COUNTY OF SAN MATEO

County Manager's Office

Date: September 23, 2003

TO: Honorable Board of Supervisors

FROM: John L. Maltbie, County Manager

SUBJECT: Final Budget Changes to the Fiscal Year 2003-04 Recommended Budget

RECOMMENDATIONS

Approve the following actions related to final budget changes to the Fiscal Year 2003-04 Recommended Budget:

1. Adopt a resolution approving the County of San Mateo budget as to the expenditures for Fiscal Year 2003-04 and making appropriations therefore;

2. Adopt a resolution approving the County of San Mateo budget as to the means of financing for Fiscal Year 2003-04;

3. Adopt an ordinance amending the Master Salary Ordinance for changes related to the Fiscal Year 2003-04 budget;

4. Adopt a resolution establishing the appropriation limit for the County in accordance with Article XIIIB of the California Constitution;

5. Accept reports related to budget items discussed during June Budget Hearings; and

6. Approve an Appropriation Transfer Request (ATR) for the Burlingame Health Center reducing Available Fund Balance by $4,750,000; reducing Other Financing Sources by $250,000; reducing Services and Supplies by $4,750,000; and reducing Fixed Assets by $250,000 in the San Mateo Medical Center Enterprise Fund.

Discussion

The Board's public hearings on the FY 2003-04/2004-05 Recommended Budget were conducted from June 23 through June 27, 2003. As a result of the adoption of the State budget, the County's financial year-end closing activities and availability of more current information, changes are proposed to the Recommended Budget.

The FY 2003-04 Recommended Budget was reduced by $29.5 million from the prior year. An $80 million General Fund budget deficit, including $33 million in estimated State budget impact, was addressed by making operational reductions, adding revenue and utilizing County Reserves. This was the second year that significant Reserves were used to balance the budget, primarily for estimated losses in state funding. Since June, the County's financial situation has improved. Upon completion of the year-end financial closing process, the County generated an additional $23.2 million in Fund Balance. A number of cost items were identified by the Controller's Office at year-end that will require the use of this additional Fund Balance and County Reserves. These include unfunded liabilities for workers' compensation and accrued sick leave/retiree health costs.

The State did not completely eliminate the vehicle license fee (VLF) backfill as originally proposed, reducing the estimated $33 million impact to the County. However, the VLF issue is still unsettled, and the State still faces at least a $10 billion deficit next fiscal year, necessitating additional program shifts and cuts in funding. A number of major budget issues also need to be considered for the development of next year's County budget. These issues are discussed individually in this report. We highly caution any reversals or restorations of budget reductions without proposals for alternative funding solutions, given the great degree of uncertainty going into next fiscal year.

FINAL FUND BALANCE ADJUSTMENTS

As adopted by Board Resolution, final adjustments to Fund Balances after year-end closing activities are included in the Recommended Budget and comply with County Reserves Policy guidelines. After FY 2002-03 year-end closing, additional Fund Balances of $23.2 million for all County funds ($20M General Fund and $3.2M Other Funds) were included in the budget. Of the total amount, $8.2M was set aside in Reserves ($3.1M General Fund and $5.1M Non-General Fund Reserves). These adjustments are summarized in Attachment D, and include the use of additional Fund Balance for increased contribution toward unfunded workers' compensation liability as identified by the Controller's Office.

FINAL BUDGET CHANGES (September Revisions)

Final budget changes for all County funds (Attachment C) result in the addition to the County Budget of $31.4 million and 296 positions, of which $20.5 million and 270 positions are related to the Burlingame Health Center. The revised County Budget is $1.27 billion and 5,264 positions. Attachment A contains a summary of position changes. The following are the significant budget changes:

1. Operation of Burlingame Health Center ($20.5 million)
   Net patient revenue ($19.3M) and funds from Medical Center capital reserves ($1.2M) have been added for the operation of this 281-bed skilled nursing facility beginning August 2003. Appropriations include salaries and benefits for 270 full and part-time positions and other operating and capital costs during FY 2003-04. These positions are phased in to reflect projected increases in patient census levels – from the current 120 patients to 210 in February 2004, and 260 in June 2004. There are no contributions from the General Fund to operate this facility. An Appropriation Transfer Request (ATR) is submitted to reverse the interim budget brought to the Board in late July, since these September final budget changes include revenue and appropriations for the period originally covered by the interim budget using the appropriate organizational units and revenue/expenditure accounts.

