WHATCOM COUNTY
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Satpal Singh Sidhu
County Executive

MEMORANDUM

TO: Whatcom County Council

THROUGH: Satpal Sidhu, County Executive

FROM: Aly Pennucci, Deputy Executive

CC: Kayla Schott-Bresler, Deputy Executive
Brad Bennett, Finance Manager
Randy Rydel, Finance Director

RE: 2025-2026 Budget Analysis

DATE: September 6, 2024

This memo is intended to help inform the County Council's budget discussions in advance of the Executive formally transmitting the 2025-2026 Biennial Budget on October 18th for review and adoption. It outlines structural challenges that are many years in the making and offers some short- and long-term policy options to address these issues. The budgetary decisions before Council are difficult ones, but the challenges are neither insurmountable nor unique to Whatcom County.

According to the Government Finance Officers Association (GFOA), "A true structurally balanced budget is one that supports financial sustainability for multiple years into the future…" Generally, a structurally balanced budget describes a budget where annual expenses do not exceed projected annual revenues. Whatcom County is facing a structural budget imbalance where ongoing expenditures for existing County services are outpacing projected annual revenues across several funds; based on analysis to date this is most acute in the General Fund (GF) and the County Road Fund.[1]

The memo is primarily focused on the County's GF; however, the strategies to address the issues are applicable across other funds that are or may in the future present a structural imbalance. Strategies discussed in this memo are under consideration by Executive Sidhu as we work with the Finance Division and all County departments and offices to develop a balanced budget proposal for the 2025-26 biennium. We are seeking input from the Council on these strategies before finalizing a proposal.

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[1] Public Works Director Kosa will provide an update on the Road Fund to the Public Works and Health Committee on September 10th. There are other funds that may have similar structural imbalances (such as the Emergency Management Fund and the Ferry Fund), which the Executive's Office and Finance Division are still reviewing.

I. **Structural Budget Imbalance**

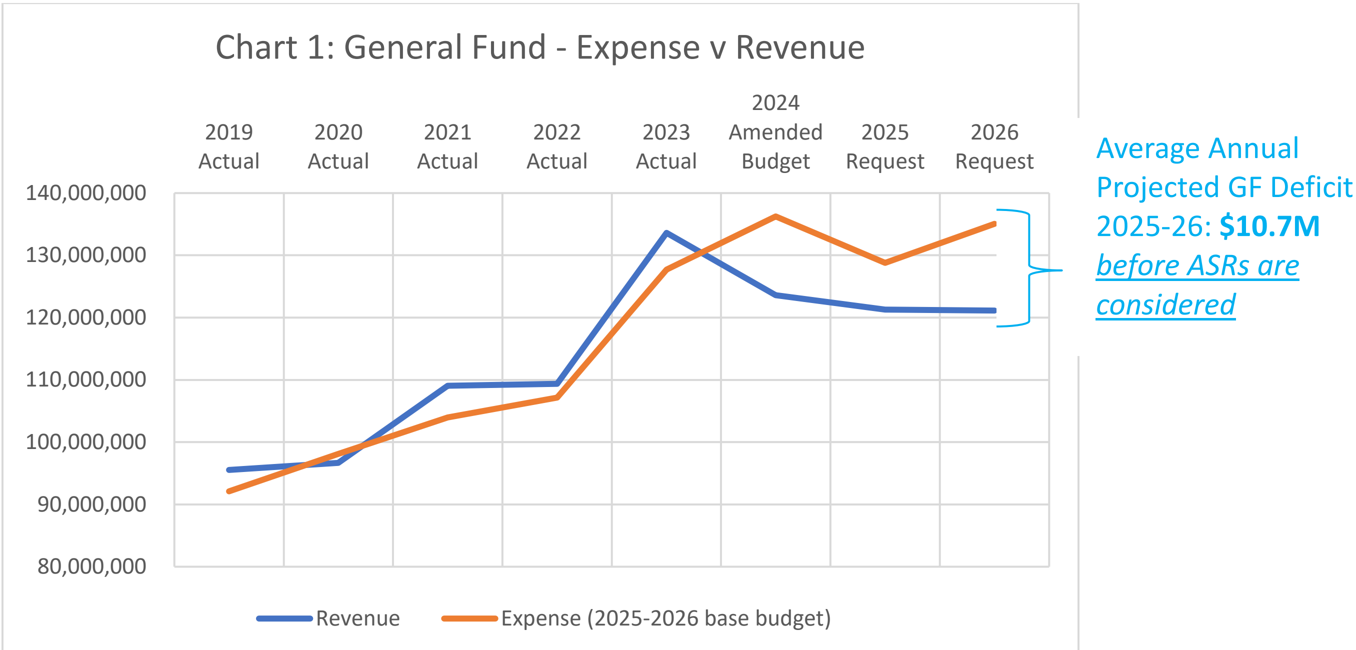
In 2022, the County Executive presented a balanced budget proposal for the 2023-2024 biennium assuming a sound financial position that allowed the County to continue to deliver core services and expand services in some areas in response to community needs. As the County prepared the 2023-2024 Biennium Budget, the Executive noted that while at that moment the financial position was sound, the national economic outlook was volatile and therefore thoughtful, measured, and timely decision making was warranted. That volatility became a reality as the County experienced inflationary cost increases on labor and the cost of goods and services.

