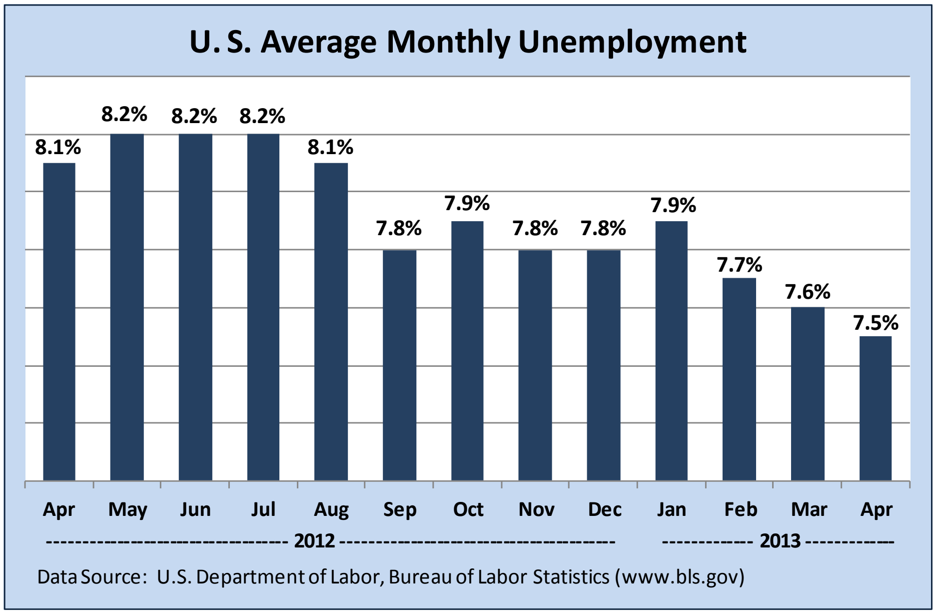
THE ECONOMIC OUTLOOK

The U.S. economy continued its slow and erratic recovery in the wake of the 2007-2009 Recession at a somewhat improved pace in Fiscal Year (FY) 2012-13. Most significantly, nationwide unemployment rates descended more rapidly in the first quarter of 2013 compared to the prior year. As reflected in the chart below, current year indicators show the country's unemployment rate increased slightly in January 2013, followed by small but steady reductions each month through April. The U.S. Department of Labor, Bureau of Labor Statistics (BLS) reported that the nation's unemployment rate dropped to 7.5% in April 2013, its lowest level since December of 2008.[1]



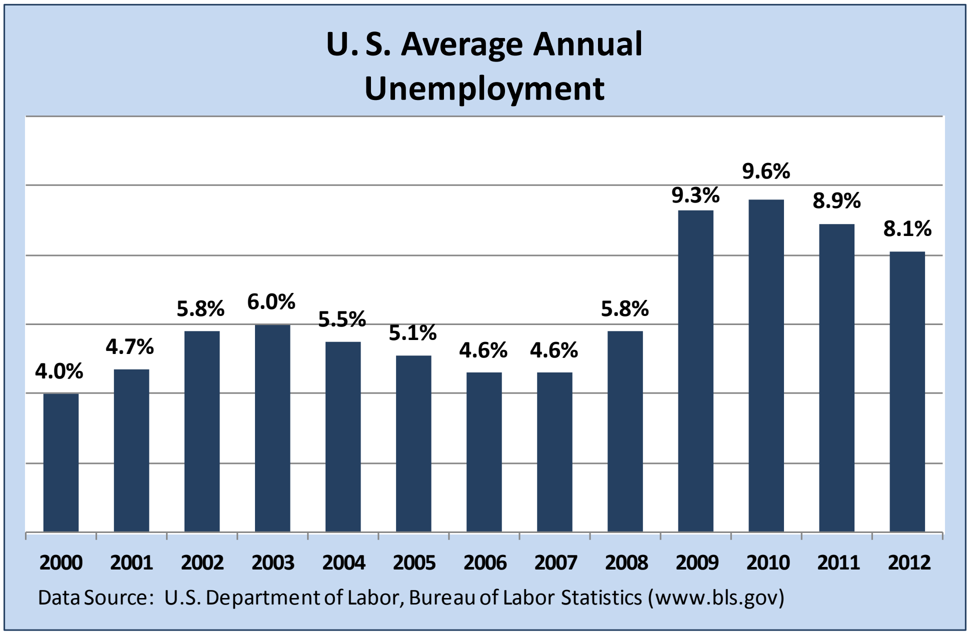
The unexpectedly strong unemployment report spiked optimism, briefly propelling the Dow Jones industrial average to an all-time high of 15,000 on May 3, 2013. Subsequent reports of higher than anticipated corporate earnings and improvement in the Japanese and European markets resulted in the Dow Jones actually closing the day above 15,000 for the first time on May 7, 2013. Standard & Poor's 500 Index also responded positively with a gain of 0.5%.[2]

Wall Street has climbed almost 15% since the beginning of 2013. Investment strategists attribute the healthy stock market to a rise in confidence as reports on economic growth, jobs and upturns in the housing market have been better than expected.[3]

Countering the positive motion of the jobs market, reports were less optimistic for the still unemployed, as sequestration cuts resulting from the Budget stalemate in Washington D.C. began impacting Federal unemployment benefits beginning in April of 2013.

Even as recent economic factors build optimism that the country is well on its way to recovery from the most devastating fiscal crisis it has experienced since World War II, current unemployment rates remain well above historic annual rates.

[1] http://data.bls.gov
[2] TIME Business & Money, "Dow Has Its First Close Above 15,000 Points" by AP Matt Craft and Steve Rothwell, May 7, 2013
[3] Ibid



Federal sequestration forced immediate cuts of approximately $85.4 billion to specified categories of Federal spending beginning on March 1, 2013. The Budget Control Act of 2011, which enacted the cuts as an austerity fiscal policy to achieve at least $1.5 trillion in savings over the period of 2012-2021, includes similar cuts for years 2014 through 2021.[4] During what has been a much slower recovery than the recovery periods following previous recessions, impacts of sequestration cuts will further constrain efforts to move forward in many areas of local government.

Output and Employment

Gross domestic product (GDP), a measure of all goods and services produced in the United States, increased by 2.2% in 2012. Durable-goods manufacturing, finance and insurance, and whole-sale trade services were the leading contributors to U.S. economic growth in 2012, according to advance statistics on the breakout of real GDP by industry from the Bureau of Economic Analysis (BEA).[5]

In the first quarter of 2013, real GDP increased 2.5% after increasing 0.4% in the fourth quarter of 2012, according to advance estimates released by the BEA. The pick up in real GDP growth was largely driven by a rebound in inventory investment, mainly reflecting an upturn in manufacturing and a smaller decrease in wholesale trade. Farm inventory investment also increased.

