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 2012 Strategic Financial Plan process presented challenges including an anemic economy and significant fiscal impacts passed down by the state.

Beginning in FY 2007-08, the County began to proactively address potential impacts of a forecasted 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 impact the County's ability to sustain service levels and establishes a need to ensure that resources and programs are aligned to county-wide 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:

- My Ballot Program – The Registrar of Voters created this program to teach high school students the value of the electoral process, democracy and civic participation. The program was designated as a "Best of Category" by the National Association of Counties (NACo) in the Civic Education and Public Information category.
- Information Technology Initiatives – The County implemented a new Assessment Tax System as well as a new Financial Accounting and Personnel system.
- 1.62% Defined Contribution Plan for New Employees – The County implemented a new optional retirement formula for new employees, "1.62% at 65," combined with a Defined Contribution Plan.
- Archaeological and Paleontological Partnership Program – OC Community Resources' OC Parks division and California State University, Fullerton (CSUF) entered into a partnership agreement for CSUF to manage, curate, and display an archaeological and paleontological collection.
- OC Parks Ranger Training Academy – The OC Parks Ranger Academy is the only academy in the United States specific to the role of county and regional park rangers. Rather than sending recruits through a law-enforcement academy that provides only some of the needed skills, the OC Parks Ranger Academy trains current and prospective park rangers with the specialized skills necessary to be an exceptional park ranger.
- Airport Improvement Program – John Wayne Airport completed construction of Terminal C, including the North and South Commuter terminals. Terminal C

added approximately 282,000 square feet, including six new commercial passenger gates, security screening checkpoints, food/beverage and news/gift concessions, three baggage carousels, and a Common Use Passenger Processing System (CUPPS). The Airport is maintaining the construction schedule for installing CUPPS in Terminals A and B; and is implementing parity improvements to the Terminals A and B ticket counters, concessions, concourse, and in-line baggage handling.

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 operating plans such as Departments' Business Plans and Balanced Scorecards. 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 include:

- Stabilize the budget and prepare for contingencies.
- Implement a competent and cost effective technology model.
- Address and fund agency infrastructure.

The primary focus of the SFP has been the portion of the General Fund, often referred to as discretionary funding or Net County Cost (NCC). This is 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.

This year's plan focused on General Fund gap analysis in an effort to highlight the significant impacts of state budget actions, the continuing impact of depressed General Fund revenues and the growing 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 2013-14 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 2013-14 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 2012 SFP including:

