A LOOK AT SANTA BARBARA COUNTY'S FINANCES

RED INK RISING

Introduction

Each year the Grand Jury, as part of its mandate under Penal Code 925, must examine the budget, operations, accounts and performances of county departments and functions. In this report, we also comment on the economic climate and fiscal soundness of the County.

One of the major challenges confronting the County this year, and into the foreseeable future, is decreasing revenue. Contributing to this revenue decline is the acute financial problem at the state level. Santa Barbara County receives approximately 42% of its revenues from federal and state sources, compared to only 22% from local property taxes. Remaining revenue is generated from fees for services, licenses, permits and other sources. The County Administrator has estimated the shortfall in state funding at $13.7 million in the fiscal year 2003-2004 and $24.6 million in 2004-2005.

Adding to the County's financial problems are the high cost of employee compensation and the retirement system. Also, the privatization criteria adopted by the Board of Supervisors limits opportunities for county employees to find work with private contractors.
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Objective

The 2003-2004 Grand Jury decided to examine ways in which county government can better manage for cost efficiency and effectiveness. The Jury recognizes that the Board of Supervisors and the County Administrator are working diligently to close the budget gap; however, the Jury believes there exists some basic structural impediments that, if not addressed, will result in increasing financial difficulties.

In this report the Jury comments on several major county cost issues and offers recommendations for improvement.

Approach

The Grand Jury undertook the following:

1. Review and analysis of the Comprehensive Annual Financial Report – fiscal year ending June 30, 2003.

2. Review and analysis of the preliminary Management Letter submitted by the County's outside auditor, KPMG.

3. Review and analysis of the County's Operating Plan, 2003-2004 Budget and Five-year Capital Improvement Program.

4. Interviews and meetings with the County Auditor-Controller and staff, County Administrator, members of the Board of Supervisors and various county department heads, consultants and financial advisors.