Emphasizing that the first quarter advance estimate does not yet reflect complete data and is subject to further change by the agency, first quarter highlights identified by BEA include acceleration in consumer spending, primarily reflecting a rise in spending for services (mainly household utilities). Exports rebounded, mainly due to upturns in foods, feeds, and beverages and in nonautomotive capital goods. Imports showed an up-turn, reflecting in part an upturn in nonpetroleum industrial supplies and materials. Also, business investment slowed, due largely to

[4] Congressional Budget Office (CBO) "Estimated Impact of Automatic Budget Enforcement Procedures Specified in the Budget Control Act," September 12, 2011

[5] U.S. Department of Commerce Bureau of Economic Analysis, BEA 13-17 Press Release, April 25, 2013

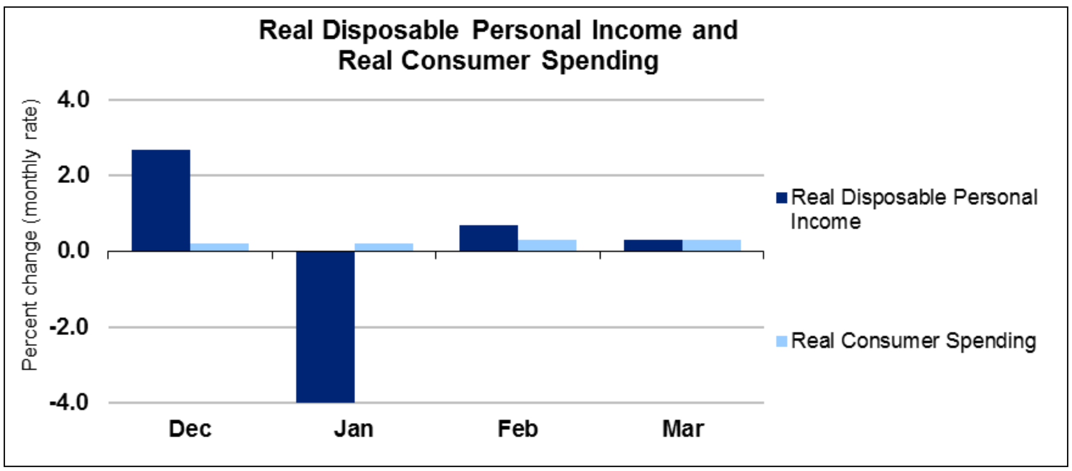
a slowdown in equipment and software (mainly in information processing) and a downturn in structures.[6]

The UCLA Anderson Forecast first quarter report for 2013, issued in March, projects that the country's GDP "is poised to surpass the 2% annual growth rate of the past four years and reach 3% by 2014."[7] The Forecast cites housing and automobile sectors as the biggest contributors, together with renewed growth in business construction and exports. The economy gained an average of 181,000 jobs a month in 2012. An equivalent gain is expected in 2013 with acceleration to 200,000 jobs a month in 2014 and 220,000 in 2015. As a result, by the end of 2015, the unemployment rate will fall to about 6.5%. [8]

The forecast for California in 2013 and 2014 projects total employment growth of 1.6% in 2013, 2.2% in 2014, and 2.3% in 2015. Non-farm payroll employment is expected to grow more slowly at 1.4%, 2.1% and 2.3% respectively.[9]

Personal Income and Saving

Based on the BEA advance estimate, real disposable personal income, which adjusts for inflation and taxes, reflects a 5.3% drop in the first quarter of 2013, after rising 6.2% in the fourth quarter of 2012.



Source: U.S. BEA, April 29, 2013 (www.bea.gov)

The change reflects a number of factors, including a downturn in dividend payments after companies accelerated payments to the fourth quarter, and acceleration in contributions for social insurance, which are subtracted when calculating personal income, due to the expiration of the Federal "payroll tax holiday."[10]

The personal saving rate, identified as saving as a percent of disposable personal income, was 2.6% in the first quarter of 2013, compared with 4.7% in the final quarter of 2012.[11]

Prices

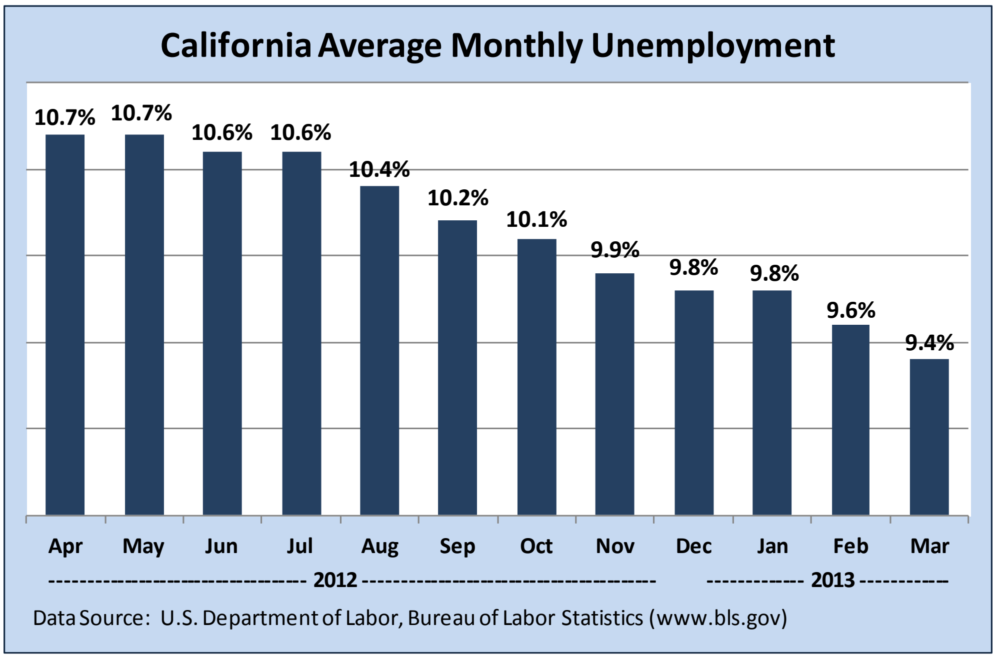
Also noted in the advance BEA report[12], prices of goods and services purchased by U.S. residents slowed in the first quarter, increasing 1.1% following a fourth quarter 2012 increase of

[6] BEA Advance Estimate of GDP, April 26, 2013
[7] UCLA Anderson Forecast, Press Release "National Economy on the Rise; California Employment Expected to Improve," March 13, 2013
[8] Ibid
[9] Ibid
[10] BEA Advance Estimate of GDP, April 26, 2013
[11] Ibid

1.6%. Indicators show a turn-down in energy prices and a slight slow-down in food prices. Excluding food and energy, prices increased 1.3% in the first quarter of 2013 after a 1.2% increase in the last quarter of 2012.

STATE AND LOCAL ECONOMIC OUTLOOK

Information released by the California Employment Development Department (EDD) in April 2013 reported that the State's unemployment rate decreased to 9.4% in March, compared to a rate of 10.7% in March of 2012, with nonfarm payroll jobs showing a total gain of 746,800 jobs since the recovery began in February 2010. According to the same report, a year-over-year comparison (March 2012 to March 2013) of nonfarm payroll employment in California increased by 285,900 jobs, up 2.0%.[13]



The State unemployment rate was 1.8% higher than the national rate for March 2013. California's unemployment rate has dropped by 3.0% points since its peak of 12.4% in February 2010.[14]

The EDD reports that more than 400,000 unemployed Californians will feel the impact of the Federal government's sequestration spending cuts when their Federal unemployment benefits are reduced by nearly 18% beginning at the end of April 2013. As sequestration fund cuts hit California, the State may lose more than $30 million in Federal funding for administration of the Unemployment Insurance program over the next 15 months. Additionally, the EDD will lose $3.3 million in Federal funding that supports job search assistance for job seekers at local One-Stop Career Centers throughout the State. Sequestration further requires at least a $15 million funding cut to local Workforce Investment Boards (WIB), providing job training in local areas of California. [15]