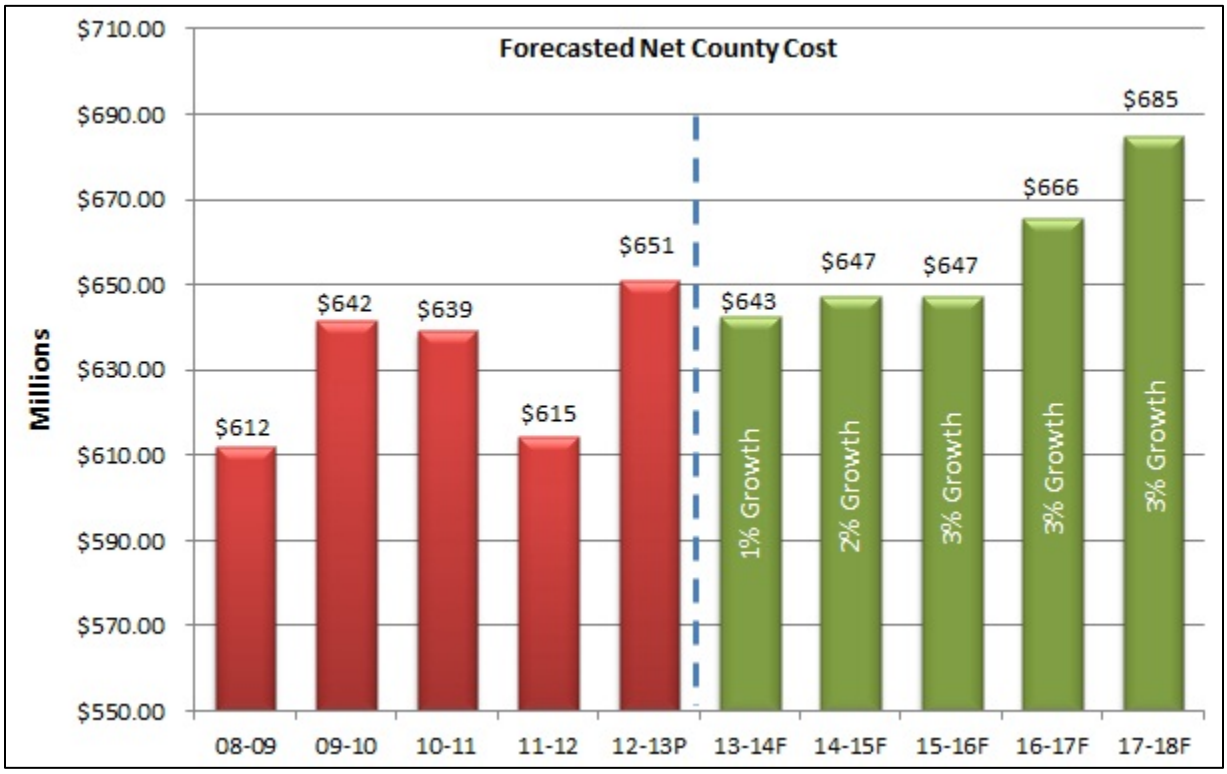
- General Purpose Revenue forecast developed in conjunction with forecasts by the Auditor-Controller, the 2012-13 Local Assessment Roll of Values, and receipt trends.
- Various projections for capital and operating inflationary factors, as developed by governmental or industry experts in the related 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.

Economic data compiled in August 2012 was included as part of the 2012 SFP instructions. As changes occur in the economy, some projections may be updated during the FY 2013-14 annual budget process.

<u>Key Assumptions</u>:

- Salary Assumptions
  - Years 1 through 2: 0.0%
  - Years 3 through 5: 2.0% to 3.0%
- Retirement Rate Assumptions (Tier II)
  - Safety Rate from 51% to 61% (excludes retiree medical)
  - Non-Safety Rate from 27% to 31% (excludes retiree medical)
  - Retiree Medical for AOCDS at 3.2% (4.1% for Law Enforcement Managers)
  - Retiree Medical for OCEA at 3.2%
  - No County payment of Employee Pickup
- Health Benefit Cost Assumptions
  - 5-Year Growth from $171M to $241M (40.9%)
- 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 2013-14 NCC limits were projected using the adopted FY 2012-13 limits ($655.9 million) as a starting point, with amendments for technical adjustments and removal of one-time items resulting in proposed baseline limits for FY 2013-14 of $644.2 million (1% growth was proposed for FY 2013-14 limits). Departments have identified $34.1 million in reductions that would be required to meet the FY 2013-14 NCC limits. After factoring in NCC Limit growth of 1% in year one, 2% in year two, and 3% in years three through five of the Plan, Departments still identified a 5-year cumulative budget gap of $239.0 million. The following table summarizes historical and forecasted NCC limits.