The effect of historically high rates of inflations, combined with decisions made through the biennial and supplemental budget actions to expand County services in many areas (i.e. from criminal justice and behavior health, to homeless services and fentanyl response, to climate resiliency and recreation opportunities), is increased pressures on the County's resources. In addition, there are several future obligations, including major capital projects such as the NW Annex and the new Criminal Justice and Behavioral Health facility, increasing costs associated with claims against the County, and labor contract renegotiation, that necessitate long term financial planning for the County. Further, forces outside of the County's control, such as the Washington State Bar Association's revised Standards for Indigent Defense Services, and other unfunded mandates from the State, will continue to increase County expenses. This is happening simultaneously with stagnation or declines in certain ongoing County revenue streams and as one-time resources from the American Rescue Plan Act are depleted, resulting in increased use of one-time fund balances[2] and a structurally imbalanced budget.

One way to see this structural imbalance is by looking at revenue growth compared to expenses. By 2026, expenses are projected to grow 15 percent compared to expenses in 2019 while revenue growth is projected to grow by only seven percent. As noted previously, this imbalance is most acute in the County's GF that supports many of the County's core services.

Chart 1 illustrates the projected structural imbalance in the County's GF, illustrating that, before considering Additional Service Requests (ASRs), the projected average annual operating deficit in the GF for the 2025-2026 Biennial Budget is about $11 million. This again is due to increased cost pressures and the flattening of projected GF revenues. This projection assumes approval of a one percent increase in the Current Expense Levy for the GF in 2025 and 2026 and builds in some assumptions about cost increases to support Public Works' Equipment Rental and Revolving Fund (ER&R), Administrative Services cost increases, and adds a risk reserve for 2026 to reflect that certain County expenses are likely to increase related to open labor contracts, insurance premiums, other legal settlements, etc.

[2] Fund balances are used to mitigate current and future risks (e.g., revenue shortfalls and unanticipated expenditures) and to ensure stable tax rates. The GFOA recommends, at a minimum, that general-purpose governments maintain unrestricted budgetary fund balance in their GF of no less than two months of regular general fund operating revenues or regular general fund operating expenditures.



Based on the initial review of the ASRs[3] submitted for the 2025-2026 biennium, and considering future liabilities as outlined above, that average deficit is likely larger if no other changes are made to increase resources or decrease spending.

In the current year (2024), the projected GF operating deficit is $12.7 million. To balance, it is assumed that the County will:

- Lapse $8.9 million of budgeted GF expenses. Put another way, we are assuming that departments will underspend their 2024 GF budgets by $8.9 million, equivalent to ~6.5 percent of 2024 budgeted GF expenses; and
- Use $3.9 million of one-time fund balance.