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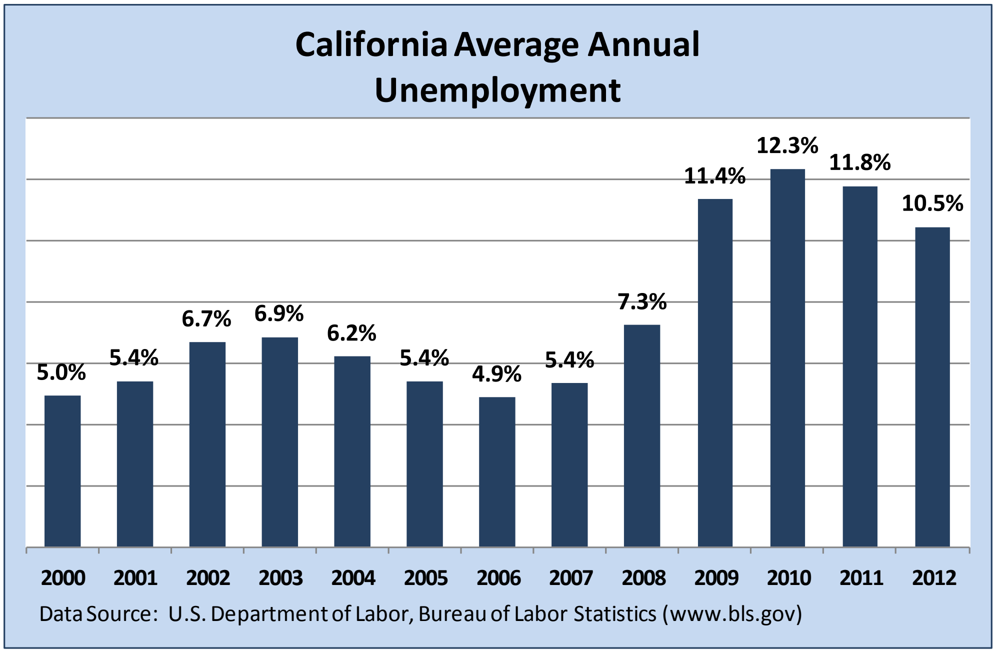
[12] NOTE: The second estimate of GDP and an estimate of corporate profits for first quarter of 2013 will be released on May 30, 2013, and can be found on the BEA website: www.bea.gov
[13] EDD News Release No. 13-18, April 19, 2013
[14] Ibid
[15] EDD News Release No. 13-17, April 17, 2013

As previously discussed, at a time when the local jobless rate still remains well above pre-recession levels, effects of sequestration cuts are likely to impact the currently improved rate of recovery.



The 2013 UCLA Anderson Forecast first quarter report, "Is California at an Inflection Report?" by Senior Economist Jerry Nickelsburg questions whether or not California has "lost its competitive edge" since the start of the 2007-2009 recession, and concludes, "not likely." This is supported by recent data on non-farm employment, which shows no indication of a widening gap between California and other states. Additionally, the report points out that "over the last ten years exports through California's air and sea ports have held their own in the world marketplace."[16] The projected outlook for California calls for "slow, steady but unexceptional economic growth in the current year with gradually accelerating growth in the following two years." Even in the gradual recovery, factors that have driven California employment and income growth to higher rates than the U.S. remain in play, and as the world economy and investment in the U.S. improves, "California will once again have a disproportionate share of the improvement."[17]

Real personal income growth is forecast to be 1.4% in 2013, followed by 3.6% in 2014 and 3.3% in 2015. Unemployment is expected to fall through 2013, ending the year with an average of about 9.6%. In 2014, the unemployment rate is expected to fall to 8.4% and then to 7.2% in 2015.[18]

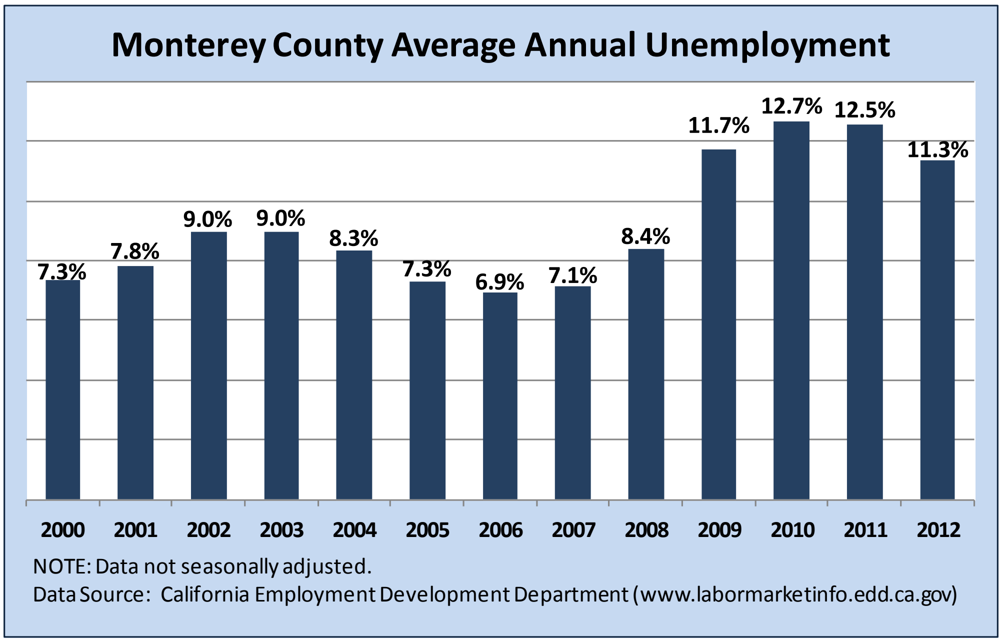
Jobs in Monterey County

At its peak in November 2010, unemployment in Monterey County hit nearly 13.9% on a seasonally adjusted basis. Since then the unemployment rate has been falling fairly consistently, with a small exception during the first quarter of 2011. The County's unemployment rate averaged 11.3% in 2012, declining 1.2% below the 2011 average.

[16] UCLA Anderson Forecast, "Is California at an Inflection Report?" by Senior Economist Jerry Nickelsburg,
[17] Ibid
[18] Ibid

During some time periods, increases or decreases in the unemployment rate can be misleading, reflecting the number of people entering or leaving the workforce. The unemployment rate may rise as residents resume their job searches, or it may fall as discouraged workers drop out of the labor force. These results are due to the way unemployment rates are calculated. As such, a rising unemployment rate is not necessarily indicative of deterioration in local labor markets, and a falling rate does not necessarily suggest improvement. The steady decline in Monterey County's unemployment rate since 2011 has been more a product of increasing employment and falling unemployment. In addition, the rate has fallen despite the fact that many of Monterey County's previously discouraged workers have started to re-enter the labor market and resume their job searches.

As with the previous charts for the U.S. and California, the graphic below shows that Monterey County still has a long way to go before local jobs regain pre-recession levels. Nonetheless, recent progress indicates that economic conditions continue to move in a positive direction.



