# County of San Mateo

Inter-Departmental Correspondence

**Department:** COUNTY MANAGER

Board Meeting Date: 1/29/2019

**Special Notice / Hearing:** None
**Vote Required:** Majority

**To:** Honorable Board of Supervisors

**From:** Michael P. Callagy, County Manager

**Subject:** FY 2018-19 Mid-Year Budget Update

**RECOMMENDATION:**

Recommendation to:

A) Accept the FY 2018-19 County Mid-Year Budget Update, including key revenue and expenditure projections and budget assumptions; and

B) Accept the Proposition 172 Maintenance of Effort Certification.

**BACKGROUND:**

Entering the mid-year of the FY 2018-19 budget cycle, we are pleased to report the County of San Mateo remains well positioned in regard to financial health. We ended FY 2017-18 with a surplus of $177.5 million, while adding $121.7 million to the General Fund Reserve, which is 16.9 percent of Net Appropriations. The combined contingencies in all funds are currently $508 million. We have been fortunate to see five straight years of property tax revenue growth, with growth during this period being 7.5 percent. Growth in general revenues is at $574 million or 5.19 percent per year. Although construction activity is still moving forward at record rates, we are preparing for a softening in the real estate and construction markets due to an increase in interest rates, the mounting pressure of tariffs and federal politics, and the volatility in equity markets. San Mateo County is a region of diversity, still experiencing growth at San Francisco Airport, in our biotech and technology firms, and in our financial institutions. Because of our Board's steadfast prudence in addressing the unfunded pension gap, the County continues making great strides to significantly reduce our unfunded pension liability by 2023.

The County has seen eight years of growth since the great recession of 2008. History illustrates that nothing continues to go up forever and the region's current economic growth is no exception. Like the rest of the country, the County is entering a time of uncertainty. It has been said, "The pessimist complains about the wind; the optimist expects it to change; the realist adjusts the sails." As uncertainty looms, now is the time for the County to adjust its sails which will allow the Board the creativity to turn challenges into opportunities to meet the uncertainty of our changing environment.

We must do our best not to let change just happen, but rather play a vital role in its direction with bold and creative moves that will allow us to meet our core objectives, while focusing on inclusion of our residents and the transparency of our County government. Oliver Wendell Holmes once said, “The great thing in the world is not so much where we stand, as in what direction we are moving.” We must do our best to keep moving toward building upon the inclusion of our residents, the delivery of our services, the diversity of culture and thought, and the achievement of our core objectives in San Mateo County.

- Capital Projects:

  In November 2018, we obtained $217 million in our first round of lease revenue bond financing for the projected $487.6 million necessary to complete our capital projects within the Project Development Unit. These projects include the following:

| | |
|---|---|
| Cordilleras Health System Replacement | $120 million |
| San Mateo Health Campus Upgrade | $120 million |
| South San Francisco Health Campus | $37 million |
| County Office Building 3 | $152 million |
| Parking Structure 2 | $47 million |
| Skylonda Fire Station | $9.9 million |
| Lathrop House Relocation | $1.7 million |
| **Total** | **$487.6 million** |

- Housing:

  San Mateo County is diverse not only in business, but also its cultures and communities. However, the diversity that makes this county so great is threatened by the high cost of housing. The median home price is $1.29 million, requiring a minimum household income of $300,000. San Mateo County ranks second (behind San Francisco) for the lowest level of affordability in the state; only 15 percent of county households can afford the median-priced single-family home. Renters also face severe burdens: to afford the median asking rent of $3,500 for a two-bedroom apartment, a household would need an annual income of $140,000. These high housing costs threaten the stability of our families and communities. To address these challenges, the County has contributed approximately $110 million to affordable housing since 2012, funding the construction, preservation, or rehab of over 2,600 units.

- Transportation:

  With the recent defeat of Proposition 6 (repeal of SB1) and the recent passage of both Measure W (November 2018) and Regional Measure 3 in June 2018, San Mateo County voters sent a clear message they are willing to pay for better roads, congestion relief, more bike lanes, regional approaches to transportation, increased bus and train service, and new and innovative transportation modes. The anticipated result is that San Mateo County will continue to receive $9.6 million in FY 2018-19 due to the defeat of Proposition 6 and additional funding of $1.3 million starting in FY 2019-20 due to the passage of Measure W.

- Health:

  The uncertainties faced last year regarding the Affordable Care Act (ACA) still remain even with the current changes in Congress. There are currently approximately 58,000 San Mateo County residents enrolled in health insurance through ACA.

  Although the ACA does act as a stabilizing factor for now, the Health System currently faces a large funding gap. I commend Health Chief Louise Rogers and her staff for the effective and efficient manner in which they will implement changes to address that gap in the upcoming FY 2019-21 budget cycle. But given the magnitude of the ongoing deficit, maintaining the County's goal of ensuring access to affordable health care services to everyone will take long-term structural changes along with work with our health care partners.

- Fire Protection:

  San Mateo County faces a new safety paradigm due to climate change which has led to devastating and deadly wildfires resulting in the catastrophic loss of life and property in Northern California in recent years. At the urging of this Board, a new task force has been formed and is being led by Public Safety Communications Director Dan Belville. This multidisciplinary task force, with the use of experts, will work to understand and prepare for the exponential nature of wildfires in the changing environment in which we are living.

  In February 2019, Director Belville will present an update to the Board on the formation of the task force and the goals it hopes to achieve. The findings of this group may require more funding in the way of early detection systems and active management of our forest areas.

Our county has a long history of collaboratively addressing issues to provide the highest degree of service to those depending on us for assistance. Now, more than ever, we must come together as a nation, as a state and as a county to collectively address some of the daunting challenges we face nationally and locally. Although effecting change at the federal and state levels takes time, positive change can be made every day at the local level. Let us not waste a day. Instead, ask daily how we can improve.

- How can we better serve our community?
- How can we become more effective and efficient?
- How can we better collaborate with our neighbors on shared goals?
- How do we become more inclusive to ensure the voice of our county community is heard?
- How do we become change agents that act to transform government?

Let us all work together today to achieve tomorrow's dreams and never forget our shared commitment to work collectively and collaboratively for the common good.

**DISCUSSION:**
Each year the Board reviews the current fiscal year budget at mid-year to ensure revenues and expenditures are in accordance with estimates and to provide direction to the County Manager regarding preparation of the next budget. This update includes year-end Fund Balance estimates, a variance analysis for all County funds, identification of major issues affecting the preparation of

midterm budget adjustments, data for local economic indicators, and projections for general purpose revenues, Measure K, and Public Safety Sales Tax (Prop. 172).

The Bay Area economy continues to grow with unemployment in San Mateo County declining to 2.1 percent. Annual per capita personal income in San Mateo County has increased from $106,615 in 2016 to $113,410 in 2017 (six percent). Boardings at San Francisco International Airport (SFO) and construction activity remain at record levels.

Year-end Fund Balance in the General Fund has consistently been in the 20 percent range. Due to one-time funding of approximately $200 million for major capital and IT projects, as well as the pay-down of unfunded pension liabilities, undesignated reserves are at 12.2 percent of Net Appropriations. The County of San Mateo continues to hold the distinction of being one of only a handful of counties in the state with AAA ratings from both Moody's and Standard and Poor's.

It is important to note that these mid-year projections do not include continuing labor negotiations and others that were not concluded until late December and mid-January. The estimated value of these negotiations is $11.5 million in the current FY 2018-19.

## FY 2018-19 Year-End Fund Balance Projections

| County of San Mateo Agencies by Fund | FY 2018-19 Working Budget | FY 2018-19 Budgeted Reserves | FY 2018-19 Projected YE Fund Balance | Projected Fund Balance Variance |
|---|---|---|---|---|
| Criminal Justice - General Fund | $ 463,372,612 | $ 29,757,649 | $ 34,878,138 | $ 5,120,489 |
| Health Services - General Fund | 453,861,525 | 8,092,870 | 8,901,446 | 808,576 |
| Health Services - Other Funds | 0 | 24,681,149 | 24,541,814 | (139,335) |
| Social Services - General Fund | 61,977,434 | 24,003,760 | 28,688,471 | 4,684,711 |
| Community Services - General Fund | 199,123,115 | 12,434,499 | 22,384,226 | 9,949,727 |
| Community Services - Other Funds | 588,264,425 | 150,983,884 | 210,267,130 | 59,283,246 |
| Admin-Fiscal - General Fund | 167,595,483 | 18,540,414 | 23,874,639 | 5,368,300 |
| Admin-Fiscal - Other Funds | 0 | 22,550,390 | 22,750,292 | 199,902 |
| Fund | 393,069,007 | 191,760,081 | 360,036,926 | 168,276,845 |
| Subtotal General Fund | $1,738,999,176 | $ 284,589,273 | $ 478,763,845 | $ 194,208,647 |
| Subtotal Non-General Fund | 588,264,425 | 198,215,423 | 257,559,236 | 59,343,813 |
| **Total ALL Funds** | $2,327,263,601 | $ 482,804,696 | $ 736,323,081 | $ 253,552,460 |

## Non-Departmental Services

The County budgets and accounts for the General Fund's portion of general purpose revenues in Non-Departmental Services, which includes revenues from property tax, Excess ERAF, sales tax, Measure T Vehicle Rental Tax, and interest and investment income. Non-Departmental Services is also where the County budgets General Fund contributions to major capital and IT projects, as well as additional one-time contributions to the retirement system to accelerate the pay down of the County's unfunded pension liability.

The year-end Fund Balance for Non-Departmental Services is projected to be $360 million. This represents a drop of $33 million from the beginning FY 2017-18 Fund Balance, due to many expenditures increasing.

