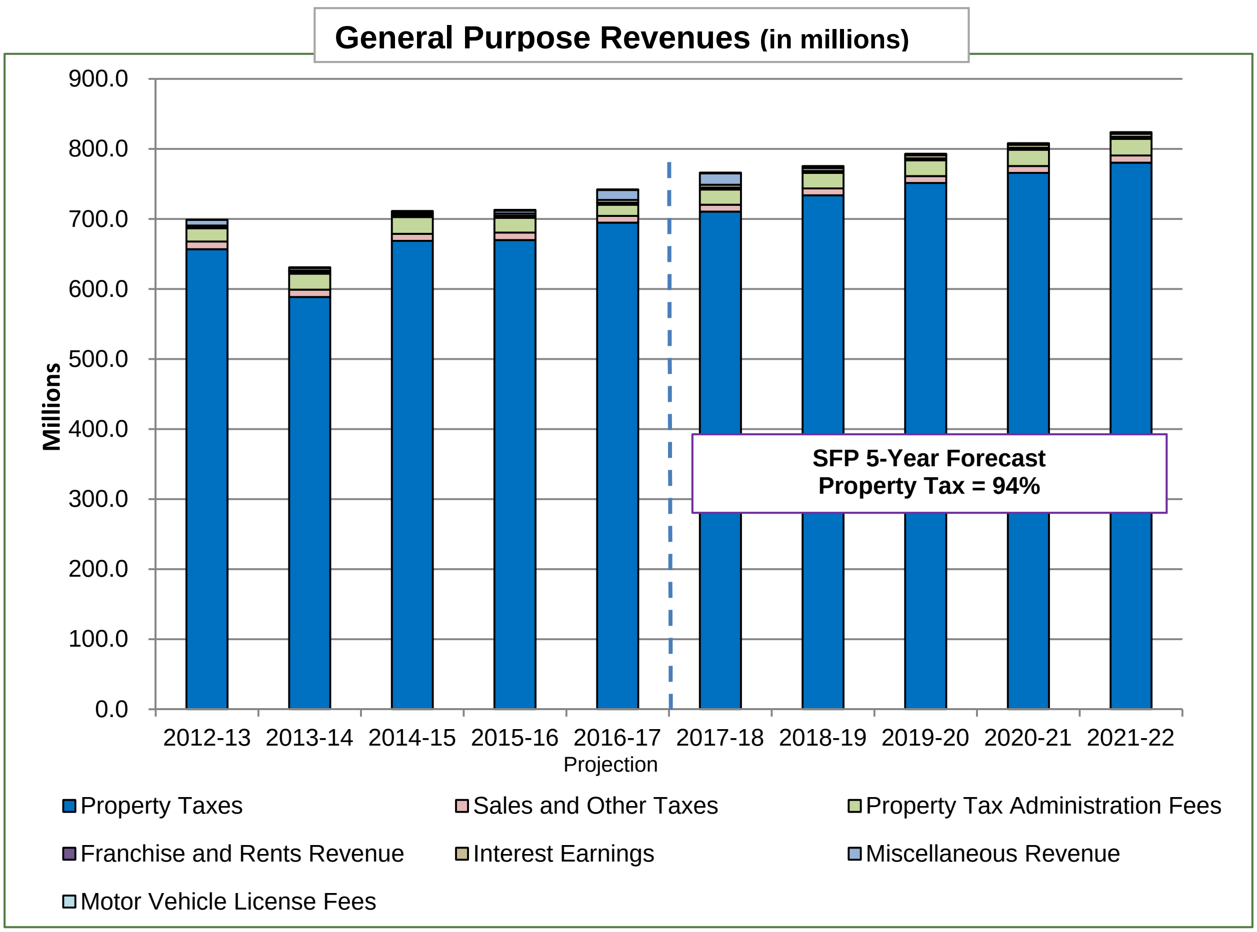


Excludes Retiree Medical

Revenues

As previously illustrated, departmental base revenues (sources) are growing slowly, and in year one are projected to be below growth in departmental base expenditures (uses). The Plan forecasts a moderate increase in GPR and reductions to key departmental revenue sources such as Public Safety Sales Tax and Public Safety Realignment.