Agriculture

Long referred to as the "salad bowl of the world," agriculture remains a critical component of Monterey County's economy. County farmers grow an abundance of leafy greens and other vegetables for shipment all over the world. Crops produced in Monterey County in 2011 reflected a production value of $3.85 billion. [19] But the local agriculture industry casts an even broader economic net throughout the County as a result of jobs, goods, and services that complement the industry. A recent study, "Economic Contributions of Monterey County Agriculture," finds that agriculture contributed $8.2 billion and more than 73,000 jobs to the Monterey County economy in 2010.[20]

According to the study produced by Dr. Jeff Langholz and Dr. Fernando DePaolis, in addition to the crops production value, local agriculture contributes $5.1 billion in direct economic output and $3.1 billion in the form of expenditures by agriculture companies and their employees. This makes agriculture the County's largest economic sector, representing 18.5% of the County's total

[19] 2011 Monterey County Crop Report

[20] Economic Contributions of Monterey County Agriculture, "Leading the Field – 2011"

economic output. As an industry, local agriculture makes $102.2 million in indirect business tax payments each year. In the local jobs market, agriculture includes 45,140 direct employees, approximately 20% of all jobs in the County. The study further identifies that there are 28,289 additional jobs created through the expenditures of agriculture companies and their employees.[21]

Tourism

The County also relies heavily on its tourism industry for both jobs and revenue. Based on year-to-date receipts for Transient Occupancy Tax (TOT) from local unincorporated areas, a revised estimate projects an all-time high of $17.9 million in total TOT revenue in FY 2012-13, reflecting a 7.5% increase over the FY 2011-12 total of $16.6 million. The County's highest previous year revenue from TOT was a total of $16.9 million in FY 2006-07. International travelers are a large factor in the current year growth, increasing by 4.0% in 2012, according to the U.S. Department of Commerce. The increase is largely attributed to the favorable exchange rate for Europeans and the rising middle class in China. The U.S. Travel Association reported a 2.0% increase in leisure travel by Americans during the same time.[22] The Monterey County Convention and Visitors Bureau predicts "slim to modest" growth in tourism during the summer 2013 tourism period.[23]

OUTLOOK FOR COUNTY FINANCES

The 2007-2009 recession had a profound impact on government revenues. During this period and in its wake, Monterey County managed to make significant progress towards aligning expenditures with long-term revenues. Guided by the Board's three-year strategic plan to achieve structural integrity, adopted in FY 2008-09, Monterey County was able to achieve structural balance by the end of FY 2011-12. After four years of budget reductions, Monterey County ended Fiscal Year 2011-12 with a General Fund operating surplus of $5.5 million. Year-end estimates for FY 2012-13 project a surplus total of $0.9 million. Though critical to ensuring the County's ongoing fiscal stability, the necessary efforts and reductions to achieve structural balance have eliminated budget flexibility in almost all areas of County government. With identified expenditure needs that reflect increases at a faster pace than anticipated revenues, the County must remain clearly focused on maintaining its hard-earned fiscal integrity. Finding balance between this and the current and future resources needed for County departments to maintain desired levels of service will be an ongoing challenge. Federal and State budget actions combined with local issues, including pending increases in PERS Retirement costs and health insurance premiums on behalf of County employees, will threaten to compromise both efforts.

The General Fund: Maintaining Structural Balance

The vast majority of County departments rely on contributions from discretionary General Fund revenue at some level, if not entirely, to maintain necessary functions and services. As the largest County fund, the General Fund supports basic governmental functions, including public safety, land use and environment, recreation, health and sanitation, public assistance, and finance and administration requirements.

The FY 2012-13 Adopted Budget included $560.9 million in appropriations, increasing $25.5 million over the prior year. This growth was primarily the result of realignment by the State, moving responsibility for numerous programs to local government. The adoption of Assembly Bill (AB) 118 (Chapter 40, Statutes of 2011) by the State Legislature in FY 2011-12 revised and

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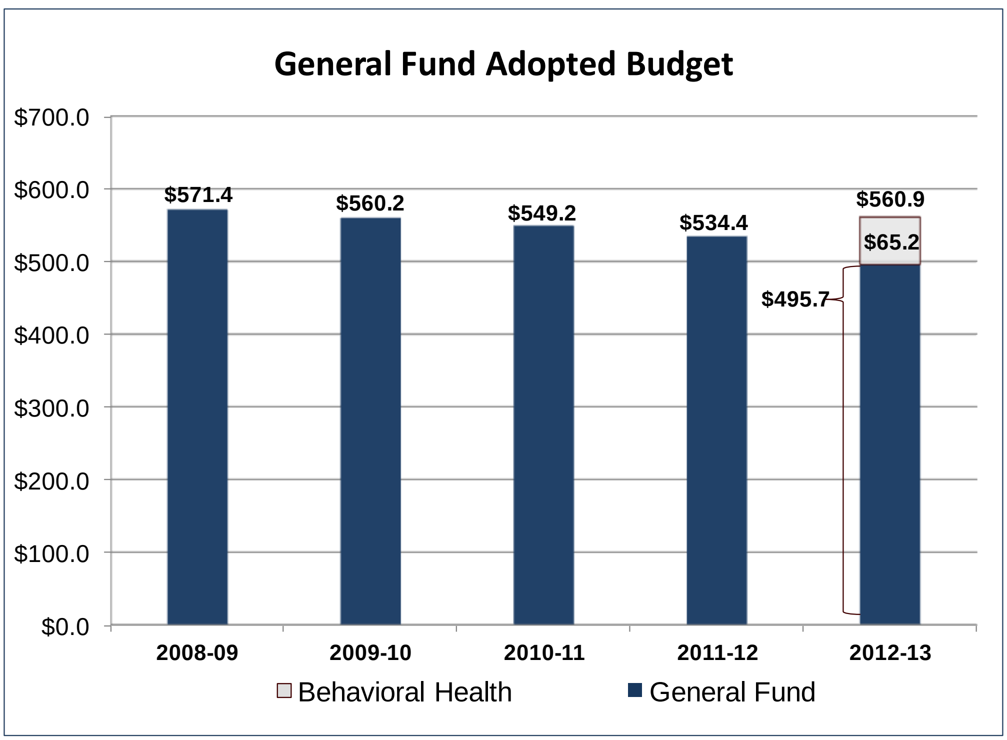
[21] Ibid
[22] Monterey County Herald, "Slim to modest growth seen for Monterey County tourism" by Phillip Molnar, May 8, 2013
[23] Ibid

expanded realignment of certain health and social services responsibilities to counties. AB 109 (Chapter 5, Statutes of 2011) additionally realigned responsibilities for specified “lower level” offenders, adult parolees and juvenile offenders from the State to local jurisdictions. The net impact of realigned health, social services, and probation responsibilities increased budgeted expenses and revenues formerly budgeted at the State level. Fearing future State actions that might impact related funding for the support of the realigned programs, California voters approved a ballot measure in 2012, protecting the revenue sources for ongoing support of the programs at the local level. Even so, it is unclear that these revenues will be sufficient to adequately support the new responsibilities moving forward.

As a result of realignment, the FY 2012-13 Budget included a combined increase of $35.4 million for former State programs assumed by the Health Department, Department of Social Services, and Probation. To provide perspective on the nature of the FY 2012-13 Adopted Budget, if these funds and related increased expenditures and responsibilities were factored separately, adopted appropriations would total $524.5 million, a drop of $9.9 million compared to the Adopted Budget in FY 2011-12. In simple terms, this means that the FY 2012-13 Budget represented a fourth consecutive year of reductions in General Fund Contributions (GFC) to most County departments.

The State’s realignment of responsibilities to local government additionally dictated that the funding to Behavioral Health programs be budgeted in a new Fund. In complying with this requirement, the FY 2012-13 Budget includes a funding transfer of $65.2 million, the total of both existing and new funds, to Fund 023, resulting in an actual General Fund Adopted Budget total of $495.7 million.