The following table summarizes NCC by program:

Program	09-10	10-11	11-12	12-13P	13-14F	14-15F	15-16F	16-17F	17-18F
Public Protection	$351.1	$370.7	$311.2	$345.7	$328.9	$334.7	$343.6	$352.8	$362.3
Community Services	166.2	145.1	136.2	135.4	134.4	137.1	141.2	145.4	149.8
Infrastructure	34.9	31.0	30.7	33.4	34.7	35.4	36.4	37.5	38.6
General Government	96.5	95.8	98.6	99.0	96.7	98.7	101.7	104.8	108.1
Capital Improvements.	1.1	10.8	39.7	16.9	26.7	22.2	23.0	23.8	24.5
Debt Service	20.5	20.4	23.1	19.5	19.3	19.3	0.9	0.9	0.9
Insurance, Reserves. & Misc.	-28.8	-34.7	-23.3	1.0	1.8	0.0	0.2	0.3	0.5
GRAND TOTAL NCC	**$641.5**	**$639.1**	**$616.2**	**$650.9**	**$642.5**	**$647.4**	**$647.0**	**$665.5**	**$684.7**

*Note: FY 12-13 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. However, economists caution that tax increases and spending cuts at the federal level, referred to as the "fiscal cliff," could have negative short-term impacts on the economy should Congress take no action before the end of the calendar year. Please see further discussion of economic impacts in the *Economic Forecast Summary* section of this document.

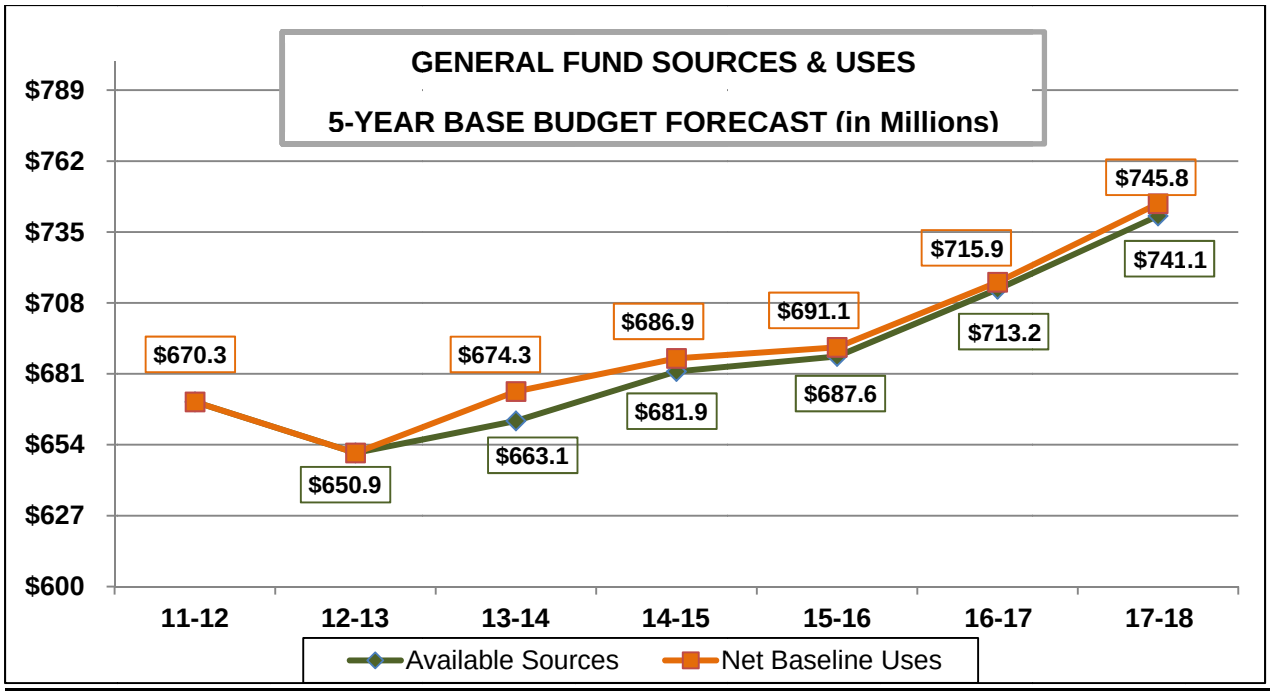
This SFP has been conservatively developed and includes modest growth consistent with current economic conditions. The County continues to follow fiscal policies implemented beginning in 2007 to trend the County's budget downward including: continuing of the hiring freeze, elimination of vacant positions, no backfill of State budget reductions, and unanticipated revenue and revenue received in excess of budget to be used to replenish General Fund Reserves. All of these measures have positioned the County to weather the Great Recession and other factors impacting the budget.