Occasional use of underspend assumptions and fund balances to balance a budget hole are not in all cases an inherently bad thing, but delaying more targeted reductions in the absence of new revenues, and persistent use of fund balances to support ongoing expenses will pose problems in the future.

[3]We are reviewing ~389 ASRs submitted for consideration in the 2025-2026 Biennial Budget; 59 percent are "Cost Maintenance" ASRs. Within those requests, there is about $3.1M of GF requests in 2025 and $2.7M in 2026 (more than half of those requests are cost maintenance ASRs).

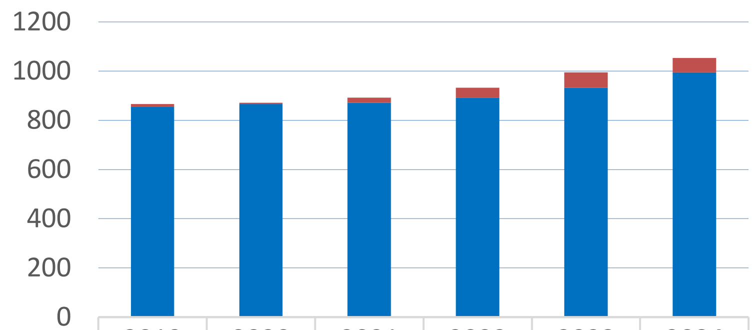
Cost Maintenance ASRs are typically small requests and do not involve new services or increased. They are intended to be an easy means of requesting increases due to inflation or increased software maintenance contracts.

How did we get here?

As noted above, this structural imbalance is a result of a combination of stagnation in revenue growth, inflationary impacts on expenses, and new or expanded programs and services without commensurate increase in revenues or reductions in spending in other areas.[4]

The impacts of inflation and wage growth on the budget's structure can be seen when looking at expenses for wages and benefits and FTE numbers. Since 2019, County expenses for wages and benefits in the GF increased by 50 percent. In the same period, County FTE positions, supported by all funds, increased by 23 percent (198.9 FTE).

Chart 2: FTE Growth 2019-2024



	2019	2020	2021	2022	2023	2024
Annual increase	10.7	4.9	21.5	40.6	62.0	59.2
Previous Year Base	855.2	865.9	870.8	892.3	932.9	994.9

The growth in the number of FTEs and the associated increases in the cost of wages and benefits reflects adjustments made in part to address decades of under-resourcing departments. A portion of federal ARPA dollars were used to address this historic pattern of under-resourcing and as those funds are depleted the need for those positions and funding remain if the County wants to maintain current levels of service. Just five departments account for more than two-thirds of the FTE increase (141.3 FTE):

- Health and Community Services (67.3 FTE)
- Sherriff's Office (21.0 FTE)
- Public Works (21.0 FTE)
- Public Defender's Office (19.0 FTE)
- Parks and Recreation (13.0 FTE)

Importantly, most FTE growth in Health and Community Services and Public Works are not paid out of the GF; however, the addition of these positions has increased work in other areas of

[4] The County primarily relies on two conventional sources of local revenues, namely sales tax and property tax. State and federal funding, if any, are provided for very specific purposes and limited periods of time. This system of funding local governments from mid-1800s is outdated, and we intend to advocate for an overhaul of this system as we engaget with state partners in Olympia.

County services that are supported by the GF. Without an equivalent increase in resources in Administrative Services, we have seen those divisions stretched almost to a breaking point. There are several ASRs for consideration to modestly increase staffing and resources in those divisions to address this.

It is not surprising to see this growth in wages and benefits expenses given that most County programs and services rely heavily on human labor so those inflationary impacts and expansion or addition of services will see an equivalent increase in personnel expenses. The recent uptick in public sector wages is in response to post-pandemic worker shortages and inflation. Many public sector employers adjusted wages in late 2023 and early 2024 that are more in line with adjustments the private sector made in 2021 and 2022; competitive salaries are fundamental to recruitment and retention of talented public sector workers.