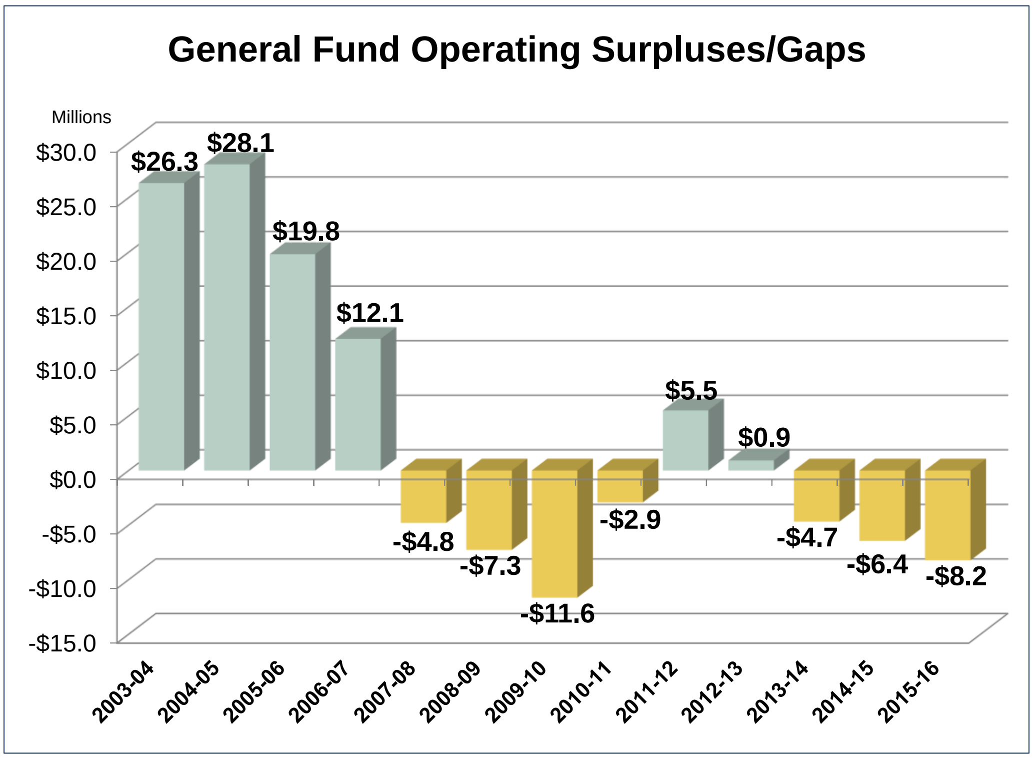


Source: Monterey County FY 2012-13 Three-Year Forecast, March 2013

Looking Ahead

Development of the Recommended Budget begins with preparation of year-end estimates based on actual revenues and expenditures at mid-year, and projection of future year costs assuming current year levels of staffing and services. This is presented to the Board of Supervisors each year as the Three-Year Forecast. The annual Three-Year Forecast provides a review of the County's current and pending financial condition based on the identified expenditure needs and anticipated revenue levels developed by all County departments. Subsequently, forecast findings offer policy-makers important insight into the County's capacity for meeting local needs, and help focus the development of strategic decisions to maintain service levels. The FY 2012-13 Three-Year Forecast was presented to the Board of Supervisors in March 2013.[24] Some of the highlights of Forecast findings are detailed below.

Of significance, details provided in the FY 2012-13 Three-Year Forecast indicated a re-emergence of a gap between expenditure requirements and available sources for funding them. Based on information available through the budget mid-year, expenditure needs would result in a year-end shortfall of $3.8 million in FY 2013-14. The short-fall almost doubles to $6.4 million at the end of FY 2014-15, then increases to $8.2 million by year-end FY 2015-16.[25]



Source: Monterey County FY 2012-13 Three-Year Forecast, March 2013

It should be noted that these increases do not represent growth in service levels or programs. Forecast details simply help identify the increasing costs of current year levels of service moving forward. In reality, identified cost increases for the most part do not recover any of the losses incurred through four previous years of expenditure reductions, nor do they acknowledge individual department equipment replacement needs and technology upgrades. Primary cost drivers identified in the Three-Year Forecast include the following:

[24] The County's Three-Year Forecast is available at www.co.monterey.ca.us/admin/badivision

[25] County of Monterey Three-Year Forecast, February 2013

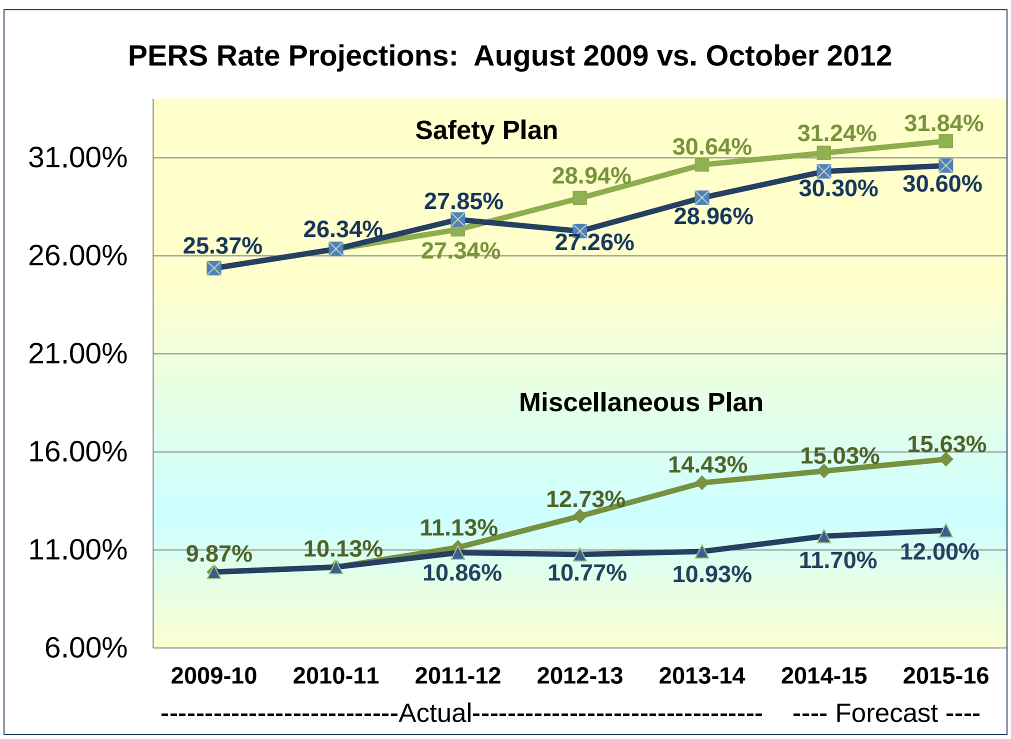
Vacant Positions

The primary cost driver throughout the three years of the forecast is an assumption that departments will fill existing vacant positions. At February 2013, General Fund departments had an estimated 267 vacancies. In many cases, budgeted positions have been held vacant in order to have salary savings to meet departmental needs within adopted limits of General Fund Contribution (GFC). This has required aggressive management of available resources and ongoing efforts by existing staff to continue "doing more with less." It must be recognized, however, that after four years of budget reductions and growing service demands in many sectors of government programs, pressure to fill vacant positions is escalating.

The Rising Cost of Pensions

Perhaps one of the most highlighted issues since the onset of the 2007-2009 economic crises, the rising costs of retirement is a dilemma impacting nearly every business sector, given an aging population, younger retirees, and advances in healthcare allowing people to live longer. The soaring costs of retirement imply profound impacts most particularly in local government, where in many cases negotiated retirement benefits have added escalators to overall retirement expenses.

The County's FY 2012-13 Forecast projected a cost increase in retirement benefits of $1.9 million in FY 2013-14. Projected costs increase by $3.1 million in the following year. Cost increases are based both on departmental plans for filling vacant positions and increases in PERS retirement rates.