In January, the County received Excess ERAF of $170 million, which exceeds the FY 2017-18 amount by $41 million. Of the $41 million, $21 million was the result of a one-time modification to the distribution schedule, and is not due to new Excess ERAF funding. Pursuant to County policy, one-half of anticipated Excess ERAF is budgeted for ongoing expenses while the remaining portion may only be used for one-time purposes. One-time projected spending is expected to approach $75.3 million. This includes additional pension contributions of $25.7 million; contributions of $10 million (e.g., SMMC Water Tower Project, Butano Resilience Project, North Fair Oaks Forward, Enhanced Flood Control Zone, and Courthouse Construction Fund); one-time capital and IT expenditures of $15.6 million; Property Tax System Projects of $19 million; and SMC Saves grants of $5 million.

Given the conservative nature of mid-year projections, it is anticipated that by year-end the final Fund Balance figures may change. The final figures will largely depend on the timing of capital outlays, loans, contributions, and labor negotiations.

**General Fund Operating Departments**

Overall, General Fund operating departments are projected to end FY 2018-19 with a variance of $194.2 million in Fund Balance. These projections, which are spread across all departments, reflect budget savings from vacancies, one-time projects either in progress or delayed, and budgeted reserves. At this point, all General Fund operating departments are expected to stay within budget and meet their year-end targets.

**Five-Year Revenue and Expenditure Projections (including Measures K and T)**

General purpose revenues are expected to increase 5.19 percent or $28 million in FY 2018-19 from the prior year. This is primarily due to the Secured Property Tax increasing by eight percent. The County's share of Excess ERAF in FY 2018-19 has also increased by $41 million from FY 2017-18 (including the one-time $21 million increase referenced above resulting from the modification to the distribution schedule). This is offset by some reductions in other revenue sources.

The County continues to budget other general purpose revenues conservatively in the out years with projected growth ranging from three to four percent, resulting in average annual growth of $20 million over the five-year period. Secured Property Tax is expected to remain strong. Future growth projections for Prop. 172 and Measure K sales tax have been conservatively projected at two percent in the out years.

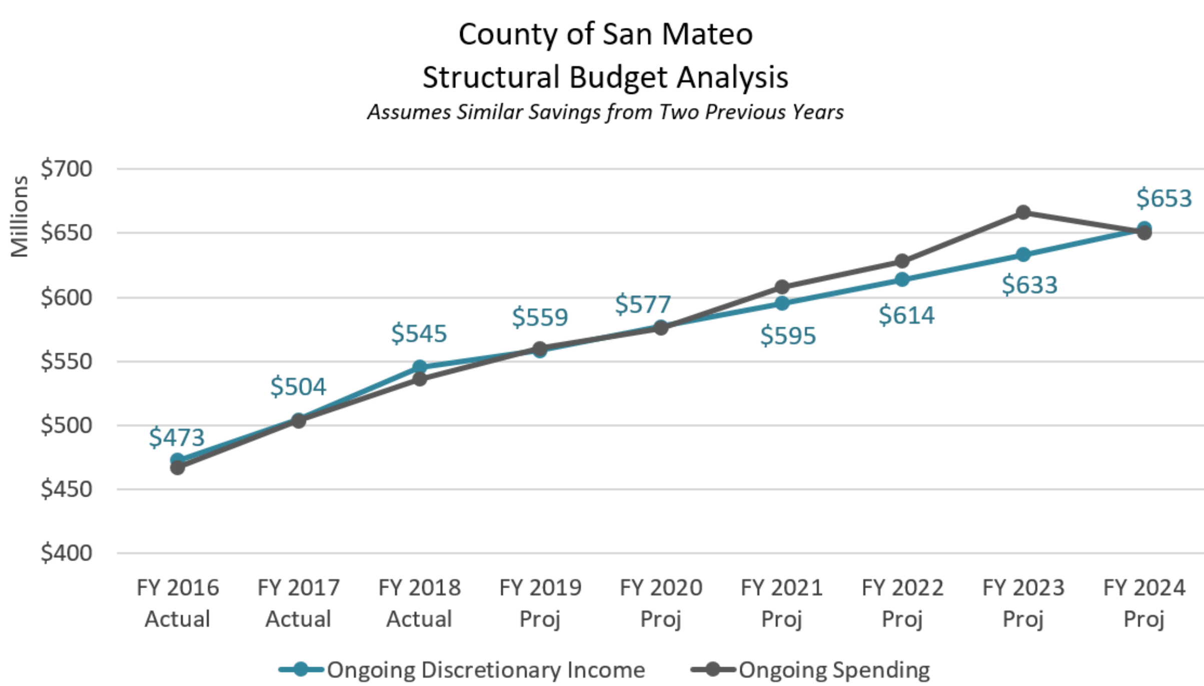
| General Purpose Revenues | FY 2019 | FY 2020 | FY 2021 | FY 2022 | FY 2023 | FY 2024 |
|---|---|---|---|---|---|---|
| Secured Property Tax | 8.0% | 5.0% | 4.0% | 4.0% | 4.0% | 4.0% |
| Unsecured Property Tax | 7.5% | 1.0% | 1.0% | 1.0% | 1.0% | 1.0% |
| Excess ERAF (Ongoing Portion) | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| Vehicle Rental Tax (Measure T) | 27.1% | 2.0% | 2.0% | 2.0% | 2.0% | 2.0% |
| Sales Tax | 5.9% | 2.0% | 2.0% | 2.0% | 2.0% | 2.0% |
| Property Transfer Tax | -5.6% | 3.0% | 3.0% | 3.0% | 3.0% | 3.0% |
| Transient Occupancy Tax* | -28.2% | 88.5% | 11.7% | 10.7% | 9.8% | 9.1% |
| Property Tax In-Lieu of VLF | 8.4% | 5.0% | 4.0% | 4.0% | 4.0% | 4.0% |
| Interest & Investment Income | 6.0% | 3.0% | 3.0% | 3.0% | 3.0% | 3.0% |
| Other Revenue | -3.7% | 0.3% | 0.3% | 0.3% | 0.3% | 0.3% |
| Overall Growth | 5.19% | 3.88% | 3.05% | 3.07% | 3.09% | 3.11% |
| Public Safety Sales Tax | 2.0% | 2.0% | 2.0% | 2.0% | 2.0% | 2.0% |
| Measure K Sales Tax | 2.0% | 2.0% | 2.0% | 2.0% | 2.0% | 2.0% |

*Assumes opening of the 350 room Airport Hyatt in 2019

| General Purpose Revenues | FY 2019 | FY 2024 | 5-Year Growth |
|---|---|---|---|
| Secured Property Tax | $270,658,110 | $330,820,936 | $60,162,826 |
| Unsecured Property Tax | $10,862,207 | $11,413,944 | $551,737 |
| Excess ERAF (Ongoing)* | $60,000,000 | $60,000,000 | $0 |
| Vehicle Rental Tax (Measure T) | $13,911,496 | $15,359,416 | $1,447,920 |
| Sales Tax | $25,467,746 | $28,118,450 | $2,650,703 |
| Property Transfer Tax | $10,396,068 | $12,051,892 | $1,655,824 |
| Transient Occupancy Tax | $1,656,511 | $4,627,602 | $2,971,091 |
| Property Tax In-Lieu of VLF | $115,299,096 | $141,627,816 | $26,328,720 |
| Interest & Investment Income | $16,652,922 | $19,305,301 | $2,652,379 |
| Other Revenue | $48,875,146 | $49,695,277 | $820,131 |
| General Purpose Rev Growth | $573,779,302 | $673,020,634 | $99,241,332 |
| Public Safety Sales Tax | $82,489,489 | $91,075,061 | $8,585,572 |
| Measure K Sales Tax | $91,395,040 | $100,907,510 | $9,512,469 |
| Excess ERAF (One-Time)* | $110,341,973 | $0 | -$68,919,064 |

*One half of anticipated Excess ERAF ($55 million) is budgeted for ongoing purposes and no assumptions for one-time revenue is made in future years.

Ongoing expenditures are expected to grow approximately $90.5 million over the next five years, assuming similar savings from the prior two years. This is essentially the same pace as ongoing revenues. This is due to inflationary factors and ongoing labor negotiations. If the pace is not kept in line, we could exceed the revenues during this same period. It will be important to keep a constant eye on expenditure and revenue growth in consideration of the current economic environment.



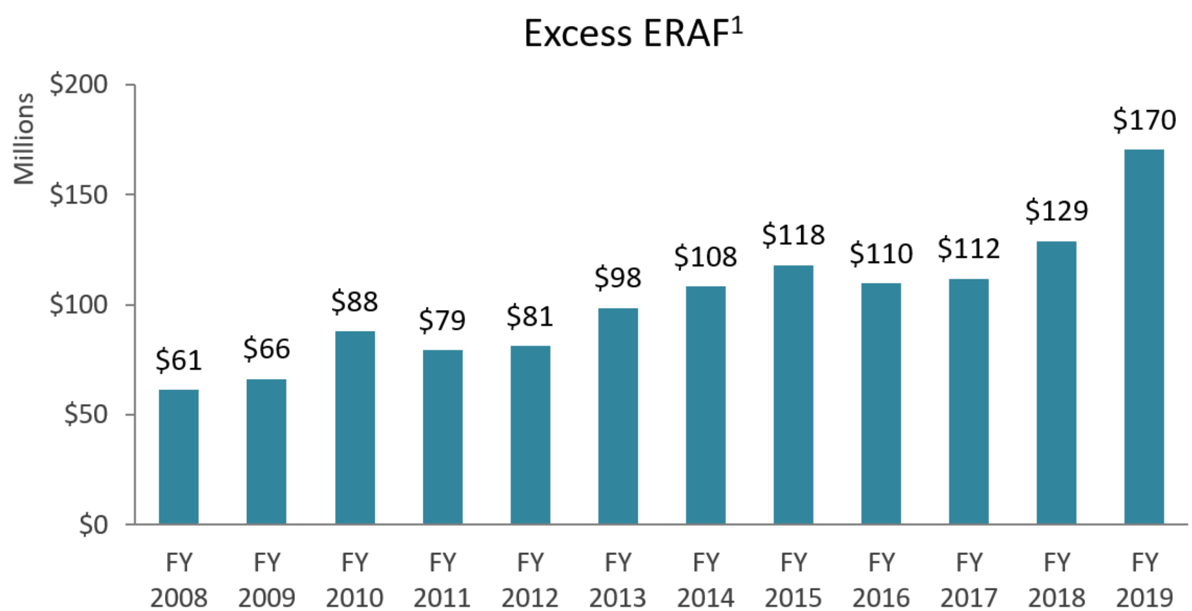

## **Excess Educational Revenue Augmentation Fund (ERAF)**

Pursuant to Revenue and Taxation Code 97.2 and 97.3, property tax contributions made by local governments to the ERAF in excess of State-mandated school funding levels are returned to the local governmental entities that made the contributions. The County is one of a handful of Excess ERAF counties in California. This is due to the relatively high number of school districts in the County with local property tax revenues exceeding the funding levels guaranteed by the State's Local Control Funding Formula (LCFF). Future Excess ERAF amounts to be received by the County could decline as a result of increases in the LCFF funding levels, increased allocations of ERAF for special education, changes in school enrollment, or further State legislative changes to the school funding model.