Expenditures

Key Issues –

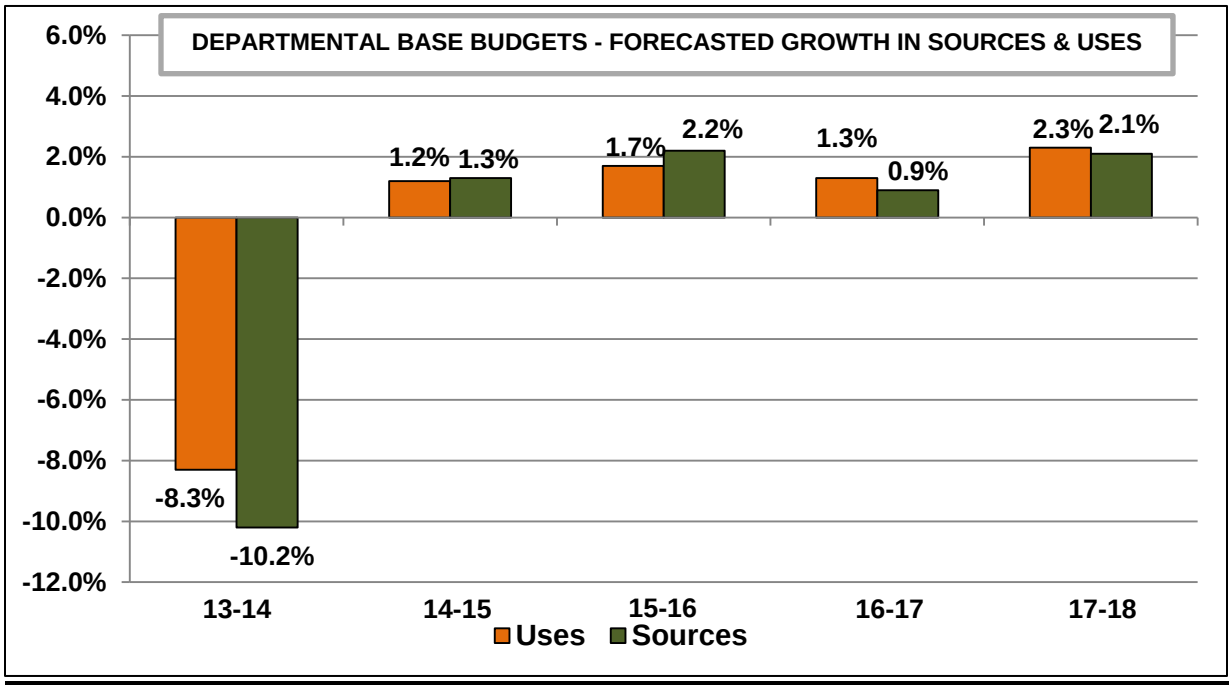
- Cost of doing business continues to grow.
- Potential changes in the Orange County Employee Retirement System (OCERS) discount rates could cause retirement cost plan projections to increase by $25 million to $50 million annually.
- Plan assumptions include employee pension cost pick-up not yet negotiated with bargaining groups.