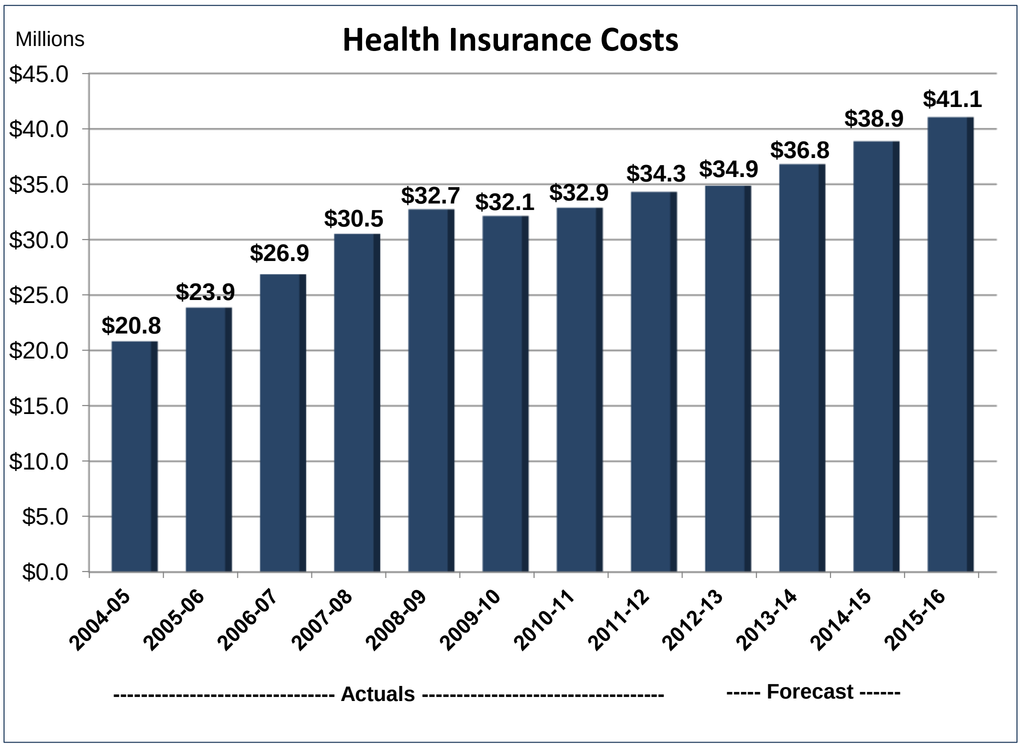


Source: Monterey County FY 2012-13 Three-Year Forecast, March 2013

Rising Health Care Costs

Health care spending reached $2.6 trillion in the U.S. in 2010 ($8,402 per person) and is expected to continue climbing to $4.5 trillion by 2020 according to an August 2012 report from the California Health Care Foundation (CHCF).

Monterey County provides health insurance benefits for most of its employees. The costs of these benefits rose sharply in the years prior to the recession, increasing from $20.8 million in FY 2004-05 to $32.7 million in FY 2008-09 due to annual premium increases and a CalPERS' decision to switch from statewide to regional pricing, which had the effect of accelerating premiums for higher cost Monterey County. The Three Year Forecast indicated that health care expenditures are expected to begin climbing again under the Affordable Care Act (ACA). Factors contributing to increased costs include elimination of lifetime dollar limits, free preventive care, and the provision allowing young adults to remain on their parents' plan until age 26. The CHCF projects expenditures to rise on an average of 6.2% annually beginning in 2014. Using a more conservative estimate of 5.6% annual growth (the 2000-2010 average), the County's health insurance costs would rise from the estimated $34.9 million in the current year to $41.1 million by FY 2015-16.

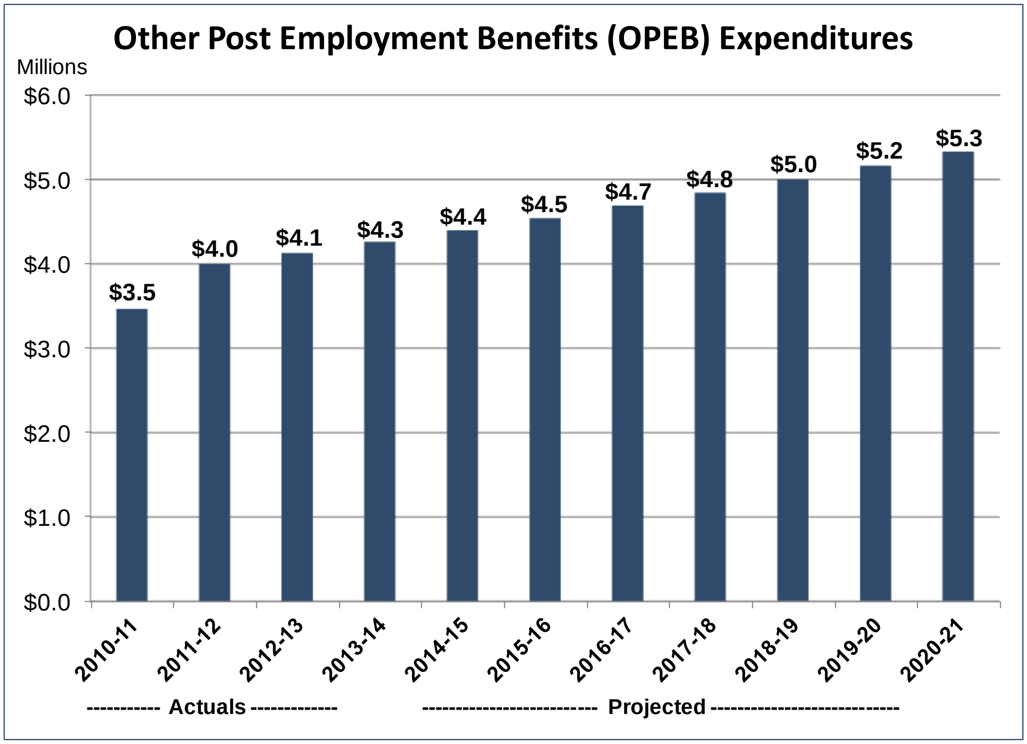


Source: Monterey County FY 2012-13 Three-Year Forecast, March 2013

Retiree Health Benefits

Currently, 644 retired County employees receive retiree health insurance benefits based on the latest GASB 45 actuarial analysis. Governmental Accounting Standards Board (GASB) Statement 45 requires public agencies to account for and report the Annual Required Contribution (ARC) of Other Post Employment Benefits (OPEB) on financial statements. Examples of OPEB include post-retirement medical, dental, and benefits not associated with a pension plan. Prior to June 2009, the County paid OPEB benefits as they came due. However, this pay-as-you-go approach does not satisfactorily address the magnitude of future OPEB obligations, adding risk to the County's long term finances. CalPERS established the California Employer's Retiree Benefit Trust (CERBT) in March 2007 at the request of public employers to provide a low cost, professionally managed investment vehicle for pre-funding retiree health benefits and other post- employment benefits. Now, the County makes regular contributions to CERBT where the funds are professionally invested similar to the CalPERS retirement funds.

To participate in the CERBT, PERS requires a funding policy. The County's policy is to obtain an actuarial valuation at least every two years and to consistently contribute an amount at least equal to 100% of the current year ARC as specified in the applicable actuarial valuation. For the period ending June 30, 2012, the County's contribution to CERBT was $4.0 million. OPEB payments are expected to continue rising to $5.3 million by FY 2020-21 according to the actuarial study. The latest valuation also indicates an actuarially unfunded liability of $27.3 million.