II. What are our tools?

To address this structural imbalance while costs continue to increase, community needs continue to expand, and state mandates impact costs, County decision makers will need to work together to consider both the short and long-term options, including the implications of budget reduction strategies. Part of this process is recognizing where we are today, what is possible in the short-term to develop and adopt a balanced budget for the 2025-2026 biennium, and what are the longer-term strategies to recover from this structural imbalance.

The Government Finance Officers Association provides resources for local government called Fiscal First Aid to help reverse periods or patterns of financial decline. At the core they identify three stages towards recovery: Bridge, Reform, and Transform. In the bridge stage, the goal is to avert immediate crises. In reform, the goal is to balance the budget without making things worse in the long-run. And in transform, the goal is to come back better, stronger, and more resilient than before. The County is currently in the "bridge" stage, where we have identified there is a problem and are taking some immediate steps to try to prevent worsening of the problem. Those steps include having public discussions about the budget challenge, implementing a hiring freeze, reviewing large new contract requests and delaying that spending where possible, and directing departments to prepare their 2025-2026 base budgets assuming no new resources are available. The Executive's goal is to develop a 2025-2026 Biennial Budget proposal that moves the County into the "reform" stage and identifies ongoing work to move into the "transform" stage by the next biennium.

<u>Strategies to reform: to deploy as part of the 2025-2026 Biennial Budget</u>

Note that not all of the strategies described below need to be fully deployed to move the County to the reform stage. In addition, this list is not exhaustive, other strategies could be deployed, like eliminating programs, implementing furloughs, layoffs, or freezing salaries (strategies that impact personnel would likely need to be bargained). Those options would benefit from information from the prioritization work described under "strategies to transform" section but if there are proposals to add new services in this biennium an offsetting cut should be identified.

1. **Prioritize continuity of services.** Prioritize any budget increases for those that are necessary to provide continuity of core County services. This will mean no increases, and in some cases may require decreases, in County GF expenses that do not support core services. Core services are those services that are mandated by statute, though there may be an opportunity for level of service decision-making within those mandates. Administrative services remain necessary to support all core functions.

   The Executive's Office is currently reviewing all ASRs, including any new non-departmental spending requests, to determine the overall impact of the requests and what is possible given current resource constraints. Of the approximately 398 ASRs submitted for consideration, about 239 (64%) are requests for expenses from the GF directly or requests from fund that have an impact on the GF (i.e. expenses from the Administrative Services Fund). The total amount of funding requests directly from the GF are summarized in Table 1 (these excludes some GF ASRs that we already identified as needing corrections); Staff will provide more details about the GF requests during the presentation on September 10th and information about all submitted ASRs in the next week or so.

   If there are specific areas of the County's budget the Council is interested in reducing to support other services, that input is welcome at this time.

Table 1: GF Annual Service Requests (ASRs) Summary

	2025	**2026**
Cost Maintenance ASRs	1,670,525	1,828,778
New or Expanded Programs and Services ASRs	1,520,374	830,729
Total	*3,190,899*	*2,659,507*

2. **Use remaining one-time resources from the Local Assistance and Tribal Consistency Fund (LATCF).** The County has $2.7 million in one-time funding from the LACTF that have not been budgeted to date. The purpose of the LATCF program is to serve as a general revenue enhancement program where there have been fluctuations in revenues.