Due to the potential volatility of Excess ERAF, and in consultation with the County Controller, the County continues to conservatively budget only one half of the projected General Fund apportionment of Excess ERAF for ongoing purposes. Pursuant to Board policy, the remaining portion may only be used for one-time purposes, including reductions in unfunded liabilities, capital and technology payments, productivity enhancements, and cost avoidance projects. When Excess ERAF exceeds projections, the excess is recognized in the year-end Fund Balance and appropriated the following fiscal year.

Regarding anticipated Excess ERAF, which is now averaging $129 million (with the removal of the one-time $21 million in one-time funds), it is recommended that the County adjust annual budgeted revenues from $55 million to $60 million, which would be one half of the new five-year average. If revenue continues in excess of $120 million, future budgeted revenues should be adjusted accordingly.

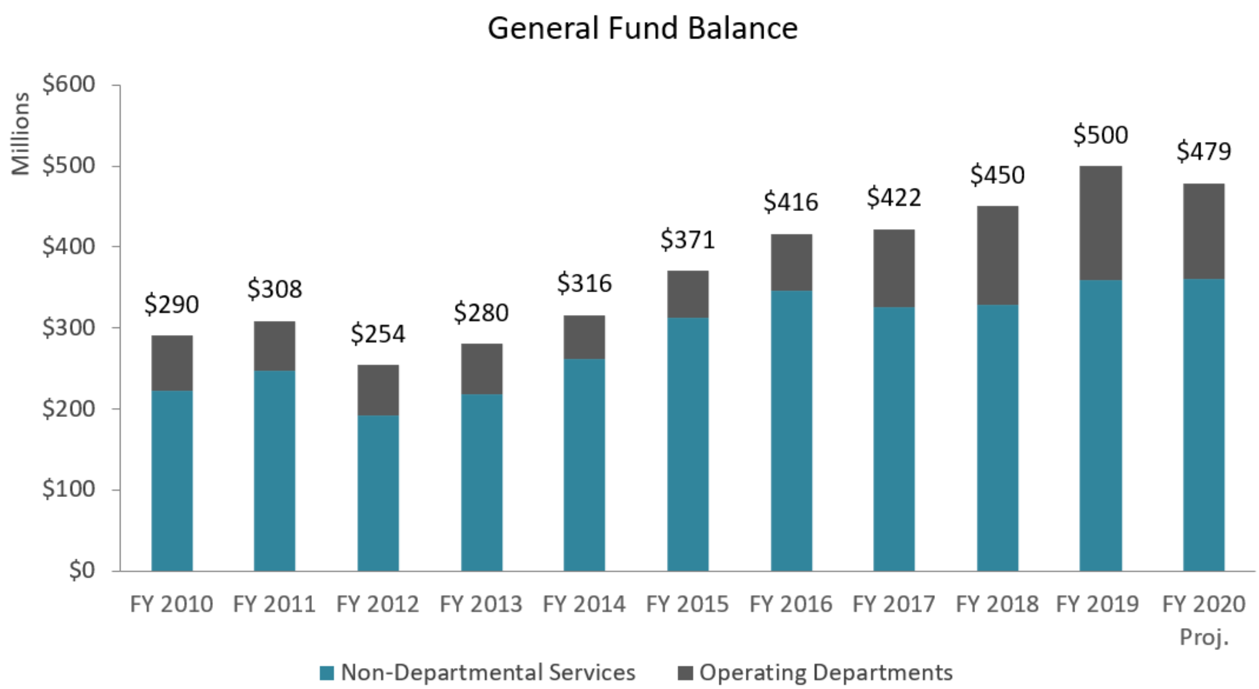
The following table shows the General Fund's share of Excess ERAF received from FY 2007-08 through FY 2018-19.




[1] This distribution amount includes Excess ERAF from prior years. The Excess ERAF amount for any given year is not finalized until after the final Certified School Reports are received from the California Department of Education. For example, the 2015-16 school reports were not finalized until June 2018. Thus, the County has adopted a policy to stagger the Excess ERAF distributions.

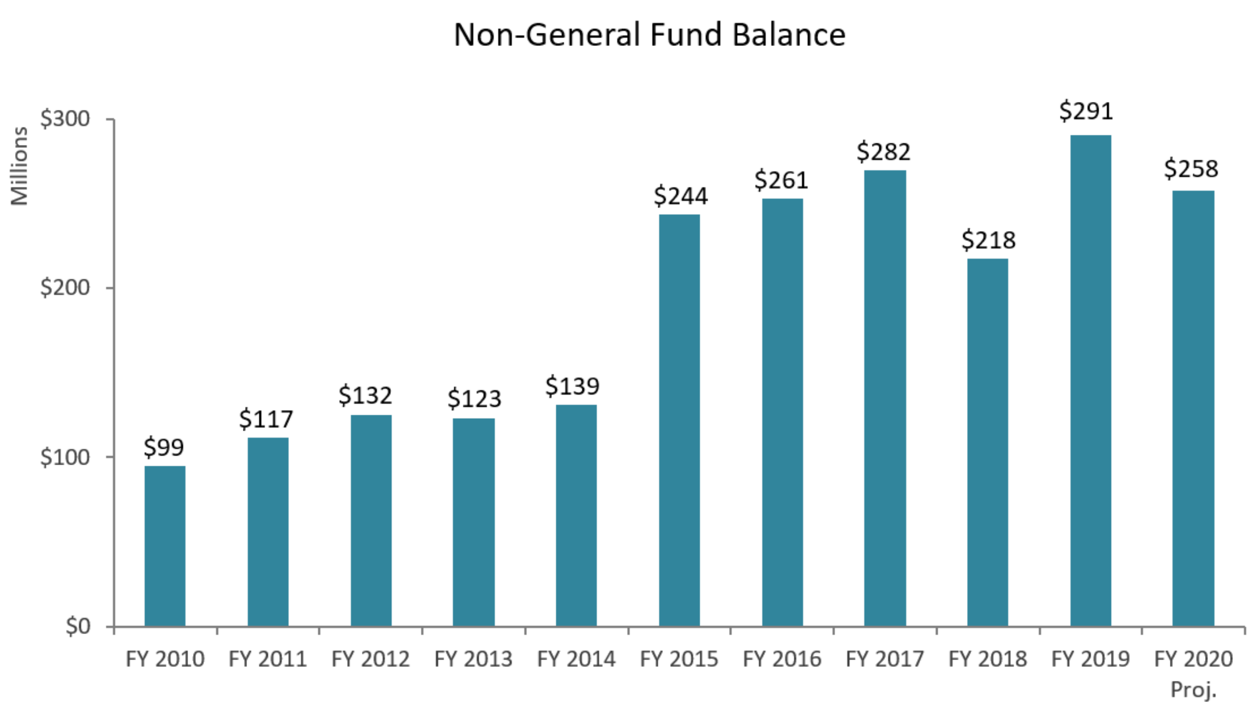
## General Fund Summary

Overall, it is projected that the General Fund will end FY 2018-19 with $479 million in Fund Balance, the basis for the FY 2019-20 projection. However, this calculation does not include any costs associated with labor agreements since the projections were completed in December, prior to any labor negotiations being concluded. The County currently has a structurally balanced budget, in which ongoing expenditures are aligned and supported by ongoing revenues, the County will need to continue to monitor expenditures in the upcoming FY 2019-21 budget cycle. Proactively monitoring revenues and expenditures will reduce the likelihood of triggering structural deficits.




**Non-General Fund Summary**

Overall, Non-General Fund budget units are projected to start FY 2019-20 with $258 million in Fund Balance, a decrease of $33 million from FY 2018-19. The decrease is primarily related to one-time projects.



**County Retirement Contributions**

The actuarial calculations for defined benefit retirement contributions are very complicated and include a variety of factors, including, but not limited to, future investment earnings, wages, Consumer Price Index (CPI), life expectancy assumptions, and the benefits themselves. For instance, the greater the benefit, the higher the cost. The lower the assumed earnings rate (or discount rate), the higher the cost.

