County of Los Angeles
CHIEF EXECUTIVE OFFICE
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WILLIAM T FUJIOKA
Chief Executive Officer

April 17, 2012

The Honorable Board of Supervisors
County of Los Angeles
383 Kenneth Hahn Hall of Administration
500 West Temple Street
Los Angeles, California 90012

Dear Supervisors:

FISCAL YEAR 2012-13 RECOMMENDED COUNTY BUDGET
(3-VOTES)

The Fiscal Year (FY) 2012-13 County of Los Angeles Recommended Budget total of $23.781 billion reflects a decrease of $565.0 million in total requirements. General County funds, including the General Fund and Hospital Enterprise Funds ($18.224 billion) reflect a net decrease of $275.0 million. Special District/Special Funds reflect a decrease of $290.0 million.

TOTAL REQUIREMENTS – ALL FUNDS – 2012-13
(Dollars in Billions)

Fund	2011-12 Budget	2012-13 Recommended	Change	% Change
Total General County	$18.499	$18.224	$(0.275)	-1.5%
Special Districts/Special Funds	5.847	5.557	(0.290)	-5.0%
Total Budget	$24.346	$23.781	$(0.565)	-2.3%
Budgeted Positions	101,425	101,610	185	0.2%

BUDGET ECONOMIC OUTLOOK

The current economic outlook for the nation and California shows slow positive growth for the remainder of 2012 and into 2013. Retail sales are showing strength as household positions improve and consumer confidence grows. County sales tax revenues are now on pace to return to pre-recessionary levels by 2012-13. Although the County's unemployment rate remains high, the labor market has made modest gains recently and economists expect this downward trend to slowly continue.

Month	Unemployment Rate
January 2011	12.5%
November 2011	12.1%
December 2011	12.0%
January 2012	11.8%

Unfortunately, the housing market continues to struggle with many obstacles in the way of a recovery. Those obstacles include the high unemployment rate, foreclosures, negative equity and tighter lending standards. In spite of this, some economists are predicting that the end of 2012 may be a turning point in the housing market.

BUDGET OVERVIEW

Since 2008-09 the County has faced significant budget deficits in the net County cost (NCC) portion of our budget. NCC is that portion of our budget financed with locally generated revenues. These deficits have been managed without service reductions, layoffs or furloughs. This achievement has been made possible through the leadership of your Board, County managers and the hard work of all County employees. The Board's long-standing conservative budget practices and our strong compliance to fiscal policies set us in a good position to weather these trying economic times. Our budget solution strategy during this period had been to close the budget gap through a combination of ongoing departmental curtailments and new revenue solutions coupled with one-time funding from County reserves and reductions in the County's capital program. To control costs the County has also aggressively pursued savings through our Efficiency Initiative Program and implemented a hard-hiring freeze and a freeze on non-essential services, supplies and equipment. Throughout this difficult period, employee labor groups have actively partnered with the County by agreeing to zero salary increases, while step increases for County managers were and continue to be suspended.

Today, we face a much more manageable ongoing deficit estimated to be $75.8 million and as a result, for first time in four (4) years, the Recommended Budget does not include any departmental curtailments. The table below outlines the progress that has been made in closing our budget gap.

Fiscal Year	NCC Budget Gap History
2008-09	$33.0 million
2009-10	$360.5 million
2010-11	$491.6 million
2011-12	$185.2 million
2012-13	$75.8 million

The primary components of the 2012-13 NCC Budget Gap are described below.