3. **Reduce or eliminate transfers from the GF to other funds and redeploy or maximize use of dedicated fund sources:**

   a. Remove the annual transfer from the GF to the Capital Facilities Reserve (current annual GF transfer is $500,000) until the GF budget is stabilized. This GF transfer supplements other traditional sources that we use for capital facilities including REET I, REET II, and Public Utilities Improvement (EDI). Amounts in the capital facilities reserve fund have not been earmarked for specific purposes; recently these funds were used for the purchase of Unity Street and N Commercial Street properties.

   b. Reduce the amount budgeted in the base budget for annual vacation cash outs to the historic average of $200,000. This is currently budgeted at $400,000 annually so would reduce GF expenses by $200,000 annually.

   c. Consider using a portion of the Behavioral Health Fund or the resources from the opioid settlement for existing GF expenses that support implementation of the County Councils resolution identifying Whatcom County approaches to the fentanyl emergency, such as jail healthcare expenses or the drug taskforce.

d. Consider redeploying some or all of the funding in the Community Priorities Fund, previously planned for the 23 Hour Crisis Relief Center, for other behavioral health investment currently supported by the GF ($2.3 million; one time).

e. Continue to review all ASRs that impact the GF and determine if there are other restricted funds that could support the request.

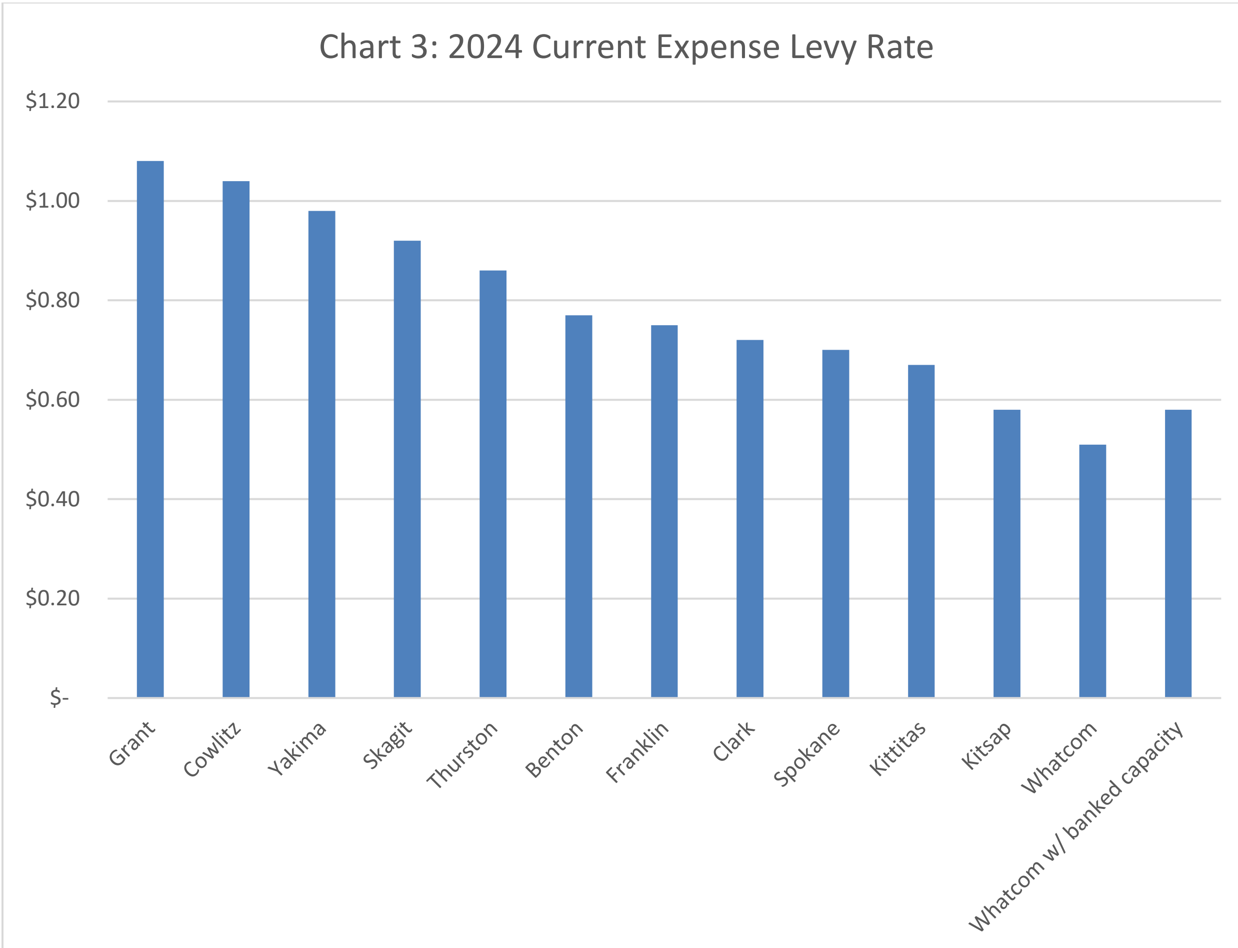
4. **Underspend assumptions:** Ask all departments to assume a five to 10 percent GF underspend target in the 2025-2026 biennium. This will mean not immediately filling vacancies when they occur, reducing or delaying contracts, and reducing non-labor costs such as travel and training expenditures. This could be a request across all County operating funds; that would help slow spending overall and preserve options as the County engages in a prioritization exercise (see longer term strategies later in the memo).