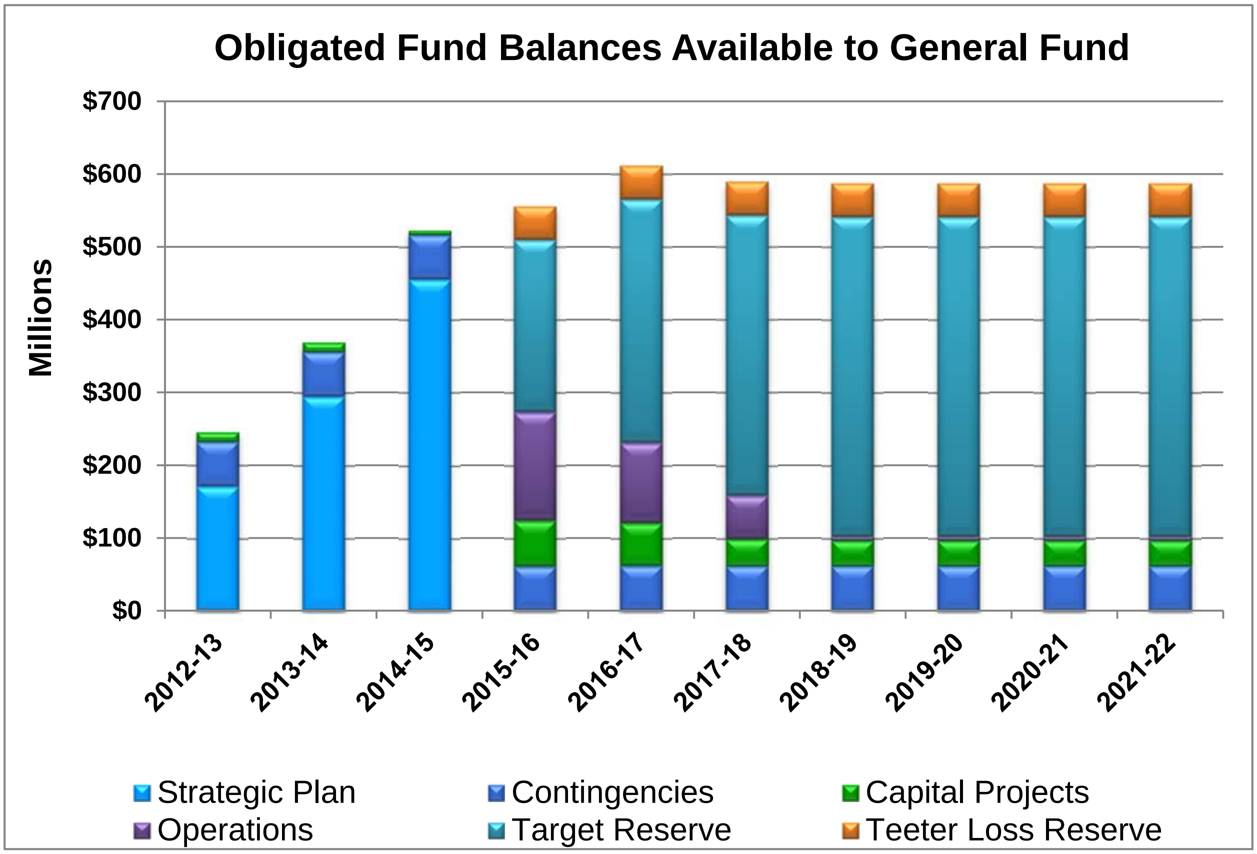
The following chart summarizes historical and forecasted growth in GPR. Detailed analysis of each component of GPR and Fund Balance Unassigned is provided in the *General Purpose Revenue Forecast* section of this document.



Note: Miscellaneous Revenue includes transfers in from other funds.