2012-13 NCC Budget Gap

2011-12 One-Time Budget Solutions	$(185.3) million
Unavoidable Cost Increases	(103.7) million
Program Changes	(31.5) million
Revenue Increases	187.7 million
Assistance Caseload Changes	33.1 million
Ongoing Funding Used for One-Time Needs in 2011-12	23.9 million
Total Budget Gap	$ (75.8) million

2011-12 One-Time Budget Solution

Our principle strategies to deal with the past budget deficits was to judiciously use reserves built up over the last decade, capital funding and structural changes to departmental budgets along with savings through aggressively pursuing efficiencies. Had the County relied solely on departmental curtailments, the impact to County services and its residents would have been much more draconian and would have resulted in the reduction of critical services and the layoff of a large number of County employees. This would have surely put an even greater strain on an already fragile local economy. We believe that the effects of the recession on our budget (i.e., declines in revenues and increases in assistance caseloads) are a cyclical consequence of the recession and its aftermath. Over the last four years, structural changes to the budget came from departmental curtailments of approximately $360.1 million. These measured actions, along with the use of one-time funding sources, have allowed us to more strategically achieve a balanced budget by maintaining sustainable core services. Through this strategy we have sought to avoid wholesale reductions to department budgets, and will continue to conservatively use one-time funding solutions to bridge us forward. The County's reliance on one-time budget solutions continues to decline and for 2012-13 reflects less than two percent (2%) of the County's ongoing locally generated revenues. In contrast, the savings from efficiency initiatives has totaled $245.9 million, which represents five percent (5%) of the County's ongoing locally generated revenues.

Unavoidable Cost Increases

The primary drivers of unavoidable cost increases are employee benefits. The County's retirement contribution rates will increase by five percent (5%) primarily due to the losses sustained by the Los Angeles County Employees Retirement Association (LACERA) in FY 2008-09. The investment losses suffered by LACERA created an unfunded actuarial accrued liability of $9.4 billion as of June 30, 2011. Under California county retirement law, liabilities not funded through member contributions are the responsibility of the employer. LACERA's funding policy calls for asset gains and losses to be smoothed over a five-year period, and the unfunded portion of the liability to be amortized over thirty years. In addition, increases in health insurance premiums for County employees and the restoration of the deferred compensation match are contributing factors effecting unavoidable cost increases.

Revenue Increases

As the economy begins to slowly improve, we are forecasting increases in a variety of locally generated revenues along with increases in statewide sales tax revenues.

For the second year in a row, the Assessor is forecasting an increase in assessed valuation. Since the forecast is preliminary and the Assessor is scheduled to release updated forecasts in May 2012 with a final assessment roll forecast in July 2012, our office will continue to monitor and update our property tax projection accordingly.

Once again, we are seeing year-over-year growth in Proposition 172 Sales Tax and Realignment Sales Tax. Based upon this increase and a survey of local economic forecasts, we have assumed a 3.5 percent growth factor in our overall sales tax projection for the 2012-13 Recommended Budget. Like property taxes, we will continue to monitor these revenue sources and update our projections going forward throughout the budget process.

Assistance Caseload Decreases

During the past three years, the high unemployment rate caused many to seek public assistance from the County. This in turn caused assistance caseloads and costs to dramatically increase. The cost of providing general relief (GR) is particularly acute, since the County bears the entire cost of providing this assistance. The 2011-12 budget assumed that the GR caseload would peak in December 2011 and gradually decline ending 2011-12 with an average caseload of 112,487. With the drop in the unemployment rate and our Board-approved GR restructuring efforts being implemented, we are beginning to see a decline in the ranks of the GR caseload. The GR caseload appears to have peaked in August 2011 at 113,034 and continues to decline with the January 2012 caseload at 106,186. This drop in GR caseload has resulted in a $27.4 million reduction in cost to the 2012-13 budget.

Fiscal Year	Average GR Caseload	NCC Cost
2006-07	58,599	$132.9 million
2007-08	62,897	$147.7 million
2008-09	74,763	$178.4 million
2009-10	91,499	$219.0 million
2010-11	106,348	$254.3 million
2011-12	112,487 (Budget)	$271.2 million
2011-12	108,216 (Estimated)	$261.3 million
2012-13	101,518 (Projected)	$243.8 million

2011-12 NCC Budget Gap Solution

As stated earlier, we recommend that the $75.8 million budget gap be solved with one-time budget solutions. Since it appears that we have weathered the worst of the economic crisis and the economy is growing slowly, we believe that it is fiscally responsible to utilize one-time funding sources to help bridge our budget gap. It is important to note that neither the Reserve for Rainy Day Fund ($93.2 million) nor the Provisional Financing Uses-Economic Reserve ($83.6 million) were used to close this year’s budget gap. These reserves remain intact and available to address future uncertainties.