5. Examination of surveys of compensation practices in Santa Barbara County.

6. Attendance at several Board of Supervisor meetings.

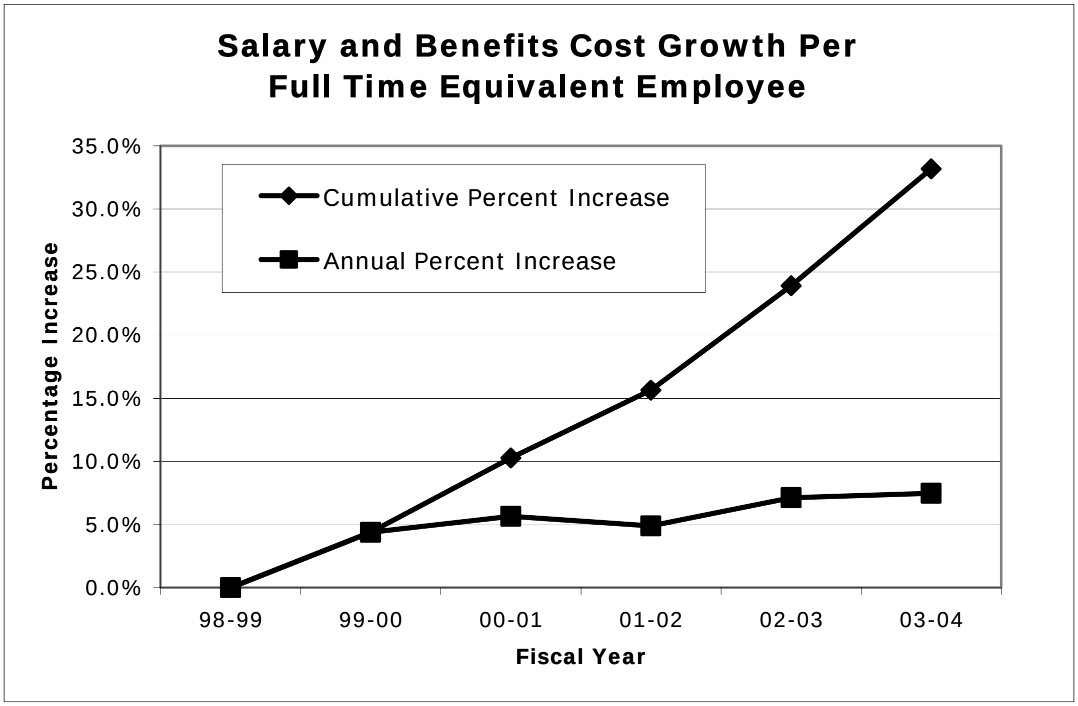
Observations

County Employee Compensation

Ten years ago Santa Barbara County went through a financial crisis similar to the one it faces today. At that time, the 1994-95 Grand Jury conducted an investigation and issued a comprehensive report entitled *"Compensation of County Employees."* Then, as today, compensation to county employees (salary and benefits) accounted for over 50% of the total county budget.

That report concluded, "*In an era of diminishing fiscal resources available at all levels of government, the continued payment of generous wages, salaries, benefits and the growth in these packages is unacceptable."* That comment is as true today as it was ten years ago.

The County's Fiscal Year 2003-2004 Recommended Budget shows the average cost per full-time equivalent employee will increase almost 7.5% from FY 2002-2003 to FY 2003-2004.



Source: Santa Barbara County Operating Plan, Proposed Budget Fiscal Year 2003-2004.

Over the past five years the **average** total compensation (salaries plus benefits) for a county employee has increased from $59,100, up almost 35%.

Salaries and benefits account for 53.5% of the County's 2003-04 recommended budget ($332.1 million out of $620.6 million). Even though the recommended budget shows a decrease of 142.3 positions (3.2% reduction), salary and benefit costs will increase $12.7 million (4% increase over the fiscal year 2002-03 adopted budget). Unless these costs can be brought under control, the upward spiral will continue well above inflation rates.

The Jury heard a number of reasons for the large increase in employee compensation from County officials:

- Government worker unions are a major political force in the County and State
- The State mandates "this or that"
- We need to pay top dollars to attract and retain good people

- We need to pay competitive wages compared to other public agencies

While these statements may have merit, they are not valid reasons to avoid hard bargaining and to manage costs more effectively.

It is time for the compensation plans to reflect the County's financial crisis. This includes tough negotiating with employee unions. For example, the County has agreed to cost of living increases (COLAs) based on the increase in property tax revenues. Fifty percent of the annual increases in property tax revenues are given as COLAs. This was described as a good way to insure that funds are available to pay the negotiated cost of living increases. The Jury does not understand the rationale for the connection between property tax revenues and COLAs for county employees. COLAs should be tied to increases in the cost of living index.

The Board of Supervisors voted themselves a COLA increase in a year of deficit spending.

The Jury concluded that the private sector has done a reasonable job in dealing with employee compensation during difficult economic times. The Jury recommends that an independent "Blue Ribbon" committee, drawn from the private sector, be established to conduct a in-depth review of County compensation policies and practices. This Committee would consist of unpaid volunteers with expertise in, salaries, benefits, collective bargaining etc. It would make recommendations for changes to bring County compensation into better cost control.

Finding 1

County employee compensation is increasing at an unsustainable rate.

Recommendation 1

Impanel an independent "Blue Ribbon" committee to conduct a comprehensive review of county employee compensation policies and practices. The Committee should report its findings and recommendations to the Board of Supervisors and also release its report to the public.

Downsize and Privatize

Unlike government, the private sector is not restricted by regulations of the Civil Service Code nor is it subject to the collective bargaining agreements that control County labor costs. For these reasons, privatization of some county functions should result in significant savings. The Board of Supervisors in February 2003, however, in a 3 to 2 vote adopted a policy of Privatization Criteria that in effect kills the benefits of privatization. This policy requires that private contractors offer jobs to county employees at their current compensation and benefit level. Given the current budget deficit, layoffs are inevitable. County employees will be better off having the opportunity to work for a private contractor at lower compensation than having no job at all.