The General Fund departments submitted baseline requests plus restoration requests that exceed available sources by $27.1 million over the five-year Plan period. 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 2017-18. Funding previously allocated for bankruptcy payment has been set aside pending Board direction. The following table illustrates the projected General Fund Sources and Uses:

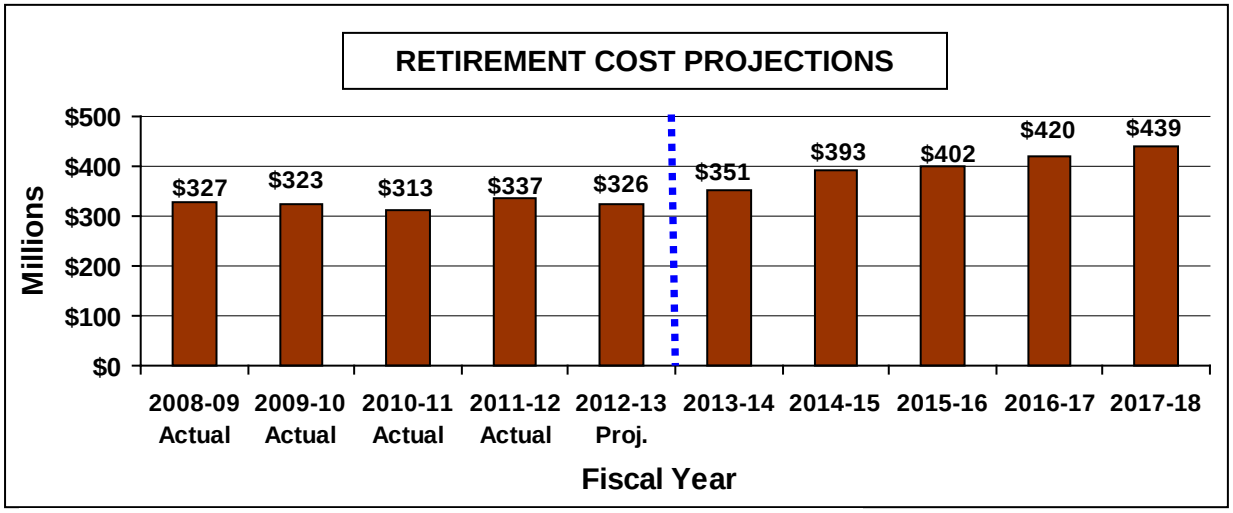


It is important to note that the General Fund Sources projections include Vehicle License Fee Adjustment Amount (VLFAA) revenues of $73 million to $86 million annually over the five years. The VLFAA revenues are currently disputed by the State and a pending lawsuit regarding these revenues could threaten the County's fiscal condition. ***Should the Court decision favor the State's position, the County projects a 5-year funding gap of $385.2 million.***

The following chart summarizes variances in departments' forecasted base sources and uses before any General Fund contribution (e.g. NCC):