We must also keep in mind that as the County's budget situation improves, we must do whatever is necessary to grow these reserves. If the County's revenue situation improves in the coming months, we would likely recommend that some of this increase be used to supplement County reserves. County budget policy requires a ten percent (10%) reserve of locally generated revenues be set aside in the Reserve for Rainy Day Fund.

Countywide Efficiency Efforts

The County continues to aggressively explore efficiencies as a means to generate ongoing and one-time savings while improving operations. With the support of your Board, our office has placed a high emphasis on both countywide and departmental efficiencies over the last three (3) years, working with departments to cut operating costs through diligent efforts and innovative reengineering of existing processes. The County's ability to avoid the serious cutbacks and layoffs that many other jurisdictions have suffered in this economic crisis is in part due to these cost-saving efforts.

Major examples of the County's efficiency initiative projects include:

- Dramatically lower pharmaceutical drug costs through streamlined/volume purchasing and inventory management ($100.3 million per year);

- Conversion of General Relief recipients to collect Supplemental Security Income ($18.6 million one-time savings);

- Negotiation of enterprise software licenses ($10.8 million one-time savings);

- Improved Medi-Cal claims processing and reduction of denied days ($8.0 million per year);

- Increased clinic participation and expansion of industry-sponsored assistance to reduce indigent client medication costs ($6.1 million per year);

- Systematic monitoring and termination all unused phone/data lines ($5.5 million per year);

- Increased collections through offering payment plans at hospitals ($2.5 million per year);

- Requiring all county contractors to be current on their personal and real property taxes ($1.9 million one-time savings); and

Countywide, these initiative projects have resulted in $245.9 million in savings through March 2012, and we estimate savings of $255.0 million by the end of the current fiscal year.

OTHER FUNDING RECOMMENDATIONS

Listed below are some important recommendations included in the 2012-13 Recommended Budget.

- **Public Works' Road Fund** – Reflects a $77.3 million decrease in appropriation and financing primarily due to the deletion of one-time funding for unincorporated area road projects, construction and maintenance activities ($62.1 million) and various changes in operations ($35.3 million). These funding decreases are partially offset by a $20.1 million increase in Traffic Congestion Management program funding.

- **Mental Health Services Act** – Reflects a $58.6 million increase in appropriation for the Department of Mental Health primarily to continue the expansion of Prevention and Early Intervention (PEI) mental health contracted services. Also reflects funding for 8.0 positions to implement a countywide program to address the needs of veterans returning from Iraq and Afghanistan, active duty personnel, and their families. This increase in appropriation is fully offset with State Mental Health Services Act funds and, where appropriate, federal funds.

- **Mental Health Services for Special Education Pupils (AB 3632) –** Reduces both appropriation and revenue by $128.4 million for the Departments of Mental Health ($82.4 million) and Children and Family Services ($46.0 million) along with the elimination of 63.0 budgeted positions at the Department of Mental Health. This reduction is reflective of the State's transfer of responsibility for the AB 3632 program from counties to school districts.

- **Sheriff's Department** – Reflects an increase a $13.4 million in appropriation fully offset with contract law enforcement services revenue primarily for services provided to the Metropolitan Transportation Authority (MTA). This adjustment adds 109.0 budgeted positions.

- **Sheriff's Department** – Reflects a $3.4 million increase in appropriation fully offset with revenue from the 2011 COPS Hiring Program Grant. Your Board accepted the grant award in November 2011. This adjustment adds 25.0 budgeted positions.

- **Energy Efficiency Projects** – Reflects a $2.2 million investment to establish a revolving fund that finances various retro-commissioning, monitoring-based commissioning, and lighting efficiencies projects throughout the County. These projects are expected to generate utility costs savings that would recover the costs of the projects over a two-to-four year period.