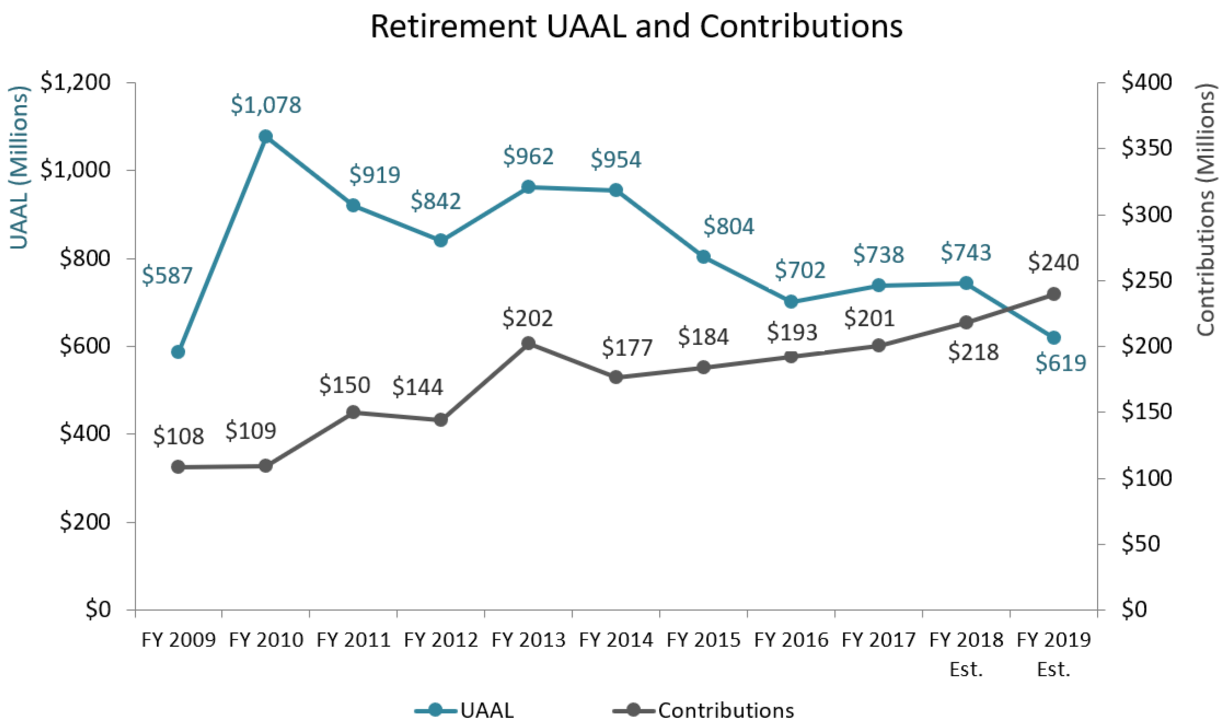
The table below shows the Unfunded Actuarial Accrued Liability (UAAL) for each of the past 12 actuarial valuations and the key assumptions for wage increases, earnings, and CPI growth.

| | | | Key Assumptions | | |
|---|---|---|---|---|---|
| Valuation Date | For Fiscal Year | UAAL | Wages | Earnings | CPI |
| June 30, 2018 | FY 2019-20 | 619,033,000 | 3.00% | 6.75% | 2.50% |
| June 30, 2017 | FY 2018-19 | 743,133,000 | 3.00% | 6.75% | 2.50% |
| June 30, 2016 | FY 2017-18 | 737,570,000 | 3.25% | 7.00% | 2.75% |
| June 30, 2015 | FY 2016-17 | 702,236,000 | 3.50% | 7.25% | 3.00% |
| June 30, 2014 | FY 2015-16 | 803,855,000 | 3.50% | 7.25% | 3.00% |
| June 30, 2013 | FY 2014-15 | 954,111,000 | 3.75% | 7.50% | 3.25% |
| June 20, 2012 | FY 2013-14 | 962,282,000 | 3.75% | 7.50% | 3.25% |
| June 30, 2011 | FY 2012-13 | 841,587,000 | 4.00% | 7.75% | 3.50% |
| June 30, 2010 | FY 2011-12 | 919,377,000 | 4.00% | 7.75% | 3.50% |
| June 30, 2009 | FY 2010-11 | 1,078,033,000 | 4.00% | 7.75% | 3.50% |
| June 30, 2008 | FY 2009-10 | 587,285,000 | 4.00% | 7.75% | 3.50% |
| June 30, 2007 | FY 2008-09 | 578,773,000 | 4.00% | 7.75% | 3.50% |

The County's funded ratio increased from 84.3 percent in 2017 to 87.5 in 2018 due mainly to employer contributions and strong market performance. Under the prepayment plan initiated in FY 2013-14, the County remains on target for significantly reducing the UAAL by FY 2022-23. Though this plan will continue to use a significant portion of the one-time Excess ERAF over the next four years, if successful, it will yield ongoing future savings.

| Fiscal Year | Statutory Contribution | Additional Contribution | Total Contribution |
|---|---|---|---|
| FY 2019-20 Est. | 215,633,142 | 24,221,475 | 239,854,617 |
| FY 2018-19 | 192,364,303 | 25,668,357 | 218,032,660 |
| FY 2017-18 | 173,305,886 | 27,631,026 | 200,936,912 |
| FY 2016-17 | 158,993,422 | 33,600,000 | 192,593,422 |
| FY 2015-16 | 164,526,705 | 19,538,000 | 184,064,705 |
| FY 2014-15 | 166,827,712 | 10,000,173 | 176,827,885 |
| FY 2013-14 | 152,225,624 | 50,000,000 | 202,225,624 |
| FY 2012-13 | 140,104,854 | 4,168,983 | 144,273,837 |
| FY 2011-12 | 147,124,756 | 3,081,311 | 150,206,067 |
| FY 2010-11 | 150,084,139 | 0 | 150,084,139 |
| FY 2009-10 | 109,028,802 | 0 | 109,028,802 |
| FY 2008-09 | 108,418,023 | 0 | 108,418,023 |

The following graph illustrates the decline in the UAAL and the increase in contributions since the great recession. These increases are due to many factors, including a conservative funding model that has seen the assumed earnings rate drop from 7.75 to 6.75 percent since 2011, strong market performance, increasing wages, and the aforementioned prepayment plan.




**Public Safety Sales Tax (Proposition 172) Maintenance of Effort Certification**

In June 1995, the Board of Supervisors approved the Maintenance of Effort (MOE) certification for the base year (FY 1992-93) and the first certification year (FY 1994-95). The Board also adopted a resolution defining public safety services to include: Sheriff, District Attorney, Private Defender, Probation, Coroner, Correctional Health, Release on Own Recognizance, Mental Health Forensics, Public Safety Communications, Emergency Services, Fire Protection, Public Safety Capital Projects, and Debt Service.

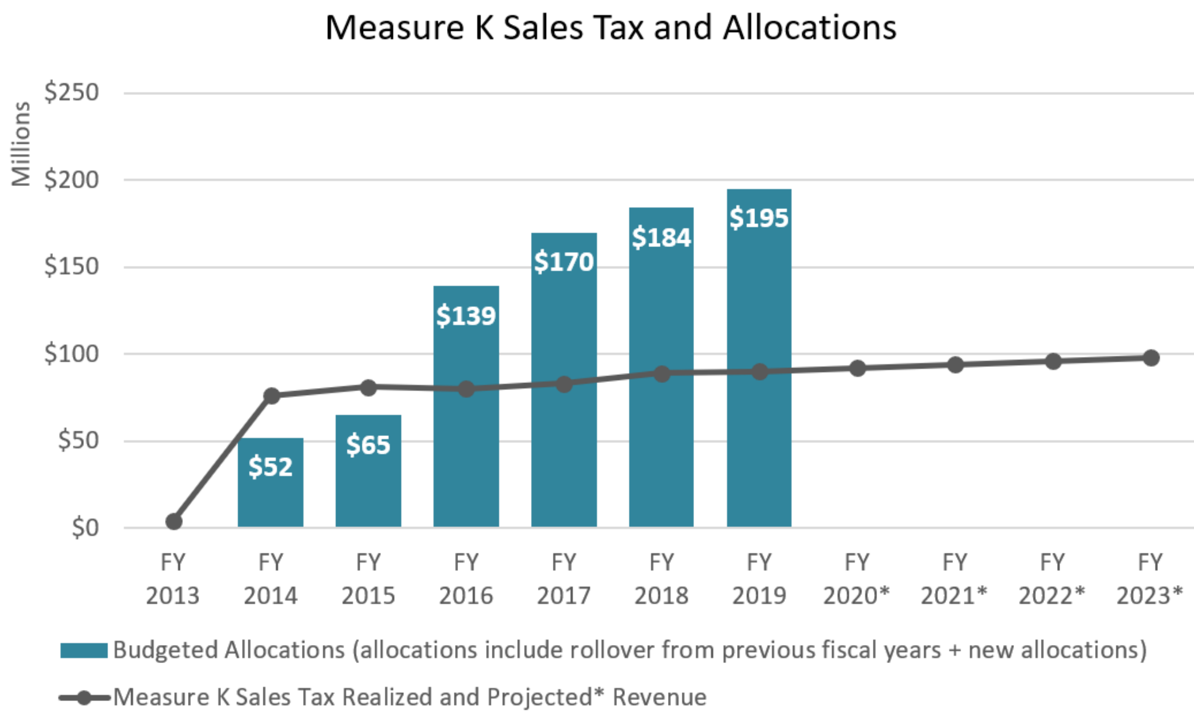
Last year, the MOE certification submitted to the Board for FY 2017-18 was $334.4 million. This figure represented the adopted budget for public safety services adjusted in accordance with the MOE guidelines and excluded certain expenditures and revenue offsets. The difference between the FY 2017-18 MOE requirement of $136.3 million and the certification of $334.4 million was $198.1 million. This is the amount by which the County exceeded the FY 2017-18 Proposition 172 MOE requirements based on the FY 2017-18 Adopted Budget.

Based on the FY 2018-19 Adopted Budget, the projected MOE certification for FY 2018-19 is $341.5 million. The difference between the FY 2018-19 MOE requirement of $138.8 million and the certification of $341.5 million is $202.7 million. This is the amount by which the County expects to exceed the FY 2018-19 Proposition 172 MOE requirement.