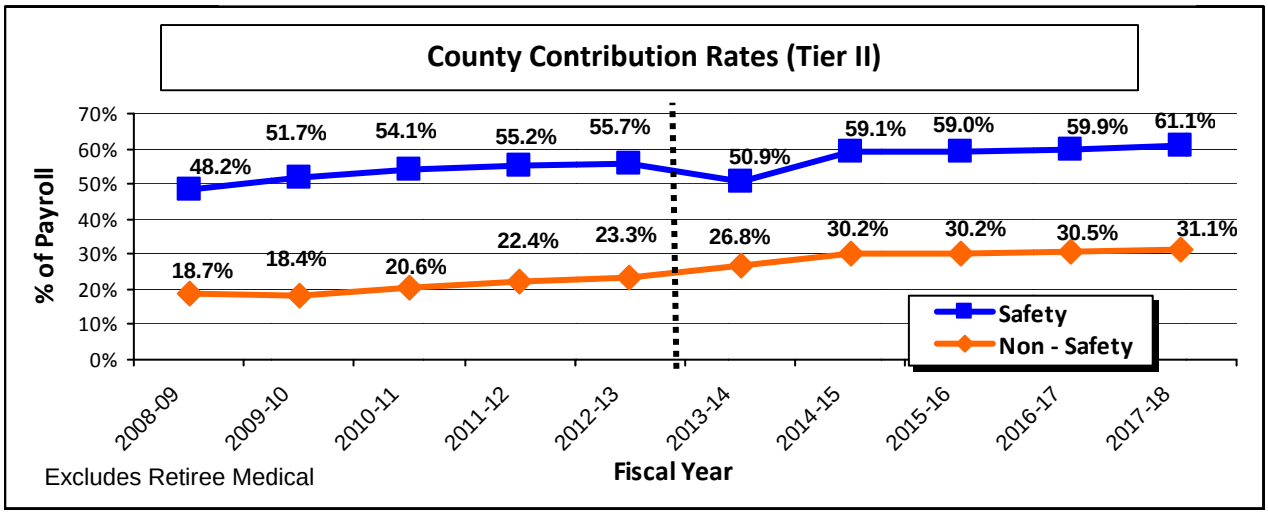


Retirement and health benefit cost increases continue to outpace revenue growth and are projected to continue to do so over the next five Plan years. As illustrated in the following chart, preliminary forecasts for retirement reflect annual costs growing from FY 2012-13 projected $326 million to a forecast of $439 million by FY 2017-18, an average annual increase of 6.2%. It is also worth noting again that potential changes in the Orange County Employee Retirement System (OCERS) discount rates could cause retirement cost plan projections to increase by $25 million to $50 million annually.



Note: Excludes Retiree Medical & Pension Prepayment

The following summary of 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:



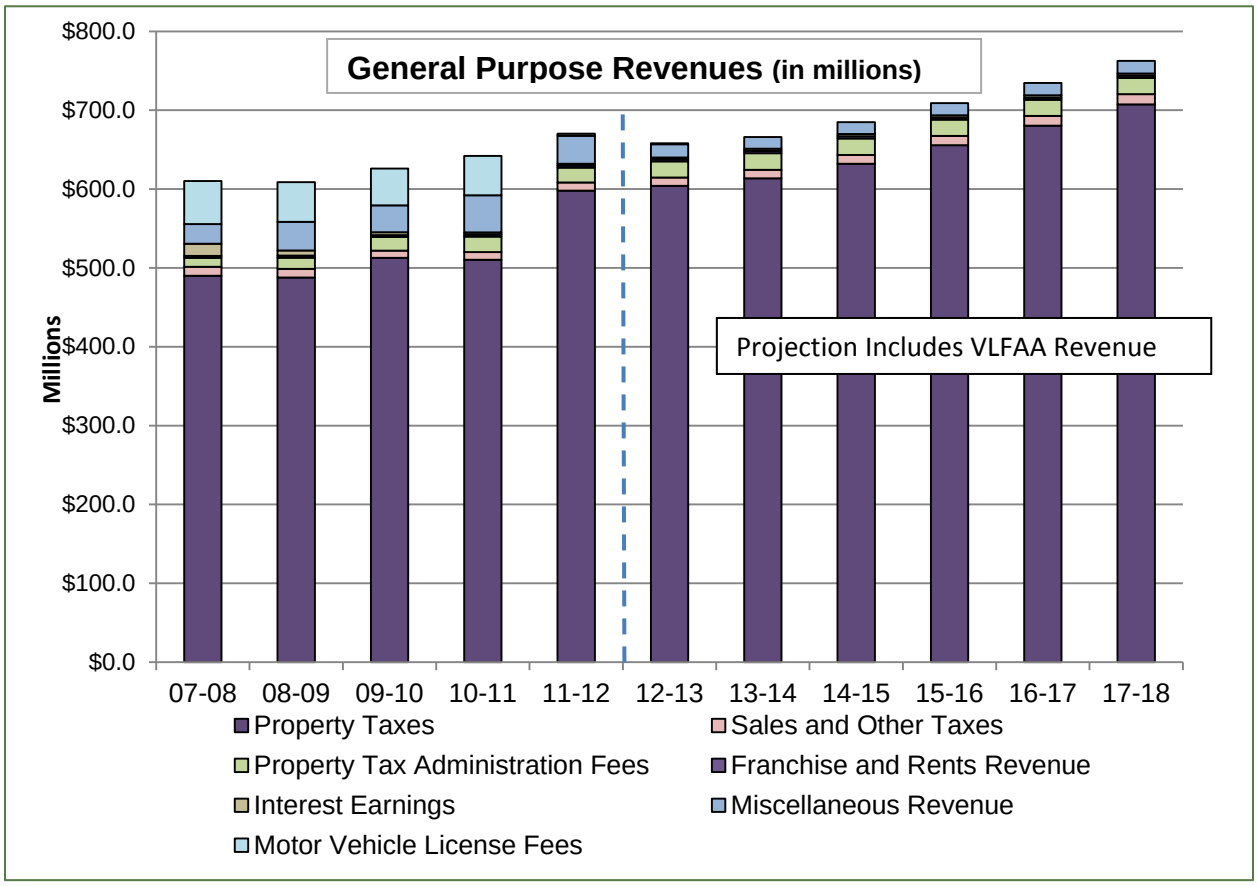
Revenues

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.)
- Vehicle License Fee Adjustment Amount (VLFAA) - $73.5 million in annual revenue disputed by the State

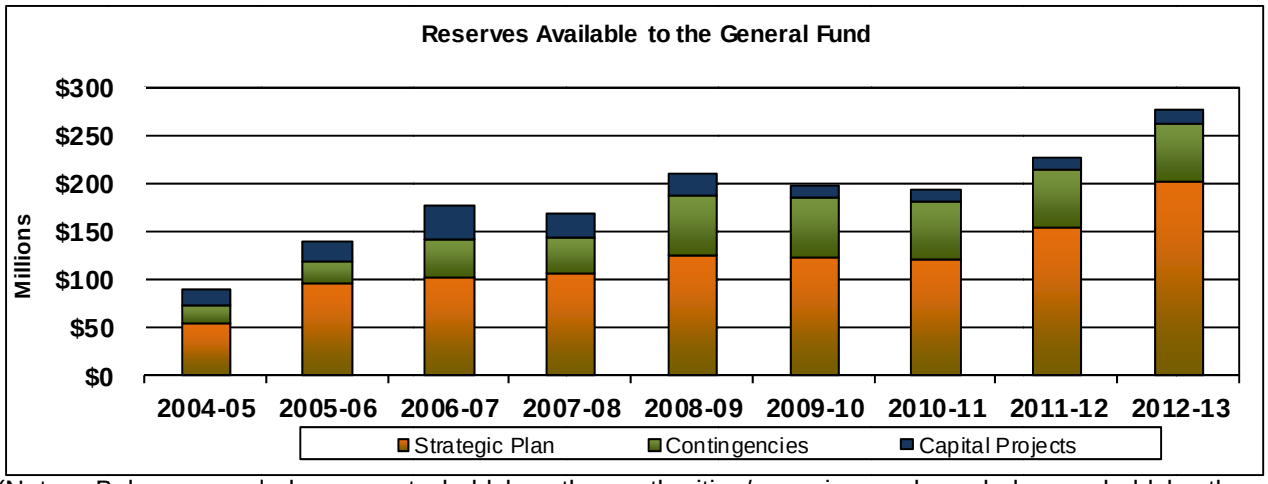
As previously illustrated, departmental base revenues (sources) are growing slowly, and in all but one year are projected to be below growth in departmental base expenditures (uses). There is a projected surplus between sources and uses after allocation of General Purpose Revenues (GPR) and restoration of department reductions to meet NCC Limits. The Plan forecasts a moderate increase in GPR and key departmental revenue sources such as Public Safety Sales Tax and Health and Welfare Realignment. Currently, state Realignment funding is projected to reimburse dollar for dollar actual expenditures; however, there is no guarantee that the state will continue to fully fund realigned programs and services.