HEALTH SERVICES

There are major changes taking place in the Department of Health Services' operations and Medi-Cal revenue streams as a result of the 1115 Waiver, particularly the Healthy Way LA (HWLA) matched program, the transition of Seniors and Persons with Disabilities (SPDs) into Medi-Cal managed care, the transfer of the Office of Managed Care's lines of business to L.A. Care, and the State's transfer of various programs to the County, including health care for inmates previously treated in the State prison system, etc. There are also major changes related to national health care reform in the future, including changes associated with the proposed health insurance exchange.

These significant program and system changes are complex and require the Department to develop new methods of projecting revenue based on new types of patient and payer mixes and different utilization patterns. The Department is working on improvements in data collection at the facilities and the development of various revenue projection models, which will provide more reliable revenue projections for future years as more experience is gained with the new programs and the other changes taking place throughout the system.

The Recommended Budget includes a revenue placeholder of $132.0 million while the Department continues to work diligently to develop and improve its revenue projections, which the Department will revise in a future budget phase.

POTENTIAL STATE/FEDERAL BUDGET IMPACTS

State Budget

On January 5, 2012, the Governor released his 2012-13 Proposed State Budget, which includes $92.6 billion in State General Fund expenditures. The budget plan projects a current year deficit of $4.1 billion and a $5.1 billion deficit for 2012-13. The Governor's plan calls for solving the 18-month deficit through a combination of $4.2 billion in expenditure reductions, a temporary tax increase and revenue solutions totaling $4.7 billion, and various other solutions estimated at $1.4 billion. The Governor's plan also sets aside $1.1 billion as a reserve.

Based upon an analysis of the Governor's budget, we estimate that the impact to the County would result in a net loss of approximately $12.1 million at this time. The estimated loss primarily affects mental health and social service programs. Since the State budget situation continues to unfold and remains fluid, we are deferring recommendations to align the County budget with actions by the Governor and the Legislature until later phases of the State Budget process when their situation becomes clearer. Similarly, we are deferring Public Safety Realignment (AB 109) budget recommendations since AB 109 allocations to counties are expected to be addressed in the Governor's May Budget Revise. Furthermore, given that this program is relatively new, it is important to continue to track actual expenditures for at least six (6) months to ensure the appropriateness and accuracy of the funding allocation.

Federal Budget

On February 13, 2012, President Obama released his proposed $3.8 trillion budget for Federal Fiscal Year (FFY) 2013, which will begin on October 1, 2012. As estimated by the Office of Management and Budget, the federal budget deficit will drop from $1.3 trillion in FFY 2012 to $901 billion in FFY 2013. The President's Budget would increase overall non-security discretionary spending from $1.0 trillion in FFY 2012 to $1.0 trillion in FFY 2013, the same levels as in the Budget Control Act of 2011, which increased the federal debt limit and reduced projected federal expenditures. It does not propose significant net reductions in entitlement (mandatory) spending, such as Medicaid, Title IV-E Foster Care and Adoption Assistance, TANF, and Child Support Enforcement, which account for most of the federal revenue received by the County.

It is widely expected that major federal budget decisions, including the enactment of FFY 2013 appropriations and possible extension of major expiring tax provisions, will be deferred until after the November elections. Given the divided government and major partisan differences, it is unclear whether major budget legislation can be enacted during a "lame duck" session before the end of the year. In each of the previous three election years, Congress enacted continuing resolutions, which left the completion of appropriations bills to the next session of Congress. Since major federal budget legislation is unlikely to be enacted until December 2012 at the earliest, and major changes enacted in federal legislation typically have a delayed effective date, it is highly unlikely that any future federal budget actions will have any effect on the County's budget during 2012-13.