**Measure K Revenue Projections and Reserves**

The amount of Measure K funds appropriated in the FY 2018-19 Recommended Budget totals $195 million, including rollover allocations from previous fiscal years for certain capital, IT, and Board

District-Discretionary projects that are continuing into the next fiscal year. With the inclusion of a 10 percent Reserve, Measure K funds are allocated with rollover resulting from ongoing and time-intensive projects and a set aside of funds moved to meet the Federal regulations for Airport Sales Tax uses. The Measure K reserves in the FY 2018-19 Budget is $9.1 million. The chart below shows budgeted allocations as well as projected revenue, adjusted upwards by two percent. It is projected that the County will receive $90 million in Measure K funds in FY 2018-19. It is anticipated that this amount will grow by two percent in each future fiscal year.




**<u>Measure K Oversight Committee</u>**

One of the requirements laid out in Measure K is for the Measure K Oversight Committee to present an annual report to the Board of Supervisors with the Committee's review of the annual audit of receipts, results of the Agreed-Upon Procedures (AUP), and performance measure recommendations for existing Measure K initiatives.

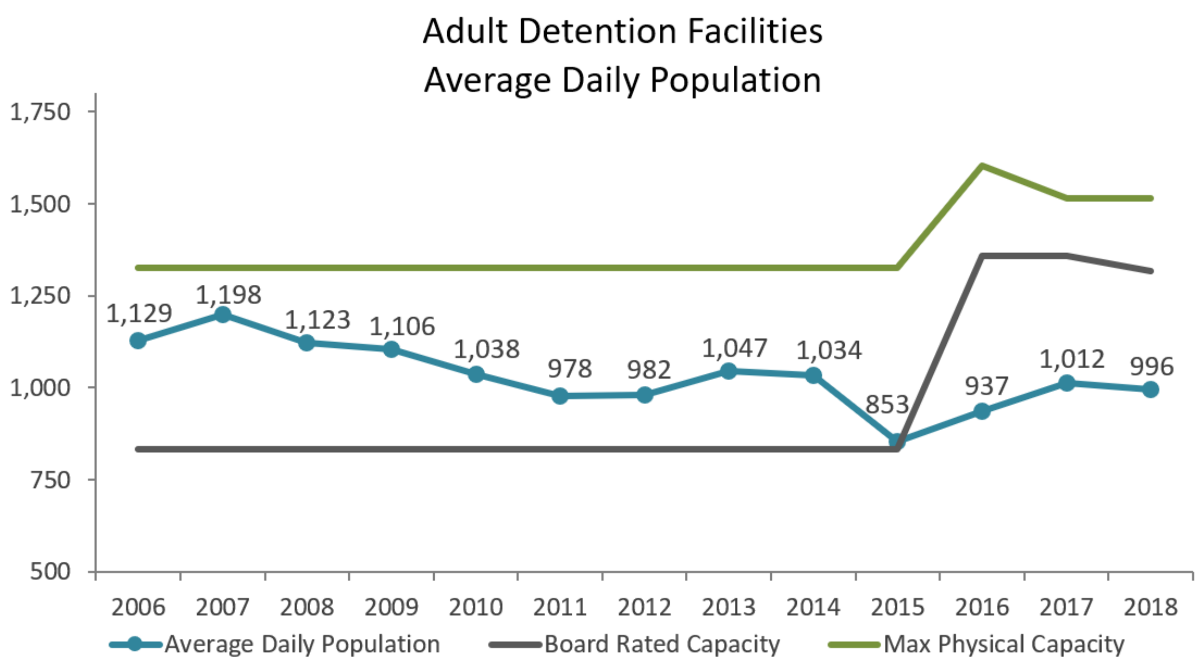
The Oversight Committee met and completed its review of the results of the Measure K annual audit and AUP performed by the Controller's Office. Following the approval of the audit and AUP, which found no exceptions or issues with the Measure K Fund, a subcommittee was formed to discuss the performance measures for existing Measure K programs and initiatives. This subcommittee evaluated the performance measures and made recommendations to be addressed in the final report and in preparation for next year's performance report to the Oversight Committee.

The full Measure K Annual Report will be presented to the Board of Supervisors as a separate item on February 26, 2019.

**<u>Criminal Justice</u>**

The County's AB109 Public Safety Realignment budget for FY 2017-19 was approximately $18 million each year. Base revenue is anticipated to be $16.5 million. The additional balance will be covered by AB109 reserves. Though some of these reserves are ear-marked for training, evaluations, and grants, the County Manager's Office is working with departments to determine if available Fund Balance can be used to fund the County's Unified Re-Entry efforts.

Maple Street Correctional Center opened in 2016, increasing Maximum Physical Capacity to 1,603. In 2017, Maximum Physical Capacity decreased slightly to 1,516 due to changes at Maguire Correctional Facility in the Administrative Segregation Unit and the opening of the repurposed space for the Behavioral Health Pod. In FY 2017-18 the average daily population in the adult detention facilities was 996.




**<u>Governor's January Budget Proposal</u>**

Governor Gavin Newsom's proposed FY 2019-20 budget—his first as Governor—proposes approximately $144 billion in State General Fund spending, a four percent increase from last year's budget. Overall, the proposed budget provides several new funding opportunities for county programs and services, buoyed by an estimated $24.1 billion in surplus revenues. While the new Governor is proposing to allocate over 86 percent of these funds to reserves, one-time debt reduction, and programmatic spending, he is also proposing to spend another 10 percent on ongoing spending, including nearly $350 million to increase CalWORKs, expansion of the Earned Income Tax Credit, family leave, and universal pre-school for income-eligible four year-olds.

For San Mateo County, the Governor's proposal to increase state General Fund contributions to the In-Home Supportive Services (IHSS) program in FY 2019-20 through FY 2022-23, as well as a rebasing of the IHSS MOE downward and reduction in the program's annual inflation factor, is welcome relief. If approved, the changes would reduce the gross services IHSS MOE for the County by approximately $3.4 million in FY 2019-20 and $4.2 million in FY 2020-21. To help cover growing IHSS costs, the Governor also proposes to end the redirect of 1991 Realignment VLF Growth, which would return $1.2 million in County funding to mental health and indigent health programs. According to the Health System, the proposed increases in State contributions to the County's IHSS program would now allow the County's Realignment Trust Fund to remain solvent for one additional year, through FY 2023-2024.

At this point, it is too early to tell what the net fiscal impact on the Health System could be as a direct result of the Governor's proposal to expand full-scope Medi-Cal coverage to eligible young adults ages 19 to 26 regardless of immigration status. However, there are 1,800 residents ages 19-25 currently enrolled in the County's ACE program that could move to full-scope Medi-Cal. Proposed investments in homelessness, particularly formula funds to County Continuums of Care, and expansion of state tax credits for housing production, could bolster the County's efforts to house the homeless and develop affordable housing. However, the County is deeply concerned about proposals to tie State transportation funding to local housing production, which could jeopardize important funding for much-needed road improvements.

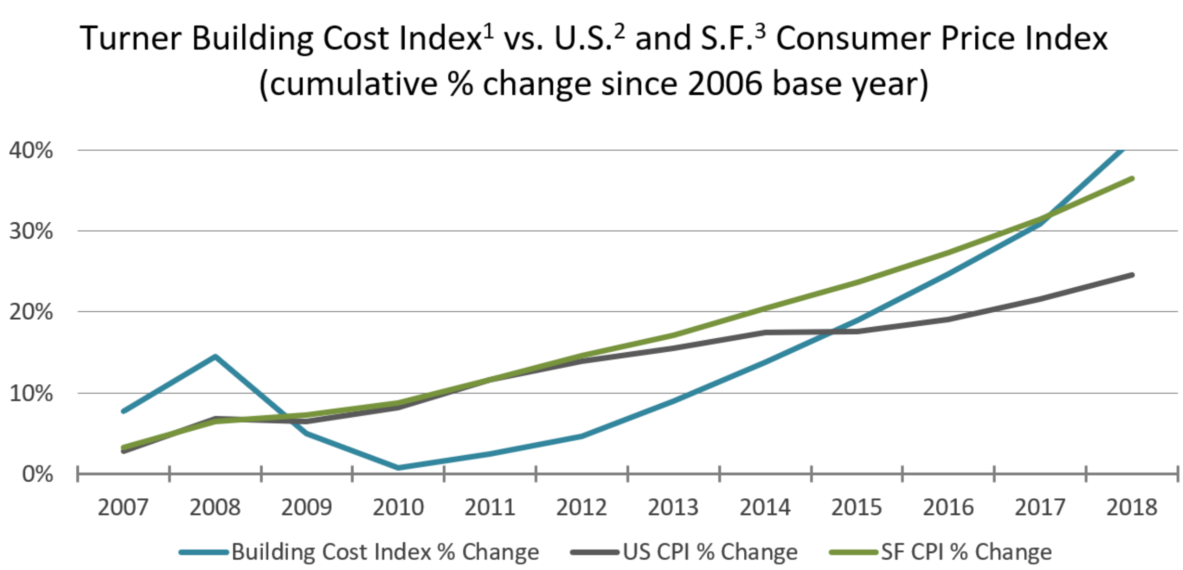
**Five-Year Capital Improvement Plan**

The County of San Mateo produced its first Five-Year Capital Improvement Plan (CIP) in 2018. The Adopted FY 2018-19 budget contains more than $308 million of appropriations for capital projects.

The updated Five-Year Capital Improvement Plan (CIP) for FYs 2019-24 will be developed and presented to the Board of Supervisors along with the FY 2019-21 Recommended Budget. The Five-Year CIP is intended as a planning tool that identifies both short- and long-term capital improvement and information technology needs of the County. The CIP's objective is to align those needs with appropriate financing, scheduling, and implementation. The CIP is intended to be used in conjunction with the County Budget. This approach will help ensure a more fiscally responsible and efficient use of existing resources. The CIP represents a commitment to building a more resilient and vibrant future for county residents, workers, and visitors.

Capital appropriations and priorities will need to be set for each two-year budget cycle. Recognizing the dynamic environment in which the County operates and monitoring expenditures to ensure they stay within the budgeted amounts will be important moving forward.