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



Reserves and Cash

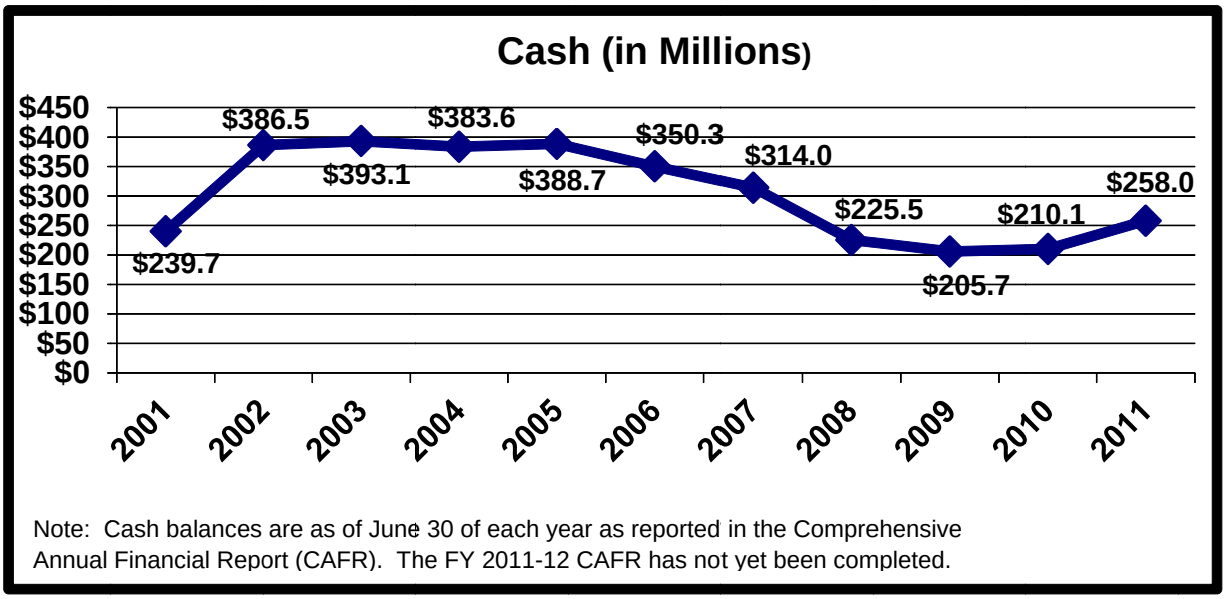
The County maintains an established reserve policy (please see the *General Fund Reserves* section of this document) to mitigate cash flow impacts, maintain best debt ratings, maintain positive borrowing position, and to provide liquidity in the event of a catastrophic event.



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

Over the last five years, reserves have been used to mitigate some of the impact of the economic downturn and reduce the severity of impacts that might have been realized. FY 2011-12 was the first year since FY 2008-09 where there was net growth in reserves. 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. The following chart reflects historical cash balances through June 30, 2011.



Note: Cash balances are as of June 30 of each year as reported in the Comprehensive Annual Financial Report (CAFR). The FY 2011-12 CAFR has not yet been completed.

Infrastructure & Capital Expenditures

Declining revenues and cuts in state funding have also 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 impact on future economic development. The added cost of continued deferral needs 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 right 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 2013-14 budget process with a goal to maintain the ability to provide quality services to stakeholders, including external clients and employees.

As part of the 2012 Strategic Financial Plan process, General Fund departments were asked to identify contingency reduction plans in the event that a Court decision favors the State in the matter of the disputed VLFAA revenue. The departments will include the contingency reduction measures as part of the FY 2013-14 budget process and be prepared to react should the State's position prevail.

Summary

The last five years 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.

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. Carrying out vital services and assurance of responsible management requires:

- That impacts continue to be evaluated and communicated timely;
- That the County should continue to apply discipline to financial management;
- That structural balance focused on values and core priorities 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.

"The future depends on what you do today." ~ Mahatma Gandhi