Santa Barbara County, under the Civil Service Code, has over 700 job classifications for about 4000 employees. This ratio adds to administrative headaches and restricts job mobility.

Finding 2
Privatization of some County functions could result in significant savings. However, in February 2003 the Board of Supervisors adopted a policy of Privatization Criteria that in effect eliminates the benefits of privatization.

Recommendation 2
The Board of Supervisors should rescind the Policy of Privatization Criteria.

A Pension Headache

The increasing cost of retirement benefits for County employees has become a serious budget issue. In 2003 the County had to add an additional $5.2 million to the pension fund. Future required increases are unknown, but some County officials estimate it may run as high as $25 million over the next five years. One county employee has likened the scenario to “being on a train and seeing the crash coming.” The reason for high pension costs is that the County of Santa Barbara provides its employees with what is known as a “Defined Benefit Plan.”

Under such a plan, the County guarantees its retirees and their spouses a set amount for their life time, and this benefit increases with inflation. Each year the County pays into a pension fund an amount that is expected to cover these future benefits. This contribution can be expected to increase each year with cost of living adjustments and longer life expectancy.

The problem is particularly severe when pension fund assets (stocks, bonds, etc.) decline in value or do not grow as fast as anticipated. In this situation, the County must make up the difference with cash from the general fund.

One solution to the pension problem is to switch to a “Defined Contribution Pension Plan.” Under this plan, the County would contribute a regular fixed amount into each employee's individual retirement account. Employees have control over how this money is invested, and when they leave or retire the money goes with them.

Most private companies concerned with rising pension costs have made the change to Defined Contribution Pension Plans. The advantages to the County in making such a change are the following:

- Pension costs are known in advance and can be accurately budgeted.
- Pension costs are not affected by declines in the stock market.
- County responsibility ends once the employee leaves or retires

Finding 3
County retirement costs are increasing at an unacceptable rate.

Recommendation 3
The Board of Supervisors make every effort to **retire** the Defined Benefit Plan and implement a Defined Contribution Pension Plan.

Planning for No More Surprises

All financial plans, whether for government, business or the family budget, must start with an assumption about future income. If revenue is not predicted accurately, then the plan will not work. ***Good planning provides for alternatives that can be implemented should economic conditions change***.

Santa Barbara County financial planners have experienced difficulty in accurately projecting revenue. This is understandable because a substantial part the county funds come from the State of California. Sacramento's budget problems have made financial planning at the county level extremely difficult.

One solution to this uncertainty is to adopt a planning process that takes into consideration more than one assumption about revenue.

The County's current budget makes only one assumption about revenue, and it covers only one year. The process could be expanded to include a downside scenario that takes into account harder economic times. Such a plan would provide both the Board of Supervisors and the public a clearer idea of what options exist in dealing with shortfalls in revenue.

It would also be practical to plan for a period longer than one year. A five-year operating plan, incorporating different economic outlooks, would provide a clearer vision as to where the County is headed and the financial resources required to get there.

Currently the County Administrator prepares a Five-Year Capital Improvement Plan that addresses nonrecurring capital needs, such as, roads, bridges, buildings, etc. The capital requirements could be incorporated into an overall five-year operating plan providing a complete picture of the County's total projected source and use of funds.

A five-year financial plan, with various economic scenarios, would be a useful tool in managing through changing economic times. While not replacing the official annual budget, it would provide the openness and transparency that taxpayers expect from their county government.

Finding 4
The County's financial planning process does not adequately take into account adverse economic conditions.

Recommendation 4

The County Administration should prepare an easy to understand, five-year financial plan that takes into account both the most likely economic outlook and downside economic projections.

Affected Agencies

Santa Barbara County Board of Supervisors

Findings	1, 2, 3, 4
Recommendation	1, 2, 3, 4

Santa Barbara County Employees' Retirement System

Finding	3
Recommendation	3