5. **Consider use of banked capacity in property tax levies**. Property tax revenues are statutorily constrained to grow at just one percent plus the value of new construction annually. Until recently, the County for many years banked the one percent, contributing to the stagnation in revenue growth. Prior to 2020, there was a period of low inflation and increased revenues from new construction that resulted in annual increases in property tax revenues even during a period when the County did not utilize the annual one percent increase; that is no longer the case. (The current estimates of the projected deficit for the 2025-26 biennium assume a one percent increase in 2025 and 2026).[5]

   The County could use banked capacity to increase revenues in the GF, Road Fund, Flood Control District, EMS Fund, and/or Healthy Children's Fund. This can be done through a councilmanic majority vote. The Council could utilize all of the banked capacity in a single year or could slowly incorporate the use of that banked capacity over multiple years on an individual fund basis.

   The banked capacity in the GFs current expense levy is $3.9 million – using this banked capacity is a long-term sustainable strategy to begin to transform the GF into a structurally balanced budget. Once banked capacity is levied, the County has the revenue annually without future legislative actions. Currently, Whatcom County's Current Expense Levy (CE Levy) rate is $0.51 per $1000 of assessed value, compared to an average rate of $0.80 per $1000 in other counties with populations between 100,000-500,000 (see Chart 3 below). If the banked capacity is used, the Whatcom County CE Levy rate would be $0.57 per $1000 of assessed value (using current valuations), still well below the average compared to other counties.

[5] Double-digit sales tax growth also supported growth in GF expenses in recent years. However, the economy has cooled significantly and 2024 sales tax receipts are essentially flat compared to 2023.



However, decisions related to use of the banked capacity should be weighed against the impact to taxpayers; if the Council chose to use all of the banked capacity for the GF Current Expense (CE) Levy, a homeowner whose home is appraised at $700,000 would see an annual property tax increase of about $45 dollars. In Table 2, we calculate the average impact to homeowners and the additional annual revenue the County would collect if: (1) the one percent increase is applied to several levies; (2) if a portion of banked capacity was authorized for the CE Levy or the Road Levy; or (3) if the Council authorized use of the entire banked capacity for the CE or Road Levies.