2. Medical Center Capital Equipment ($2.7 million)
   Funds from Medical Center capital reserves have been added for one-time purchase of Fixed Assets related to the remodeling at the Geriatric Assessment Center; projected capital expense for the Medical Center, including renovations and document imaging equipment for the Patient Finance Unit and ultrasound and mammography equipment for Radiology; and other capital equipment purchases throughout the Hospital and Clinics facilities. There are no contributions from the General Fund for these one-time costs.

3. Countywide Homeland Security and Domestic Preparedness Grants ($2.7 million)
   The Office of Emergency Services has been notified of three grant awards for countywide emergency preparedness and security. The first award is from the State (Domestic Preparedness Grant) and will be used for countywide equipment purchases and emergency anti-terrorist exercises. The other two awards are from the Federal Government (Homeland Security Part I and Homeland Security Part II) and will be used for countywide equipment purchases, emergency anti-terrorist exercises, and terrorist-response research and planning. For each of these grants, a special committee composed of involved agency officials makes allocation recommendations. Health, fire and law enforcement first-responder agencies receive the funds.

4. Food and Nutrition Staff Transfer to Medical Center ($2.7 million transfer)
   Staffing and appropriations, as well as corresponding revenue related to Medical Center food services are deleted from the Food and Nutrition Services division of Health Services. Staff will be transferred to the Medical Center budget unit as of October 1, 2003. The Medical Center has reduced its budget for service charges from Food and Nutrition and increased Salaries and Benefits and other appropriations to reflect the transfer of staff who will now be providing services directly to the Medical Center. This includes the transfer of 27 positions. Food services for the Sheriff and Probation departments remain the responsibility of Food and Nutrition/Health Services.

5. Health Insurance Telecenter ($2.3 million)

   Funding for staffing and one-time automation costs associated with the Medi-Cal Program are added in the Human Services Agency budget. A call center environment (the Health Insurance TeleCenter) has been designed to streamline Medi-Cal service delivery, disseminate information and maintain cases. A total of 20 positions and one-time automation costs are added. Funding is provided through the Medi-Cal allocation.

6. Additional Employment Services Funding ($1.4 million)

   Federal Workforce Investment Act (WIA) program funding will be applied to the Bay Area Bioscience Careers project ($840,000) to place 80 clients into training and 100 clients into internships in the biotech industry, to the Regional Technologies Employment Consortium project ($112,500) to place 80 clients into training, to Youth Employment programs ($250,000) to serve 75 clients, and to the Dislocated Worker program ($200,000) to place 60 clients into training.

7. Restoration of Funding for Mental Health Contracts ($208,750)

   A lower than anticipated reduction in the State Mental Health Managed Care allocation and an increase in the Federal Financial Participation (FFP) ratio for Medi-Cal reimbursement result in the full restoration of funding for Daly City Youth, Caminar and Mental Health Association, and partial restoration of funding for Institutions for Mental Disease. The report-back item from Mental Health in Attachment B provides additional detail on these restorations.

REPORT BACK ITEMS

Attachment B contains the following reports requested at the June Budget Hearings:

- Probation Department – Risk Prevention Program (with supplemental information from County Manager)
- Mental Health – Recommend Restoration of Contract Reductions with State/Federal Funds
- UC Cooperative Extension – Recommend Partial Restoration of County Contribution
- County Manager - Homework Centers Comparative Analysis

STATE BUDGET UPDATE

A separate County Manager's Report will discuss the impact on the County as a result of the State Budget. In the Recommended Budget, County Reserves were reduced to cover an estimated State Budget impact of $33 million. Due to the limited information that is currently available from the State regarding specific changes to county allocation levels, as well as the uncertainty surrounding the recall and the possibility of mid-year budget reductions, we are maintaining the reduction at $33 million. Additional updates will be provided to the Board as more specific information becomes available. Following is a list of known state impacts to date.

- Vehicle License Fee Backfill "Gap" ($12.5 million)
- Undesignated Court Fees ($600,000)
- Child Support Statewide Automated System Penalty ($793,000)
- Other State Budget cuts to County departments (at least $2.4 million; waiting for County-specific information from State)
- Booking fees ($0 in FY 2003-04; $1.7 million in FY 2004-05 if eliminated)

MAJOR BUDGET ISSUES

The following have been identified as major budget issues for the current and subsequent fiscal years:

Health Plan of San Mateo (HPSM)

HPSM administers the Medi-Cal health program for low-income individuals in San Mateo County, serving approximately 45,000 members through its managed care plan. In recent years, with State reimbursement rates lagging behind operating costs, the Plan's financial situation has deteriorated sharply. An $8 million shortfall is projected in the current year. Absent a rate increase from the State, HPSM is on the verge of closure; a notice of intent to terminate its Medi-Cal operations as of October 31, 2003 has been filed with the State. In the past 15 years, the HPSM has succeeded in building a large network of private and public providers to serve Medi-Cal clients by offering a higher reimbursement rate than that available through the State's fee-for-service system.