The following graph shows how the increase rate for new construction costs as measured by the Turner Building Cost Index has surpassed the Consumer Price Index for both the U.S. and the San Francisco metro region. A number of factors contribute to the increased construction costs, including increased construction, nationwide shortages of skilled labor, tariffs on steel exports from China, and the impact of natural disasters on material production and demand. Labor costs in the Bay Area exacerbate these national trends and increase construction costs further.




Sources: [1]www.turnerconstruction.com/cost-index; [2] Bureau of Labor Statistics http://www.bls.gov
[3]www.bls.gov/regions/west/data/consumerpriceindex_sanfrancisco_table.pdf

**<u>FISCAL IMPACT</u>:**
Accepting this report has no fiscal impact for FY 2018-19.

**<u>Appendices: Local Economic Indicators</u>**
The following indicators provide information on current local economic activity compared to prior years and state/national trends. Trends in the data assist in generating projections for general purpose revenue such as property tax, sales tax, and transient occupancy tax.

A. Bay Area Consumer Price Index
B. First-Time Buyer Housing Affordability Index
C. Median Home Price and Home Sales
D. Prop. 8 Assessed Value Restorations
E. Combined Secured and Unsecured Property Tax Roll Value
F. Property Reassessment and Assessment Appeals Filings
G. Building Permits Issued
H. Office Space Availability
I. San Francisco International Airport – Total Passengers
J. Unemployment Rate
K. San Mateo County Per Capita Personal Income

## A. Bay Area Consumer Price Index

The Consumer Price Index (CPI) measures the change in the price of goods over time. The change in the index is referred to as the rate of inflation, and is used in assumptions for calculating future costs. The CPI for all urban consumers, all items in 2018 increased 3.2 percent in the Bay Area, 3.3 percent in California, and 2.3 percent in the United States. The Bay Area CPI is forecasted to increase 4.0 percent in 2019, 3.1 percent in 2020, and 2.8 percent in 2021.

Bay Area Consumer Price Index

| CPI Fiscal Year Averages | Bay Area[1] % Change | California % Change | USA % Change |
|---|---|---|---|
| 2021* | 2.8 | 3.1 | 1.9 |
| 2020* | 3.1 | 3.4 | 2.4 |
| 2019* | 4.0 | 3.8 | 2.5 |
| 2018 | 3.2 | 3.3 | 2.3 |
| 2017 | 3.4 | 2.5 | 1.8 |
| 2016 | 2.8 | 2.0 | 0.7 |
| 2015 | 2.7 | 1.5 | 0.7 |
| 2014 | 2.4 | 1.4 | 1.6 |
| 2013 | 2.6 | 2.1 | 1.7 |
| 2012 | 2.8 | 2.4 | 2.9 |
| 2011 | 1.7 | 1.7 | 2.0 |
| 2010 | 1.2 | 0.7 | 1.0 |
| 2009 | 1.8 | 1.3 | 1.4 |
| 2008 | 3.2 | 3.4 | 3.7 |
| 2007 | 3.3 | 3.4 | 2.6 |
| 2006 | 2.7 | 4.2 | 3.8 |

1 Bay Area (San Francisco CMSA) includes the counties of Alameda, Contra Costa, Marin, Napa, San Francisco, San Mateo, Santa Clara, Santa Cruz, Solano and Sonoma
*Forecasts: CA Department of Finance
Sources: California Department of Finance http://www.dof.ca.gov; Bureau of Labor Statistics http://www.bls.gov

## B. First-Time Buyer Housing Affordability Index

The First-Time Buyer Housing Affordability Index shows the percentage of households that can afford to purchase an entry-level single-family home (defined as 85 percent of the median home price, with a 10 percent down payment), and is a fundamental measure of the health of the economy and the housing market. Housing prices continue to be unaffordable for the large majority of households in San Mateo County and other Bay Area counties. The percentage of first-time buyers who could afford to purchase an entry-level home in San Mateo County in the third quarter of 2018 dropped to 22 percent, down from 25 percent in the third quarter of 2017. San Mateo County is tied with San Francisco for the lowest level of housing affordability for first-time buyers. From 2016 to 2018, the Affordability Index decreased from 46 to 38 percent for the Bay Area, and from 50 to 45 percent for California as a whole. The percent of *all* households that could afford to purchase a *median*-priced single-family home in San Mateo County (measured by the Traditional Housing Affordability Index) was even lower, at 15 percent for the third quarter of 2018.

First-Time Buyer Housing Affordability Index

| Region/State/ County | 3rd Quarter 2015 | 3rd Quarter 2016 | 3rd Quarter 2017 | 3rd Quarter 2018 |
|---|---|---|---|---|
| United States | 74% | 73% | 71% | 69% |
| California | 51% | 50% | 47% | 45% |
| SF Bay Area | 41% | 46% | 41% | 38% |
| Santa Clara | 40% | 41% | 33% | 32% |
| Alameda | 41% | 44% | 38% | 35% |
| Contra Costa | 40% | 57% | 53% | 52% |
| San Francisco | 24% | 26% | 24% | 22% |
| Marin | 37% | 34% | 32% | 31% |
| **San Mateo** | **27%** | **29%** | **25%** | **22%** |

Source: CA Association of Realtors, www.car.org

## C. Median Home Price and Home Sales

The total number of homes sold in the Bay Area decreased by 15.2 percent between November 2017 and November 2018. San Mateo County experienced a 20.8 percent decline in the number of homes sold in the same period.

Despite the decrease in home sales, Bay Area median home prices increased by an average of 3.8 percent from November 2017 and November 2018, ranging from a 6.8 percent decrease in Napa County to a 9.9 percent increase in Solano County. San Mateo County's median home price increased 1.1 percent, to a median sale price of $1.29 million.

Median Home Price and Home Sales

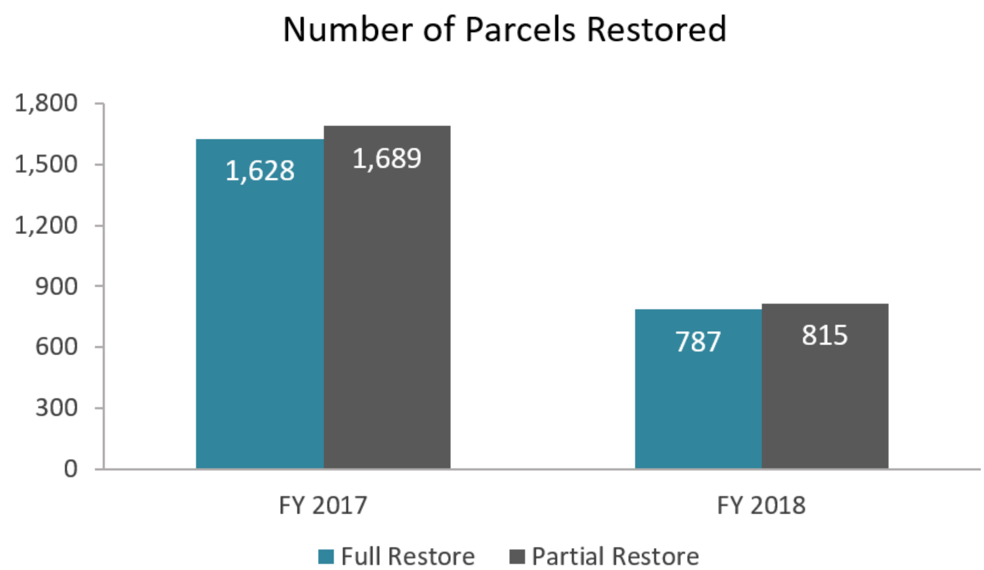
| County | Homes Sold Nov. 2017 | Homes Sold Nov. 2018 | % Change | Median Price Nov. 2017 | Median Price Nov. 2018 | % Change |
|---|---|---|---|---|---|---|
| Alameda | 1,552 | 1,271 | −18.1% | $785,000 | $815,000 | 3.8% |
| Contra Costa | 1,407 | 1,194 | −15.1% | $563,500 | $600,000 | 6.5% |
| Marin | 322 | 219 | −32.0% | $952,250 | $1,033,750 | 8.6% |
| Napa | 121 | 114 | −5.8% | $650,000 | $605,500 | −6.8% |
| Santa Clara | 1,548 | 1,364 | −11.9% | $985,000 | $1,050,000 | 6.6% |
| San Francisco | 530 | 498 | −6.0% | $1,300,000 | $1,300,000 | 0.0% |
| **San Mateo** | **620** | **491** | **−20.8%** | **$1,275,000** | **$1,289,000** | **1.1%** |
| Solano | 555 | 512 | −7.7% | $405,000 | $445,000 | 9.9% |
| Sonoma | 598 | 484 | −19.1% | $613,750 | $581,000 | −5.3% |
| Bay Area* | 7,253 | 6,147 | −15.2% | $785,000 | $815,000 | 3.8% |

*Bay Area shows total homes sold/average percent change/medium price for select bay area counties

Source: CoreLogic Data Briefs, https://www.corelogic.com/downloadable-docs/dq-news/dq-news-data-briefs/17-db-sfnov18-1218-00-san-francisco-bay-area-november-2018-home-sales-screen-122818.2.

