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# Economy & Efficiency Commission
# Presentation

*Editorial Note: Although every effort has been made to insure the accuracy of the material in this presentation, the scope of the material covered and the discussions undertaken lends itself to the possibility of minor transcription misinterpretations.*

**PRESENTATION BY**
**Mr. David Janssen**
**Chief Administrative Officer, Los Angeles County**

**Topic: The County Budget**

**September 2, 2004**

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Chairman Philibosian introduced Mr. Janssen and welcomed him to the Commission.

## The Scope of the Presentation

Mr. Janssen's presentation covered the current status of the County's finances and budget.

## The County Budget

Mr. Janssen felt that last year's budget (2003-04) was the most complicated and convoluted budget process that he has experienced in local government. Governor Davis allowed the vehicle license fee (VLF) to increase for three months until his recall. After the recall, the first action of newly elected Governor Schwarzenegger was to repeal the increase in the VLF, from 2% it returned to .65%. This action deprived local government of $4 billion a year. This was the same situation as in 1998 when Governor Wilson reduced the VLF, cities and counties were told that the state general fund would backfill the loss of revenue.

As a result of the reduction in VLF Los Angeles County ended up losing $2 million a day in November - December. The County was up to $62 million in lost revenue when Governor Schwarzenegger directed the state comptroller to pay local government from the State's general fund which they state didn't have, thus shifting the budget problem to the State. The legislature was upset over his unilateral action. In January, local government was just as upset when the Governor proposed the transfer of $1.3 billion in property tax from local government to schools. This anger increased when the Governor proposed the transfer additional local funds to schools. The State took the surplus they had from capital gains and spent it on "on-going" programs that they were subsequently unwilling to reduce. The $4 billion surplus, from the cut in vehicle license fees, was being used to back-fill local government. A third of this went into education, thus reducing class size, and part to health-care. The State asked local government to transfer property tax to deal with State expenditures.

Propositions 57 and 58, which was the $15 billion bond allowing the State to repay its past debt, passed because of the governor's influence. The governor and local government went into negotiations on the $1.3

billion way that local government could help us by working a long term deal.

As a result of Proposition 65, a local government initiative, the governor had tried to cut a deal before the dead-line for the initiative, but it was too late. He had already cut a deal with education and simply did not have the time to get a around to local government. After the initiative was qualified, the governor negotiated a favorable deal with local government that included: a short-term contribution of $1.3 billion for 2 years. The Legislature was not happy and as a result the state budget was held-up. The $1.3 billion dollars was not the problem since it was fixed, so the problem was over the policy of how the negotiated initiative would develop, particularly with cities. Counties were reasonably happy with the deal, and wanted to maintain the ability to swap sales tax for property tax in the out years.

**Fiscalization of Land Use**

Since Proposition 13, the fiscalization of land use has been a problem for California. Since Proposition 13 does not allow cities to raise property taxes, which was their primary source of revenue, they now are forced to site business based on the sales tax that it generates. A fix for this situation is to swap property tax for sales tax, so the incentive to site is no longer there. The Legislature is prohibited by the constitution from swapping sales tax and property tax, so they have now locked into the constitution public policy decision that held up the budget. In the final analysis, the legislature gave up with the cities getting protection, thus making it more difficult to deal with the fiscalization issue in the future

**The Resolution**

The resolution is Proposition 1A, entitled and summarized as protecting local taxes and preventing the State from raiding. Local government has now agreed with the governor and the legislature that each will back Proposition 1A, instead of Proposition 65. Proposition 1A is not as good as Prop 65, but it is very good for local government. First, protecting property tax, so the legislature no longer has the authority to shift property tax to schools. They can, in FY 2008-2009, borrow up to 8% of property tax from local government, but are constitutionally required, if it passes, to repay that within 3 years with interest. The State can do this twice in 10. This is the protection for local government.

Another advantage is the substitution of state general fund back-fill for vehicle license fees with property tax so they have shifted money to Los Angeles County from schools, out of the Educational Revenue Augmentation Fund (ERAF), of about $700 million. The County loses $700 million in state general fund and we get $700 million in property tax back. The vehicle license fee of .65% goes to health and human services realigned programs. The protection states that if they reduce it again local government will be constitutionally protected with backfill. At anytime the State can choose to go from .65% to 2% and make it state revenue, which they could not do before because it was constitutional local revenue.

The third issue was over the ability of the State to transferred property tax. In a suit by local government Supreme Court said the State has the authority to transfer property tax. In the decision, they answered a question that wasn’t asked, and it allowed the state in the definition of a mandate to change the sharing ratios that counties have in programs administered for the state without it being considered a mandated program. For example, 95% of the Aid to Families with Dependent Children (AFDC) is funded by the state and federal government and 5% is the county match. Under the Supreme Court decision they could change it to 50/50. This would not be a mandate and the State would not be required to reimburse counties. The Sate could do it with every health and human service of the county. Although they never used it, they do have the ability. In Prop 1A, this action would be considered a mandate and they would have to pay for it.