If HPSM closes, provider reimbursement for Medi-Cal services would shift from the current managed care rate through HPSM to a substantially lower fee-for-service rate from the State. The impact would be widespread.

- Private providers, especially private physicians currently participating in the Medi-Cal program, might choose to reduce their caseload of Medi-Cal patients, or stop serving these patients altogether due to the substantially lower reimbursement available from the State.
- As a result of private providers pulling out of Medi-Cal, patients would have severe problems finding a physician. There would be a substantial increase in emergency room visits throughout the County and in Medi-Cal patients seen at County clinics. Private physicians now see approximately 34,000 Medi-Cal clients. The County clinic system would need to absorb a 50% increase in visits over its current volume—approximately 100,000 additional patient visits—if all of these patients came to the County, requiring an enormous increase in clinic capacity.
- The Health Services and Human Services staffs would also experience significant workload increases since they provide other direct services to Medi-Cal clients. Clients would look to these agencies to help them locate medical care. As the primary point of contact with Medi-Cal clients, there would be a major impact on the Human Services Agency eligibility workers. As a result, eligibility determinations will be delayed, resulting in more uninsured patient visits at the County and other facilities and affecting San Mateo Medical Center (SMMC) revenues.
- On the other hand, the County could realize increased revenue at SMMC because Federal SB 1255 funds would be received for services rendered to inpatient Medi-Cal patients. The amount is difficult to estimate but could be as much as $5 million. The County will also be eligible for SB 1255 funds once maternity services are implemented at SMMC.
- Other HPSM programs for uninsured children and IHSS workers— Healthy Families, Healthy Kids, and HealthWorx— could operate longer, but would terminate around June, 2004 unless alternative solutions are found.

Earlier this year, the Department of Health Services (DHS) requested a rate increase for HPSM. The Department of Finance (DOF) calculated the increase for all five County Organized Health Systems (COHS), each experiencing differing levels of financial crisis, and determined it too costly in light of the State's $38 billion budget deficit. As an alternative, DHS proposed that the Federal Center for Medicaid and Medicare (CMS) authorize a "managed intergovernmental transfer" (IGT) to provide increased funds for the managed care plans. CMS rejected that proposal.

The County legislative delegation has been asked to intervene. A recent meeting between Senator Speier and the Governor's Cabinet Secretary resulted in support of a new request to DOF for a rate increase for just HPSM. That request is in process and HPSM is awaiting DOF approval. We will keep the Board apprised of further developments as they unfold in the next few weeks.

Burlingame Health Center

In order to avoid closure of these long-term skilled nursing beds, the State Department of Health Services, which was going to discontinue funding the bankrupt operation, authorized the County to take over financial responsibility and operation of the facility as of August 1, 2003. Your Board held a special meeting on July 24 and approved a 90-day interim budget and agreement with the existing Court appointed Receiver, E. Don Doyle, to manage the facility operations during the period of time that the County was hiring employees and implementing County systems at the facility. Changes to the final budget for FY 2003-04 include a Burlingame Health Center operating and capital budget of $20.5 million, including funding for 270 positions which are being filled as the number of patients in the facility increases during the fiscal year. Current patient census is 120, and is anticipated to increase to 210 by February 2004, and 260 by June 2004. For FY 2004-05, the census is anticipated to increase to 270. The facility has a licensed capacity of 281 beds. The operation is budgeted to financially break even in the first year, and is projected to generate an operating surplus of approximately $1.5 million in the second year. A multi-year financial forecast will be presented to your Board on October 7 as part of an update to be provided by Medical Center staff.