Source: Monterey County FY 2012-13 Three-Year Forecast, March 2013

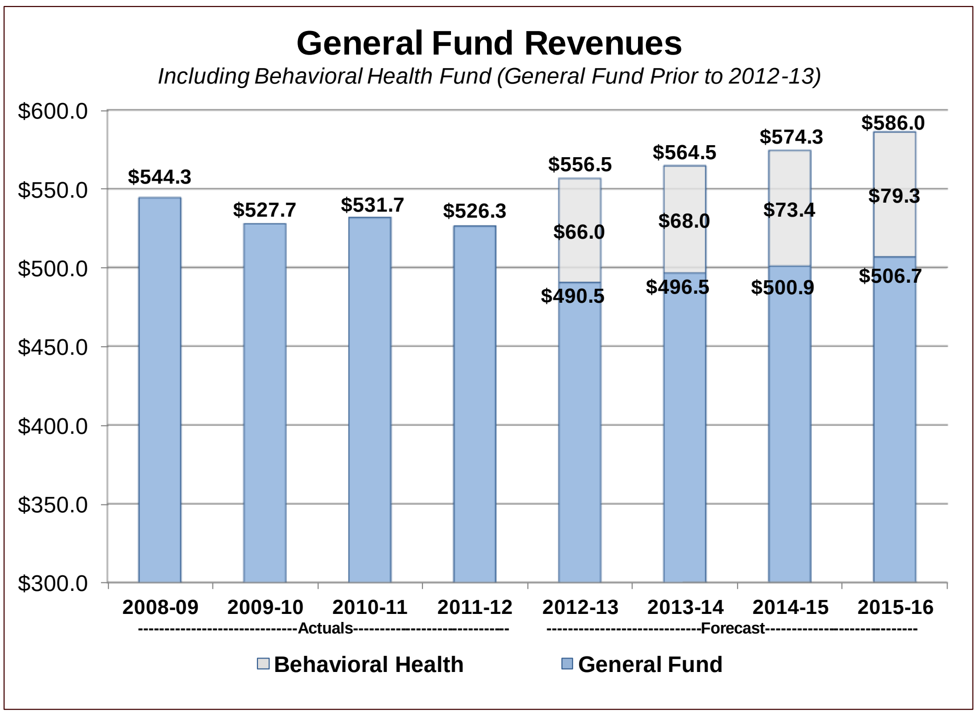
General Fund Revenues

FY 2013-14 General Fund revenues are recommended at 521.4 million, increasing approximately $32.0 million over the total year-end estimate for FY 2012-13. Departmental forecasts reflected a year-end estimate of $490.5 million in General Fund revenues.

Primary sources of revenue for the general fund include State and Federal aid, taxes, and various charges, fines, fees, and reimbursements. In prior years the General Fund received almost half of its revenue from the State, both in the form of direct State allocations and Federal sources passed through State departments. Since transferring Behavioral Health related State and Federal aid revenues into the new Behavioral Health Fund, this category now represents about 40.0% of the total revenue in the General Fund. These funds primarily support mandated public assistance and health programs. The County also relies on taxes for a significant level of General Fund revenue. Combined revenue from property taxes, sales and use tax, and transient occupancy tax (TOT) is expected to total $145.6 million at the end of FY 2012-13, providing 30.0% of General Fund revenue. Other revenue sources include charges for services, licenses, permits and franchises, fines, forfeitures and penalties. The "Other Revenue" category primarily provides for operating transfers from other funds into the General Fund to support departmental operations. Under the latest realignment, departments are required to establish separate funds (Fund 022 – Local Revenue Fund and Fund 025 – Health and Welfare Realignment) to ensure proper tracking and accounting as a condition for receiving State funding. These funds are then "reimbursed" to the General Fund operating units based on actual costs for services provided.

As indicated in the chart below, FY 2012-13 modifications for the realignment requirements resulted in a transfer of $66.0 million to the new Behavioral Health Fund 023. Had this transfer not been required, the General Fund year-end estimate would have totaled $556.5 million. Nonetheless, the increase is primarily driven by program-specific funds for mandated programs related to the additional responsibilities passed from the State to County health, social services, and public safety programs.

Program-specific funding for State and Federal mandates, primarily related to health and social services, including realigned programs, has increased in response to a higher number of people eligible for government benefits and services due to poor economic conditions. These funds are restricted for specific priorities as determined by the Federal and State government.



Source: Monterey County FY 2012-13 Three-Year Forecast, March 2013

Non-Program Revenue

General Fund program revenue provides funding for specifically designated and/or statutorily required programs. In contrast, revenue from non-program sources is the County's only true discretionary funding, critical for providing the Board with some level of flexibility to address local priorities. Monterey County historically uses its non-program revenue to support public safety functions and County administration requirements. Discretionary non-program revenue also assists with meeting matching requirements and as leverage for maximizing funding sources for required programs.

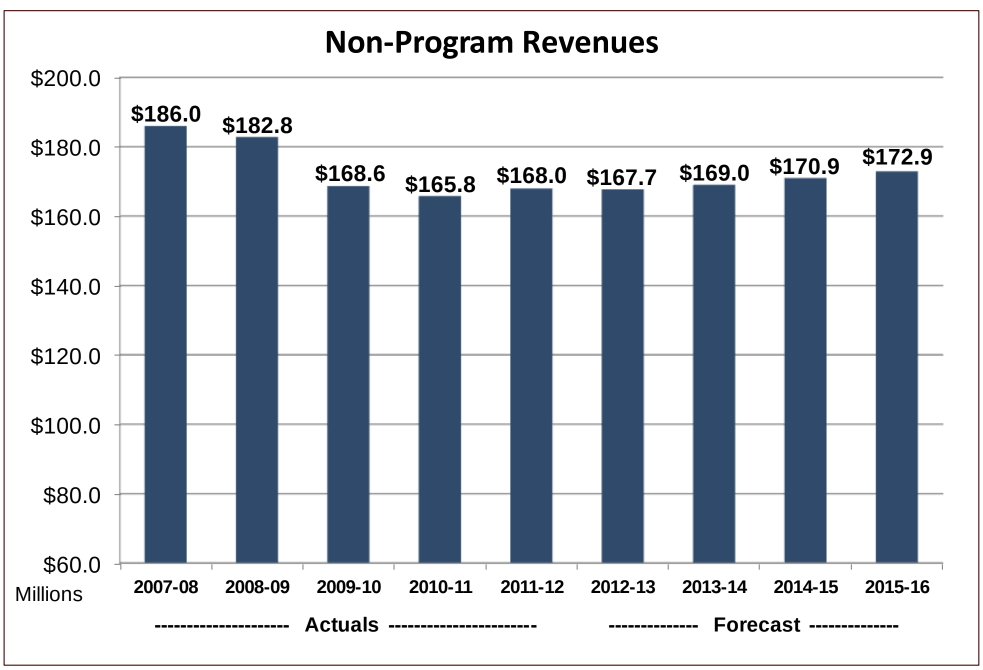
Property tax revenue comprises the bulk of non-program revenue, totaling an estimated $118.2 million (70%) in 2012-13. Transient occupancy tax (TOT), often referred to as a hotel or room tax, is estimated at $16.6 million, while Vehicle License Fees (VLF) are estimated at $8.0 million. Other significant sources of non-program revenue include sales and use tax, tobacco settlement monies, and franchise fees.