Table 2: Banked Capacity Analysis								
	2024 Property Tax		Annual Allowance: 1% Increase		Use a Portion of Banked Capacity - 3% Increase		Use All Banked Capacity	
	Impact to Avg HO*	County Revenue	Impact to Avg HO*	County Revenue	Impact to Avg HO*	County Revenue	Impact to Avg HO*	County Revenue
Current Expense Levy	$387.00	33.6M	$3.87	0.3M	$11.61	1.0M	$44.83	3.9M
Road Levy	$522.84	21.0M	$5.23	0.2M	$15.69	0.6M	$91.56	3.7M
Flood Control Zone District	$74.40	6.5M	$0.74	0.1M				
EMS Levy	$154.11	13.4M	$1.54	0.1M				
Cons Futures	$16.04	1.4M	$0.16	0.01M				
Children's Initiative	$117.28	10.1M	$1.17	0.1M				
TOTAL	**$1,271.67**	**86.0M**	**$12.71**	**0.9M**	**$27.30**	**1.6M**	**$136.39**	**7.6M**

HO = Homeowner
**The cost to an average homeowner is calculated using a Median Home Value of $700,000 based on 2024 Redfin data.*

If the use of the full CE Levy banked capacity is authorized, the projected average annual deficit would be reduced to $6.8 million (compared to $10.7 million). If that is combined with a five percent underspend target in 2025, and strategies 3a, 3b, and 4 described above, the 2026 projected ending fund balance would be relatively healthy (about 19% of projected annual expenses) before ASRs are considered. This approach would provide time to undertake the strategies to transform the GF budget described in the next section and should help stabilize the GF into the future.

Strategies to Transform: Medium- or longer-term strategies to develop during the 2025-2026 Biennium

1. **Budget Priority Exercise:** The Executive intends to lead a process, working with the County Council, departments, and separately elected offices, to inventory all County programs and services and develop criteria to categorize those programs and services into priority areas. We will use this exercise to quantify options if areas identified as lower priority were reduced or eliminated. This should start with identifying those services that are statutorily required and those that are more discretionary (though may be addressing a significant community need). In addition, a process to seek community input should be considered.
2. **Engage in medium- and long-term financial planning.** Financial planning allows policymakers to center longer-term financial sustainability considerations in near-term budget choices. See additional discussion below about why financial planning is a tool to help the County transform to a structurally balanced budget.

3. **Develop a fiscal transparency program.** Introducing a fiscal transparency program to enhance financial reporting and fiscal impact analysis (e.g., adopting requirements for Fiscal Notes). This would be combined with introducing efficiencies in internal and legislative approval process for contracting, procurement, and supplemental budget adjustments to reduce administrative burdens that can increase costs and slow down the delivery of County services. The goal would be to design the program to ensure that Council has the tools to provide oversight and provide accountability to the public while allowing for more efficient delivery of County services and enhanced financial reporting and forecasting to inform financial decisions.
4. **State Legislative and other advocacy**. New state mandates are creating a situation where county demands will outpace revenues in short order. Advocacy at the state level is necessary to increase state shared revenues for core services and to ensure new mandates are fully funded.
5. **New Revenue avenues.** The County's general fund will likely need to be maintained for statutory obligations. Pursuing new revenue streams for community priorities (such as parks and recreation) is necessary to maintain levels of service.

Why do a Financial Plan?

The Revised Code of Washington requires local governments adopt a balanced budget. However, this requirement only applies to the year being budgeted, at the time that the budget is being first adopted, and is silent on future years. However, decisions made in the current year's budget have lasting implications for future years. Furthermore, the underlying economic conditions upon which those initial budget decisions are made will change in the future.

The Executive's Office will work with the Finance Division to create a process to generate and regularly update long-term financial plans for all funds, which will include summary information, assumptions, and projected cash balances. We will apply a set of publicly available assumptions to county expenditure and revenue data to project future revenues and expenditures and identify future financial challenges and opportunities. This will result in a projection of the sustainability of current budget decisions.

This approach will allow policymakers to center longer-term financial sustainability considerations in near-term budget choices. These plans will be a tool for Council to consider prior to significant budget decisions, to highlight future year sustainability. The financial plan will memorialize the projections and provide a basis for comparisons as projections are revised.

Next Steps

Following discussion with the Council, the Executive's Office will continue to work with Finance and all County departments to finalize a Proposed 2025-2026 Biennial Budget. As needed, additional input from Council will be requested to inform that proposal.