Youth Services Center
Upon compliance with federal environmental requirements, the County will issue up to $170 million in lease revenue bonds for the construction of the Youth Services Center. The project includes the construction, furnishing and equipping of offices for Probation Administration, a juvenile hall, juvenile court, girls camp, community school, receiving home and group home. The State Board of Corrections awarded the County a Federal grant of $21.1 million to assist in the construction of the Juvenile Hall portion of the project. The completion date of September 2006 must be met in order to receive these federal funds. Annual debt service of at least $7 million will begin in FY 2006-07. Main sources of funding for debt service will be the County's General Fund, Public Safety Sales Tax (Proposition 172), Courthouse Construction Fund (new courtrooms), Facilities Surcharge, Federal/State grants (Health facilities) and reimbursement for allowable Human Services Agency (new Receiving Home) and County Reserves.

Recall Election Expense
The October 2003 Recall Election is anticipated to cost the County $1.3 million. Approximately $750,000 has been spent to date, primarily for the printing of sample, official and absentee ballots and some labor costs. If the election is postponed until a later date, the County will incur additional expense for the same types of cost items as the October 7 ballot. In addition, the County could be required to further improve voting equipment from the current optical scan voting system to comply with new state and federal laws at an estimated cost of $4.5 million. The Assessor-Clerk-Recorder expects state funding from the Voter Modernization Act to cover a significant portion of the upgrade; the required county match is $1.5 million. There is currently $1.2 million in Reserves for this equipment upgrade in the Assessor-Clerk-Recorder budget.

Negotiated Increases in Salaries and Benefits
Salaries and benefits for the General Fund are projected to increase by at least $40.3 million over the next two fiscal years. This does not include new contribution rates for retirement, which are expected to increase due to changes resulting from the most recent actuarial study as well as the next enhancement in retirement benefits effective March 2005. Upon review of preliminary retirement rates from the actuary, a projection will be prepared and included in the mid-year budget update to the Board.

Terminal Pay – Cashout of Vacation/Other Leave
The current General Fund budget includes $500,000 for terminal pay/leave cashout. A recent analysis of outstanding leave balances for over 600 employees eligible for retirement resulted in $6.4 million in potential cashout costs/terminal pay. An updated estimate will be prepared and included in the FY 2004-05 budget.

Unfunded Workers Compensation Liability
The Controller's Office has performed an audit of the County Workers' Compensation Trust Fund. Based on the results of an actuarial study, the County's total estimated workers' compensation liability is $23 million. The fund currently has a reserve balance of $9.6 million which covers 42% of the liability. This funding level is significantly lower than Santa Clara County (85%) and Contra Costa County (65%). An appropriation of $9.95 million has been added to the budget from General Fund Reserves and carryover Fund Balance for transfer to the Workers' Compensation Trust Fund so that the County is funded at the 85% level.

Unfunded Sick Leave/Retiree Health Liability
Upon retirement, management employees can convert 8 hours of sick leave balance to cover one month of health insurance premium costs. In preparing the financial statements for fiscal year ending June 30, 2003, the Controller reviewed outstanding sick leave balances to determine the County's accrued sick leave liability. Currently, the operating department that employed the management employee would be charged the monthly health premium costs once the employee retires. The Controller has recommended the designation of $8.2 million in County Reserves for accrued sick leave/retiree health costs. An amount would be deducted from these reserves annually to pay for costs incurred each fiscal year. An actuarial study will be conducted to determine an appropriate level of funding for these costs. It is recommended that $5 million in County Reserves be designated this fiscal year until the actuarial study is complete. This amount will be adjusted as part of developing the FY 2004-05 budget.

Medicare Part B Retiree Reimbursement

During June Budget Hearings, your Board approved, on a one-time basis, the addition of $1.4 million to the County's unfunded retirement liability to reimburse some retired employees on a tax free basis for the cost of the supplemental Medicare Part B insurance that is deducted from retired employees' Social Security. The $1.4 million will be financed over 20 years at 8.25% interest. This benefit is not mandated by law and is in addition to the pension benefit earned by the employee during County service. It has been funded since 1998 from excess earnings. The Retirement Board utilized its definition of "excess earnings" so that this benefit could be funded in 2003-04 despite the Association's $273 million unfunded liability. Each additional year that this benefit is granted will result in adding to the County's unfunded liability. The $1.4 million will also increase every year due to the number of retirees and the increasing cost of health insurance. The Retirement Board has appointed a committee of its members to study and make recommendations to the Board of Supervisors to resolve this issue permanently.

ATTACHMENTS

Attachment A – Position Changes Summary
Attachment B – Report Back Items
Attachment C – September Revisions (Final Budget Changes) FY 2003-04 and FY 2004-05
Attachment D – Final Fund Balance Adjustments