If Proposition 1A passes, Los Angeles County can securitize the $200 million owed to County by the State. Even though, the State budget deficit is in the neighborhood of $6 billion, the structural problem is about $5-6 billion, and they have no easy way of solving this problem. The State did not make difficult choices with the adopted budget nor did they cut significant programs, expenditures. In education, K-12 went up by 3% even though they cut a deal that saved the state $2 billion. There were no cuts in health care or to in-home supportive services. This proves that it is very difficult to cut programs and impossible to raise taxes. Thus, the State deferred to another day the resolution to the problem. Local government is not going to be part of that resolution. Local government owes the State $1.3 billion for this year 2004-05, $1.3 billion for next year 2005-06, and in 2006-07 then the Los Angeles County gets the money back it contributed - $103 million.

The negotiations with the Governor were extraordinarily successful for counties and we went from a $289 million exposure permanently, to $103 million twice. Cities and special districts picked up a larger share.

We have included in the current budget our $1.3 million contribution to the legislation. To fund that, first, the County was able to use the money set aside for anticipated food stamp error rate penalties. The governor negotiated those penalties away, because, in large part, the Department of Social Services reduced the food stamp error rate in Los Angeles Country from 23% to less than 10%. In the last year the error rate has been reduced to the neighborhood of 7.5%. This program went from potentially costing the State hundreds of millions of dollars in penalties to one that has become a model for the nation.

This County's revenues are primarily vehicle license fee, local revenues and property tax are not the problem, but rather the problem was with the Sate. We have become depended on property tax in the County, almost 74% of the local revenues now are property tax, so we must make careful decisions about expenditures. Most of the initial reductions in the General Fund were restored. Fund balance, will come in higher than anticipated in September, which could restore some of their reductions that were looked at in June.

**Looking Ahead**

Looking ahead, the County's fiscal condition looks pretty good with a salary increase of 2½% staring in January - 16 months of zero increase agreed by most of the unions except safety. The Health Department latest estimate was about $640 million cumulative deficit in 2006-07 and continues to roll about 2-3 years our and will vary from $650-$750 million just by changes, assumptions and estimates. The County has been pushing the Governor's office to get more federal dollars for State of California, since the amount of money the Federal Government spends on health care for the State is about 51st in the nation. The State was successful in getting money for in home support services and in negotiating away penalties for automation of child support and penalties for food stamps, but it has not been as active in the health care area.

The County Health Department is solely dependent on the federal government. Measure B and the tobacco settlement have been helpful, but the problem continues to be that the Department serves 900,000 people, while 600,000 have no money. Scenario 2 proposed by the Department to start downsizing the Health Department (there are two choices to stop serving people or get more money). The Department closed 17 clinics, High Desert Hospital and tried to close Ranch Los Amigos. Federal Court determined that the County could neither close Rancho Los Amigos nor reduce 100 bids at LAC/USC. That is obviously costing a good deal of the money that was anticipated to be saved in reaching an affordable system. This means that the County will have to run these facilities into the ground collapsing the entire system before asking to close these facilities that are not a core responsibility of the County. To control health cost the County should get out of the health care business and provide for the 17,000 responsibilities through contracts with private facilities. This will control both the expenditures through the level of benefits provided and the reimbursement rates to doctors and facilities.

Los Angeles with 4 hospitals with emergency rooms, Olive View, Harbor, King and LAC/USC hospitals are either located in areas of high poverty, or they have been accepting transfers from hospitals that stabilize poor patients then ship them to county facilities. This situation is made more difficult by what's going on at Martin Luther King (MLK). Since 1995, when they had the first catastrophe and the bail out by Clinton, and 1998, both the department's directors have spent significant time trying to keep MLK afloat, leaving little time to manage the department. MLK is 25% more expensive than any other hospital, so when they go in to try to strip money out they find problems and more problems. The current situation is that the regulators are never going to go in say things are fine because fear of being criticized especially by the press. MLK is now in such a feeding frenzy of regulators, but MLK does have significant operational problems that are historic and didn't happen overnight.

**Retirement System**

The contributions to the retirement system has been a problem for about 8 years. Several years ago the County was spending in the neighborhood of $300 million out of surplus earnings to pay contributions to the retirement system. No budget in the county was funding the retirement system and it would take about five years to use the surplus. At that point the County would be looking at $300 to $400 million immediate problem in its budget. Subsequently, the County started buying our way out of the problem and using less surplus and starting to require departments to pay there contributions out of their own budget. This was a successful program until the market went south. This caused every retirement system in the State a problem.