**D. Prop. 8 Assessed Value Restorations**

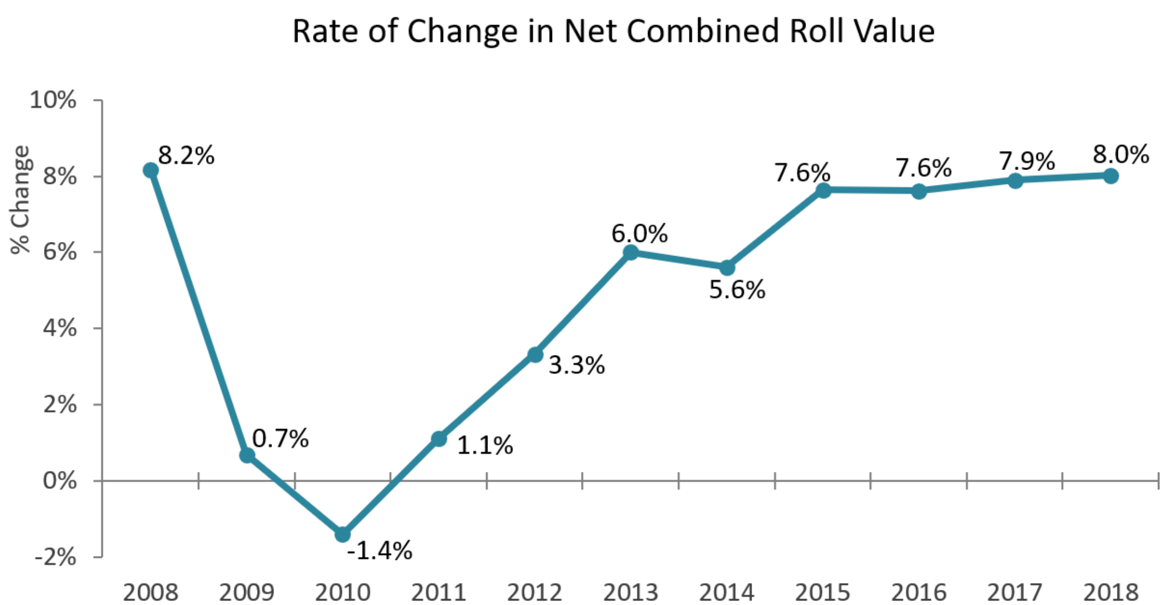
During FY 2017-18, the Assessor's Office fully or partially restored 1,602 parcels in the decline in value program (Prop. 8). Of this amount, 815 parcels were partially restored, and 787 parcels were fully restored to their assessed value. This marked the fourth consecutive year in which the number of restored parcels dropped by between 40 and 60 percent from the previous year, in line with across-the-board rises in property value. The partial and fully restored parcels resulted in a net increase of $136 million in restored value to the FY 2018-19 tax roll, a decrease (commensurate with reduced number of restored lots) from the $446M restored to the FY 2017-18 tax roll.




Source: San Mateo County Assessor's Office

**E. Combined Secured and Unsecured Property Tax Roll Value**

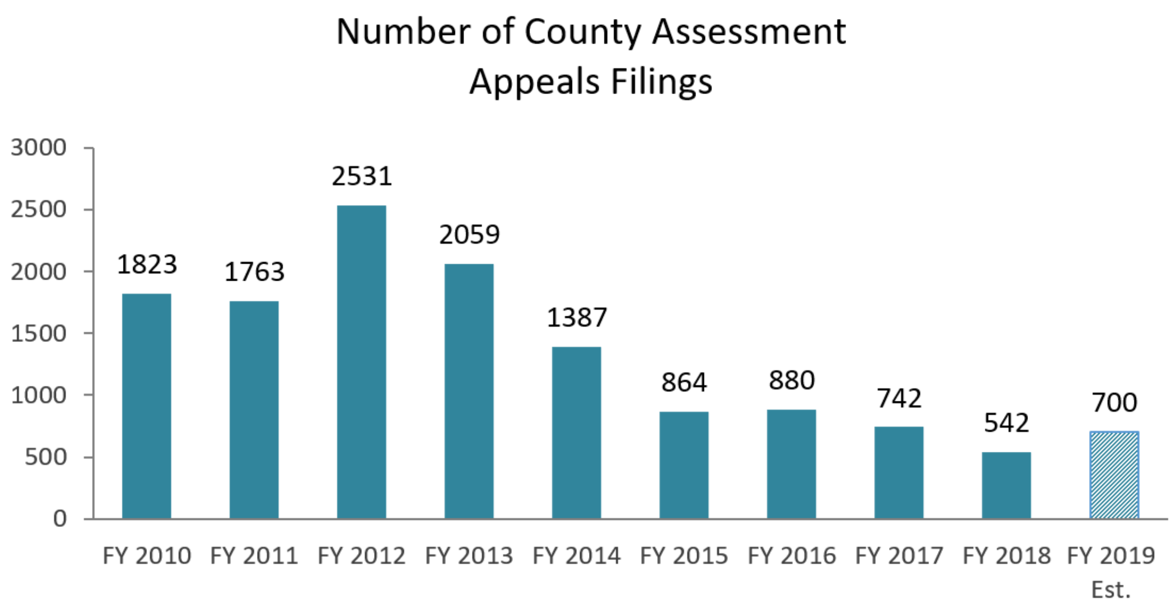
There were 236,091 assessment parcels and accounts for 2018 for a Total Local Roll of $223 billion, representing an increase of eight percent from 2017—the largest percentage growth of the assessed roll since 2008 and a continuation of steady, sustained percentage growth that has occurred since 2015. This consistent level of large growth has roots in continued expansion of business in the county. This expansion has been accompanied by similarly high levels of growth in housing through both development and rising residential property values in existing properties. East Palo Alto has again seen the highest percent growth in the county (11.4 percent), followed closely by Daly City (11.3 percent), South San Francisco (11.1 percent), Menlo Park (11.1 percent), and Brisbane (10.8 percent).




Source: San Mateo County Assessor's Office

## F. Property Reassessment and Assessment Appeals Filings

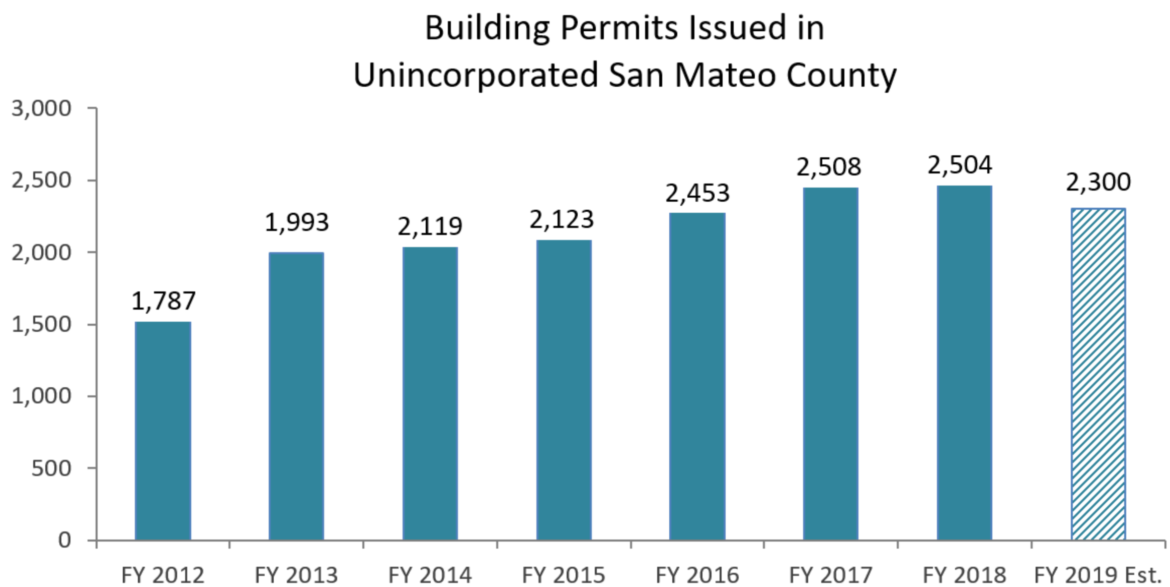
There were 542 new assessment appeals filings in FY 2017-18, a 27 percent decrease from FY 2016-17. This continued a trend of decreasing appeals that has been occurring nearly uninterrupted since the FY 2011-12 and has relatively leveled over the past three years. However, it is estimated that 700 appeals will be filed in FY 2018-19, an increase of 29 percent that would reverse the recent trend.




Source: San Mateo County Assessment Appeals Board

## G. Building Permits Issued

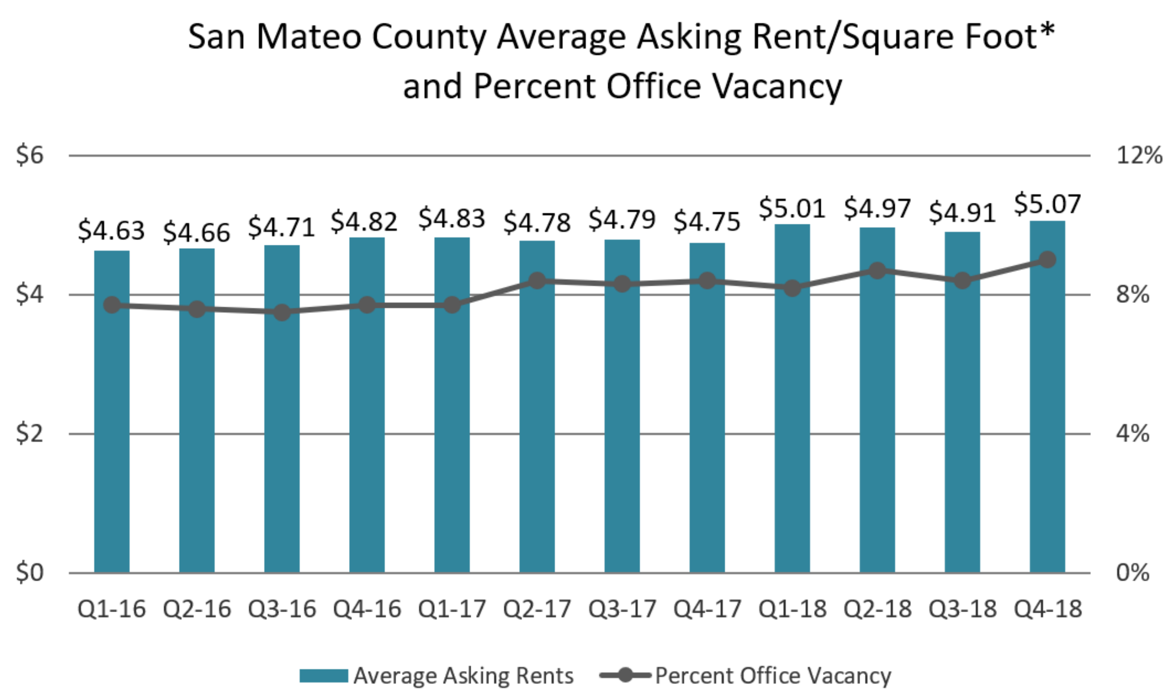
After several years of steady increases, the number of building permits issued for unincorporated San Mateo County by the Planning and Building Department flattened in FY 2016-17 and FY 2017-18 at 2,508 and 2,504, respectively. The Department estimates it will issue about 2,300 permits in FY 2018-19, which would be an eight percent decline from the prior two years, and the first significant drop from the prior year since the Great Recession.