CAPITAL PROJECTS/EXTRAORDINARY MAINTENANCE PROGRAMS

Capital Projects

The 2012-13 Recommended Capital Projects/Refurbishments Budget appropriates $1.1 billion for continued development, design, and construction of projects that address high priority health, public safety, recreation, and infrastructure needs. The recommended appropriation reflects a decrease of $51.4 million from the 2011-12 Final Adopt Budget, due to the completion of 17 projects in 2011-12. The recommended 2012-13 appropriation is highlighted by the following appropriations:

- $367.0 million for public protection facilities, such as new construction at the Biscailuz Center Training Academy, construction of new fire stations in the Santa Clarita Valley, implementation of fire station privacy and access improvements, potable water system upgrades at fire stations, security improvements at Probation juvenile halls and camps, and construction of a new animal shelter in the east Antelope Valley;

- $151.8 million for recreational facilities including construction of swimming pool facilities, community buildings, and gymnasiums at County parks, and facility refurbishments at County beaches;

- $107.9 million for general government facilities highlighted by the construction of a new Countywide data center in Downey;

- $380.0 million for health, public health, and mental health facilities, including build-out of a community hospital and construction of a new multi-service ambulatory care centers at the Martin Luther King Jr., medical campus and High Desert in the Antelope Valley, construction of a mental health outpatient clinic at Harbor-UCLA Medical Center, completion of a new public health center in South Los Angeles, and construction of new surgery and emergency suites at Harbor-UCLA Medical Center;

- $69.9 million for construction of new or replacement libraries in the unincorporated area of Stevenson Ranch, the San Gabriel Valley and Manhattan Beach; and

- $58.6 million for high priority infrastructure improvements in the County's roads, flood control and aviation facilities, soil and groundwater investigation and remediation activities, beautification of the County's Easter Hill complex and watershed testing efforts.

Sustainable Design Program

In January 2007, your Board approved the establishment of the Sustainable Design Program as a component of the County's Energy and Environmental Policy. The purpose of the program is to support the County's goal of a 20 percent reduction in its facility's energy and resource consumption by the year 2015 through the integration of sustainable, "green building" technologies into the designs of the County's capital improvement and refurbishment projects.

The 2012-13 Recommended Capital Projects/Refurbishments Budget reflects the County's continued commitment to the ideal of sustainability, with the incorporation of sustainable design technologies into 138, or 48.4 percent of the County's 285 active building or refurbishment related projects (projects related to land acquisition or non-structural in nature have been excluded from this count). In 2012-13, Leadership in Energy and Environmental Design (LEED) certification is being pursued on 23 projects, including 21 that are expected to be certified at a level of Silver, and two at a Gold level, including the Martin Luther King Jr., Center for Public Health.

Extraordinary Maintenance

The County's infrastructure requires ongoing investment to meet performance requirements and expectations. As part of the Deferred Maintenance Program, approved by the Board of Supervisors (Board) on September 28, 2010, the 2011-12 final budget appropriated funds for critical repairs at public health centers, community and senior centers, County cultural institutions, and County waste water treatment facilities. By the close of 2011-12, 80 percent of those designated critical repairs and maintenance will be complete. The 2012-13 Recommended Budget appropriates $111.9 million for the remainder of these and other high priority repairs, maintenance and accessibility modification needs at County facilities, including juvenile halls, animal shelters, County beaches, parks, and for various roof repairs throughout the County.

FUND BALANCE CLASSIFICATIONS

In 2009, the Governmental Accounting Standards Board issued Statement No. 54, which required governmental agencies to adopt new fund balance categories and terminology for financial reporting. This change replaced the longstanding fund balance categories known as "reserves" and "designations" with four new categories, as discussed below. There were various references to reserves and designations in State law known as the County Budget Act (Act). In 2011, the Act was updated to be in conformance with the new GASB terminology.