Obligated Fund Balances and Cash

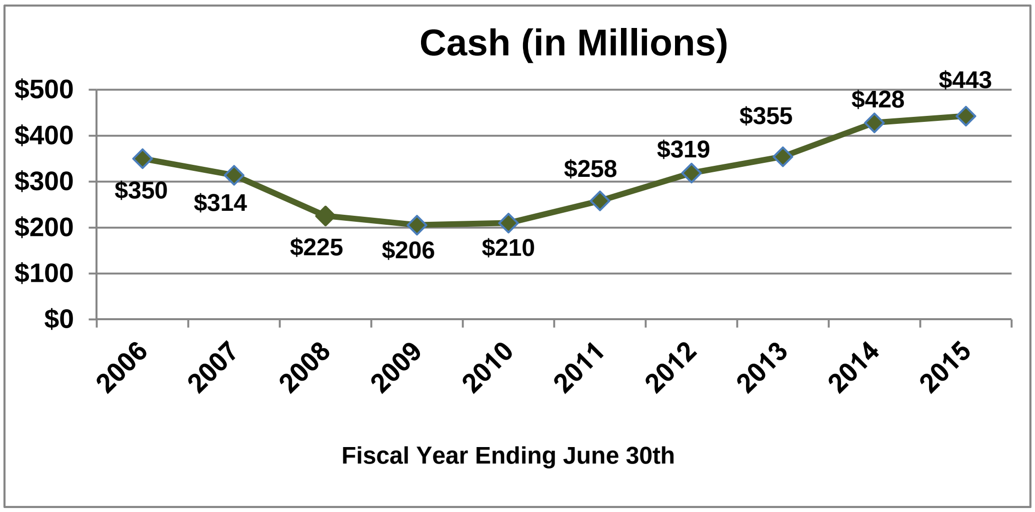
The County maintains an established reserves policy (please see the *Reserves Policy* portion of this document) to mitigate cash flow impacts, maintain best debt ratings and positive borrowing position, and to provide liquidity in the event of a catastrophic event.



(Note: Balances exclude accounts held by other authorities/agencies such as balances held by the Orange County Employees' Retirement System [OCERS]. Balances assume VLFAA payment is made from base budget rather than a draw from reserves.)

During the economic downturn, reserves were used to reduce the severity of impacts to clients and Departments. Since that time, the County has committed to build reserves back to a level that provides flexibility to maintain service levels and protects the County's cash position in order to meet its obligations. While the current and projected obligated fund balances available to the General Fund reflect a healthier reserve position, the Strategic Plan balance is inclusive of the remaining $105 million owed to the State over the first two years of the Plan.

The County is conscientious in maintaining an adequate balance of General Fund cash to address timing variances that occur throughout the year between expense and revenue transactions. 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 one and two when the two largest VLFAA payments are due to the State if the payments cannot be made from available baseline sources. The following chart reflects historical cash balances through June 30, 2015.



Note: Cash balances are as of June 30 of each year as reported in the Comprehensive Annual Financial Report (CAFR).

Infrastructure & Capital Expenditures

Economic conditions and competing priorities for General Funds influenced how the County addressed capital spending. Beginning in FY 2007-08, like other peer counties, Orange County deferred necessary investments in plant and equipment to balance strained budgets and lessen potential cuts to ongoing operations. Coming out of the Great Recession, the County is using the moderate growth in revenues to fund previously deferred critical projects such as the Central Utility Facility infrastructure upgrade, and the Sheriff's CCTV (closed caption television) jail video system. Continued 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. In addition, one-time revenues are being utilized to embark on new projects including the Year-Round Emergency Shelter and OC Animal Care Center.

Strategies

It is crucial that departments continue reviewing programs and operations to determine the best way to continue to size programs for future economic conditions and to ensure services to the community are maintained and performance goals continue to be met within the boundaries of available resources. Departments and the County Executive Office are currently planning for the FY 2017-18 budget process with a goal to preserve the ability to provide quality services to stakeholders, including external clients and employees. Part of this process is to continue looking for opportunities for additional funding to maintain ongoing operations including efforts undertaken in development of the County's Legislative Platform. In addition, projected revenue reductions in the area of public safety mean that re-evaluation of department budgets and reprioritization of projects will be required during the budget process.

Summary

The years since the Great Recession have been challenging; 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 recipients of those services. Through their commitment to fiscal prudence, the Board of Supervisors developed a vision for the County and enabled the County to adapt to a radically changing environment. This commitment to fiscal pragmatism will continue to be required as the County attempts to balance the funding of identified needs and priorities.

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;
- The County continue to apply discipline to financial management;
- Structural balance focused on values and core services continues to be a priority;
- The County continues to seek creative alternatives and partnerships.

The Board has demonstrated commitment to disciplined financial management. It is the continued coordinated efforts of the Board and the County employees that make it possible to exercise fiscal stewardship and to maintain government core services and priorities.