Because of the 3 year rolling amortization it hit the County budget this year. The County contribution was up to $513 million last year, then it went up by $234 million this year and will go up by another $100 million next year. It should then even out with the system will drop to about 85% funded from 100%. The County is now reassessing the situation to going from $30 million a year to $45 million would leave the County with about $900 million dollars a year contribution to the system. The County can manage that with surplus earnings, but retiree health is an uncontrolled problem of $400 million. The Board of Supervisors agreed in the 70's and 80's to pay 100% of health care for retirees, and it went up 13% last year and 17% this year, so it is close to $300 million. The unfunded liability of billions is far worse than workers compensation. The contract with Los Angeles County Employee Retirement Association (LACERA), which doesn't expire until 2009, requires the county to pay for that, but overall the condition of the County is good. We will probably get criticized with the amount of County's fund balance at the end of this month, because of that conservative approach in managing the budget.

## Strategic Planning

In terms of the strategic planning process, there are 40 federal programs that serve children and families with multiple funding streams/ statutory schemes that have resulted from incremental decision-making in Sacramento about how programs should be funded and how they should be implemented. For example, the County received revenues on inpatient, they said, "don't worry about it in 5 years if you prove it's cheaper to do outpatient than inpatient we'll change the revenue steam". They didn't, the revenue stream is still the same, and the County continues to get reimbursed on the number of people in beds. The organization was trying to figure out how we accomplish better results and outcomes for children and families by integrating programs, developing a culture that is collaborative, and by focusing on results and outcomes. Changing the culture of the organization as a whole is the key to being successful and improving the outcomes.

## Commissioner Questions

Commissioner Petak asked about the fundamental difference between Proposition 65 versus Proposition 1A. Mr. Janssen responded that, in Proposition 65, the State can take local government money, but they get it approved by a subsequent election by the people. Since this is unworkable the solution to the mandate issue is to allow local government to stop doing a program that isn't funded, and Proposition 65 does that. That deals with the problem of the State not reimbursing local government. The problems is that, as a practical matter, you may have 58 different programs and operations in California with the possibility of the statewide meaning intent of the program being lost.

Commissioner Ikejiri asked whether it is rare for a department head to overturn an inspectors report? Mr. Janssen replied that he didn't know for a fact, but he would be inclined to say probably yes, because of the politics involved. County employees live in a fish bowl and the inspector is the person that is onsite. The first reaction to a department head over-turning an inspectors report is they are being pressured to do something because why else would they do it. The County probably doesn't have adequate mechanisms to have an individual inspectors report reviewed by people in between. It wouldn't be surprising if that were not done because of the concern over political pressure.

Commissioner Ikejiri asked what happens when you have a rogue inspector, how do we go about improving the training, do we have a mechanism in place to monitor inspectors, and how do we go about removing inspectors without it being politicized? Mr. Janssen commented that first you have to deal with bias, but it is the obligation of the department to provide the training as a function of supervision. He feels that in every department there are places you can go to have an inspector challenged, for example, the department, the board office or perhaps the auditor. Commissioner Ikejiri felt that he just thought we should have some sort of mechanism that could prevent those kinds of excesses. Mr. Janssen agrees and believes it is a legitimate problem. He explains there have been problems in the past where county employees would try to leverage vendors for favors and when it is found out the vendor says I didn’t really have any choice. Currently there are contract provisions that specifically require people to inform the County if they are pressured.

Commissioner Barcelona asked how compatible are the means and the mechanisms in this between the cities, the counties and the state? Mr. Janssen explained that the cities and counties have forged a relationship, since in many instances they do not have similar interest when it comes to the State. Cities basically want to be independent and left alone. The responsibility of the 58 counties is to provide state and federal services as a constitutional arm with the State of California. Over 90% of the County budget is for regional services that are federal and state mandated. Historically, the State, not deliberately, successfully played cities against counties against one another. When in 1991 after cutting health care, in counties, they said the revenue source is to charge cities booking fees because cities are not required by law to have jails. The relationship with cities changed after we started charging them for something they have never paid before. In the end, counties were charging cities $38 million statewide, and the State would then reimburse cities $30 million.

Commissioner Sylva requested that Mr. Janssen elaborate on the County’s reliance on property tax (74%). Can more dialog between the cities and the County be beneficial. Mr. Janssen replied that he would start with the foundation of where the revenue is now and what the unintended consequences are of every action. The County is so reliant on property tax. Cities lost vehicle license fees as well, not as much as counties, and still have a reliance on sales tax. The sale tax in the County budget in the unincorporated area is $35 million out the $17 billion budget, so sales tax is not a major issue for the County.

Chairman Philibosian thanked Mr. Janssen for taking time out of his busy schedule to make and informative and valuable presentation to the Commission.

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