Source: San Mateo County Planning and Building Department

## H. **Office Space Availability**

The overall vacancy rate for office space (all classes) in San Mateo County has increased from 7.7 percent in Q1-2016 to below 9.0 percent in Q4-2018. While demand for office space in San Mateo County remains strong, vacancy rates have begun to increase from 2016 levels due to a large number of development projects recently completed and in the pipeline. At the same time, overall average asking rents increased slightly during 2018, ending at $5.07 in Q4-2018. According to Cushman & Wakefield, the combination of increased average asking rent and higher vacancy rate reflects the intense demand and asking rate increases in the highest demand submarkets (primarily downtown locations along the Caltrain corridor), and the influx of newly available office space and sublease space returning to the market.

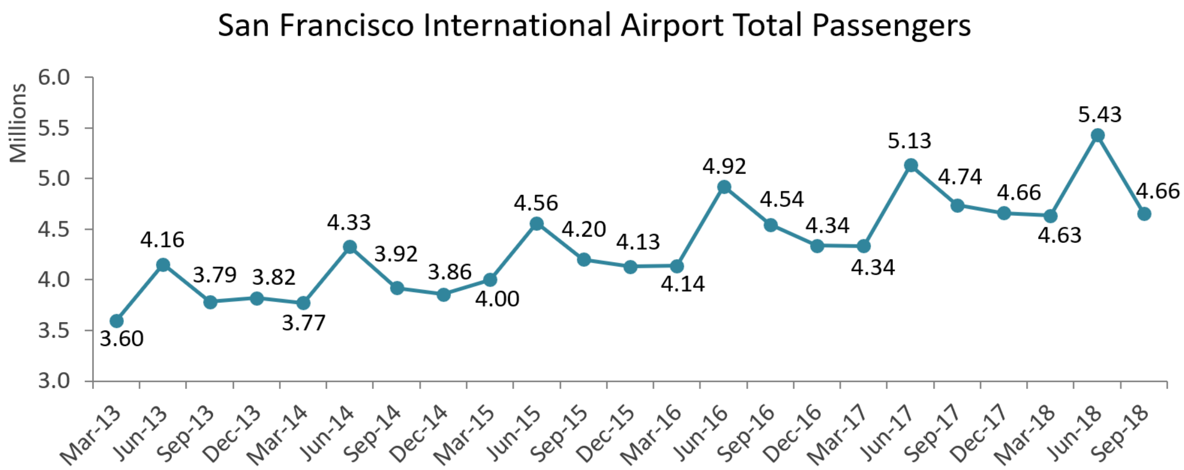



*Average asking rate includes utilities, maintenance, insurance, and all other expenses related to occupancy. Average asking rate and vacancy include all classes.

Source: Cushman and Wakefield http://www.cushmanwakefield.com/en/research-and-insight/unitedstates/san-mateo-office-snapshot/

## I. San Francisco Airport – Total Passengers

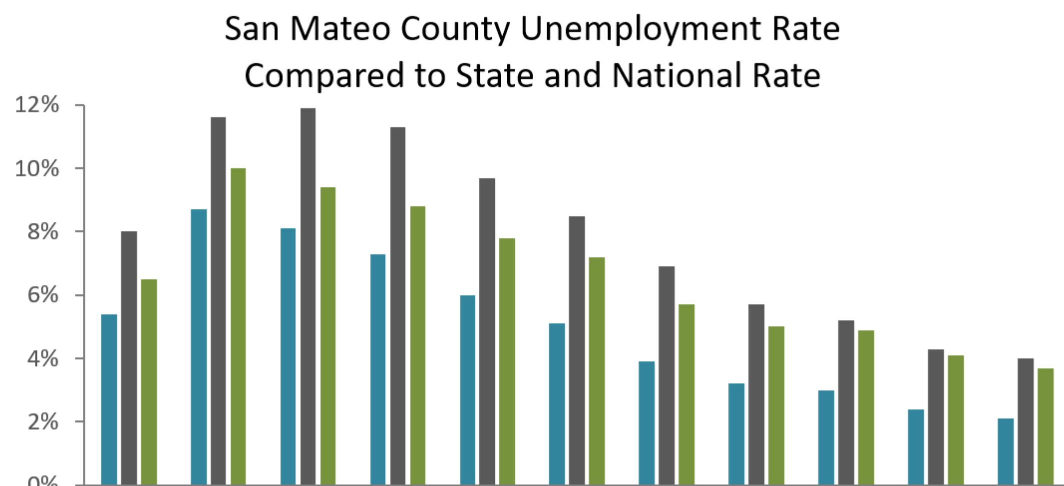
A significant portion of the County's unsecured property tax and sales tax revenues come from businesses at San Francisco International Airport, so it is important to monitor patterns in airport activity. Passenger activity has steadily increased, with 1.03 million more passengers utilizing SFO in March 2018 than in March 2013.




Source: San Francisco International Airport: http://www.flysfo.com/media/facts-statistics/air-traffic-statistics/2018

## J. Unemployment Rate

Monthly unemployment rates at the local, state, and national levels are down from last year. San Mateo County unemployment, measured in October of each year, is down from 2.4 percent in 2017 to 2.1 percent in 2018. San Mateo County continues to have the lowest unemployment rate of all counties in California.

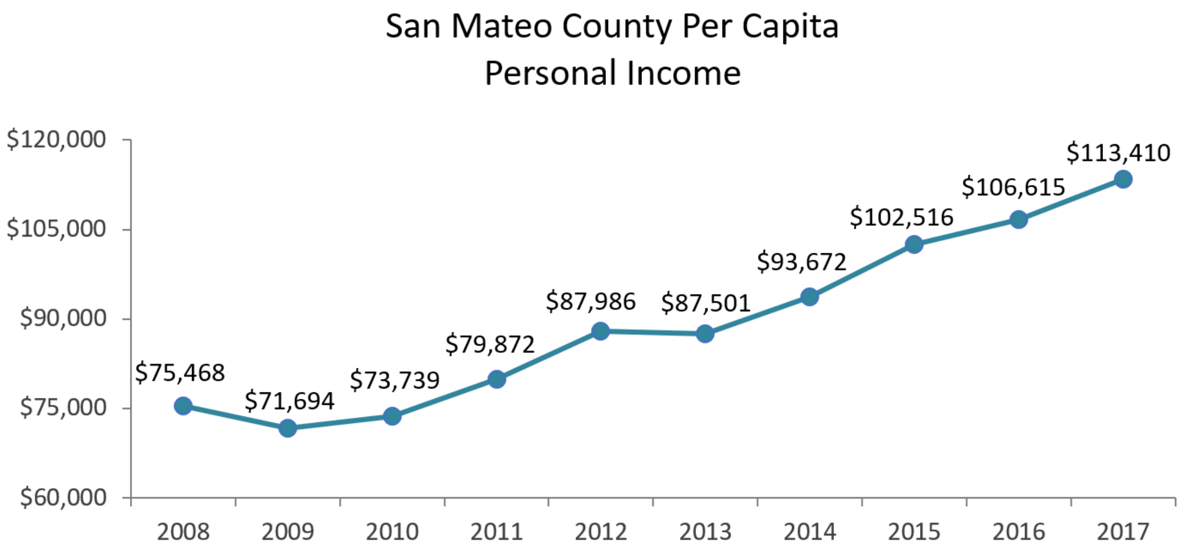



| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| San Mateo | 5.4% | 8.7% | 8.1% | 7.3% | 6.0% | 5.1% | 3.9% | 3.2% | 3.0% | 2.4% | 2.1% |
| California | 8.0% | 11.6% | 11.9% | 11.3% | 9.7% | 8.5% | 6.9% | 5.7% | 5.2% | 4.3% | 4.0% |
| U.S. | 6.5% | 10.0% | 9.4% | 8.8% | 7.8% | 7.2% | 5.7% | 5.0% | 4.9% | 4.1% | 3.7% |

Note: Unemployment rates measured in October of each year, not seasonally adjusted
Source: California Employment Development Department, Local Area Unemployment Statistics:
https://data.edd.ca.gov/Labor-Force-and-Unemployment-Rates/Local-Area-Unemployment-Statistics-LAUS-/e6gw-gvii
Bureau of Labor Statistics: https://data.bls.gov/timeseries/LNS14000000

**K. <u>San Mateo County Per Capita Personal Income</u>**

In San Mateo County, personal income increased from $106,615 per capita in 2016 to $113,410 per capita in 2017 (2018 data is not yet available). Personal income is reported in current dollars (no adjustment is made for price changes). This continues a trend of high growth seen in six of the previous seven years. The county's per capita personal income is nearly $22,000 higher than that of the San Francisco-Oakland-Hayward Metropolitan Statistical Area ($94,459) in which San Mateo County falls and $61,770 higher than that of the United States ($51,640).




Source: Bureau of Economic Analysis: http://www.bea.gov/