Existing County budget policies classify fund balances as reserved, designated, and available. For the County's 2012-13 budget, the reserve and designation terminology will be replaced with four new fund balance classifications: "nonspendable," "restricted," "committed," and "assigned." Following are definitions of the new fund balance classifications:

- Nonspendable Fund Balance – That portion of the fund balance that cannot be spent as it is either (a) not in spendable form, or (b) legally or contractually required to be maintained intact. The "not in spendable form" criterion includes items that are not expected to be converted to cash, for example: inventories and long-term receivables.
- Restricted Fund Balance – That portion of the fund balance based on constraints placed on its use that is either (a) externally imposed by creditors, grants, contributors, or laws and regulations of other governments; or (b) imposed by law through constitutional provisions of enabling legislation. Restrictions may effectively be changed or lifted only by changing the condition of the constraint.
- Committed Fund Balance – That portion of the fund balance that can only be used for the specific purposes determined by the Board through County ordinance. Committed fund balance may be changed or lifted only by the Board taking the same formal action that imposed the constraint originally. The underlying action by the Board needs to occur no later than the close of the fiscal year. At present, this category of fund balance is not applicable to the County.
- Assigned Fund Balance – That portion of the fund balance that is approved by the Board to reflect a government's intended use of resources that is neither restricted nor committed fund balance. Amounts formerly displayed as designations in the County Budget are now classified as assigned fund balance.

Previous Classification	New Classification
Reserve in nonspendable form such as Inventories and Long-Term Receivables.	Nonspendable
Reserve depending on the nature of the restriction.	Restricted
At present, this category is not applicable to the County.	Committed
Designations, General Reserve, Reserve for Rainy Day Funds, and Reserve for Imprest Cash.	Assigned
Unreserved/Undesignated.	Fund Balance Available

It is important to note that the new terminology does not change the total amount of fund balance, nor does it affect the amount of available fund balance for the budget. Board policies and actions will continue to determine the priorities and set aside amounts for fund balance. The number of votes and voting requirements associated with budget adjustments from fund balance also remain unaffected by the new terminology. The CEO and Auditor-Controller will issue revised budget adjustment guidelines which incorporate the new fund balance terminology.

BUDGET TIMETABLE

Approved schedule for budget hearings and deliberation is as follows:

Board Action	Approval Date
Adopt Recommended Budget; Order Printing, Notice and Distribution; and Schedule Hearings	April 17, 2012
Commence Public Budget Hearings	May 16, 2012
Commence Final Budget Deliberations and Adopt Budget Upon Conclusion	June 18, 2012

Prior to deliberations on the FY 2012-13 Adopted Budget, we will file reports on:

- May revisions to the Governor's Budget and updates on other 2012-13 State and federal budget legislation and the impact on the County's Recommended Budget;
- Final revisions reflecting the latest estimates of requirements and available funds;
- Allocations to counties by the State for Public Safety Realignment (AB 109) for 2012-13 along with recommendations to allocate AB 109 funding to County departments;
- Issues raised in public hearings or written testimony;
- Specific matters with potential fiscal impact; and
- Issues as instructed by your Board.

APPROVAL OF RECOMMENDED BUDGET

The matter before your Board is the adoption of the Recommended Budget.

- The documents must be available for consideration by the public at least 10 days prior to the commencement of public budget hearings.
- Adjustments to the budget, including revisions to reflect your Board's funding priorities and State and federal budget actions, can be made during budget deliberations, prior to adoption of the Budget.
- Pursuant to State law, your Board may make changes to the Recommended Budget with a simple majority (3 votes) until adoption of the Budget, if changes are based on the permanent record developed during public hearings (e.g., Recommended Budget, budget requests and all written and oral input by Supervisors, County staff and the public).
- Changes not based on the "permanent record" require 4/5 vote.

THEREFORE, IT IS RECOMMENDED THAT YOUR BOARD:

1. Order such revisions, additions and changes to the Chief Executive Officer's budget recommendations as deemed necessary and approve the revised figures as the Recommended Budget for 2012-13; order the publication of the necessary notices; and set May 16, 2012 as the date that public budget hearings will begin.
2. Approve discounted prepayment on the County's retirement contribution, if it is within the County economic interest to do so, and authorize the Chief Executive Officer to negotiate with LACERA on the County's behalf in this regard.

Respectfully submitted,

WILLIAM T FUJIOKA
Chief Executive Officer