The 2007-2009 Recession took a heavy toll on the County's discretionary revenues. Total non-program revenue levels declined $18.0 million (9.7%) from FY 2007-08 to FY 2011-12. During this time, property taxes, by far the largest portion of non-program revenue, fell from $127.6 million to $116.1 million, a loss of $11.5 million. Total revenue from property tax is estimated at $118.2 million in FY 2012-13, representing 70.0% of the County's total non-program revenue. Transient occupancy tax (TOT), estimated at $16.6 million, is the second largest source. Other important sources include sales and use tax, tobacco settlement funds, and franchise fees.

The FY 2012-13 year-end estimate for the General Fund projected a year-end surplus of $0.9 million. As mentioned earlier, the forecast is generally based on available reports of actual revenues and expenditures at the first half of the fiscal year and other known factors effecting year-end totals, including employee step advances, vacancies, and Board-approved modifications.

The County Administrative Office (CAO) additionally prepares an updated forecast of the County's non-program "discretionary" revenues based on actual revenue received by the end of the third quarter of the fiscal year. The updated forecast prepared in April 2013 indicated more favorable outcomes, largely driven by increases in property tax and transient occupancy tax (TOT) revenues. The following section includes a brief overview of Forecast findings on non-program revenue based on mid-year actual receipts, compared to subsequent recommendations for the FY 2013-14 Budget.

FY 2012-13 year-end estimated non-program revenue totals $167.7 million or about one-third of all General Fund revenue. The FY 2013-14 Recommended Budget includes estimated non-program revenue of $172.8 million, an increase of $7.5 million (4.5%) over the FY 2012-13 Adopted Budget. This reflects significant improvement over forecast totals, largely based on the third-quarter update in April 2013. Though non-program revenue remains well below pre-recession levels, the County is beginning to see gradual, but optimistic improvement in its discretionary funding levels.



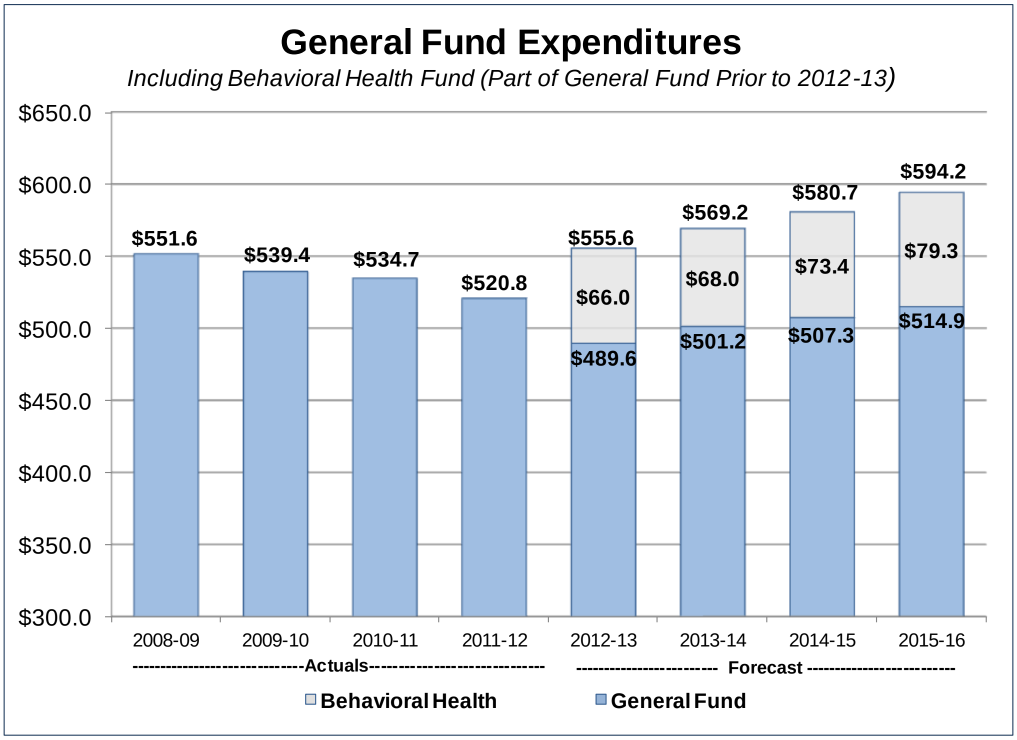
Source: Monterey County FY 2012-13 Three-Year Forecast, March 2013

General Fund Expenditures

General fund monies support 23 departments with a combined total of approximately 200 budget units, established for various departmental requirements, programs, and functions. Major functions include: social services, health services, public safety and criminal justice, land use, infrastructure, and environment programs, education and recreation, including the County Library, cooperative extension programs, and parks, and finance and administration, including the Board of Supervisors, Clerk of the Board, County Administrative Office, Economic Opportunity, Equal Opportunity Office, Auditor-Controller, Assessor-County Clerk/Recorder, Treasurer-Tax Collector, County Counsel, Elections, and Information Technology.

The General Fund is expected to end FY 2012-13 with $489.6 million in expenditures. Of the major components comprising General Fund expenditures, costs related to staffing the diversity of functions, programs and services provided throughout Monterey County are close to two-thirds of the total. Salaries and benefits costs are expected to total $313.8 million at year-end FY 2012-13. Services and supplies, including contracted services, maintenance, rent, utilities, and various other departmental needs equate to 23.0% of total expenditures, with a FY 2012-13 year-end estimate of $113.8 million. Other categories of expenditure include other charges, much of which consists of Federal and State aid payments for social services recipients, fixed assets (equipment, vehicles, etc.), and operating transfers out to other agencies.

The lower level of expenditures reflected in the following chart results from the aforementioned transfer of $65.2 million to the new Behavioral Health Fund to support the realigned function. Had this transfer not taken place, the County would end the year with $555.6 million in estimated General Fund expenditures. This growth in combined expenditures for these two funds is directly attributable to realigned Health, Social Services, and Probation responsibilities. General Fund expenditures are forecasted to grow $11.6 million (2.4%) in FY 2013-14. A number of factors driving these costs higher were discussed earlier in this report, including higher staffing levels (assumed filling of some vacancies), rising retirement and health costs, an assumed increase in positions to support centralization of Human Resources, and higher County costs to support vote by mail programs. Although some costs have been included for forecasting purposes, they are still subject to review and appropriation by the Board in the upcoming budget process.



Source: Monterey County FY 2012-13 Three-Year Forecast, March 2013

All Funds Summary

While the focus of the previous section was the general fund forecast, a number of other major funds provide significant services and are complex enough to warrant additional discussion. Details regarding all other funds can be found within the narrative sections of their respective departments.

Behavioral Health

The Behavioral Health Fund is a special revenue fund effective July 1, 2012. The Auditor-Controller's Office, County Administrative Office (CAO), and Health Department reached consensus that the best way to ensure that the County recognizes the use of mental health funds only for their required mental health purpose is to request Board of Supervisors approval for a behavioral health fund. The Board of Supervisors authorized the new Behavioral Health fund on December 13, 2011.

The Behavioral Health Bureau is a bureau in the Health Department. Behavioral Health provides mental health and substance abuse services to Monterey County residents. The Mental Health Program, pursuant to Welfare and Institutions Code Section 5600, provides a continuum of County operated and community-based mental health services through various contracts. The program provides a range of inpatient, social rehabilitation, supportive housing, and outpatient services to Monterey County Medi-Cal beneficiaries who meet the State Department of Mental Health's medical necessity definition. Services provided in the Alcohol and Drug Program include residential, transitional housing, perinatal residential, outpatient, prevention, early intervention, narcotic replacement, drinking driver programs, drug court, and drug diversion Penal Code 1000.

The forecast for the Behavioral Health Fund shows that expenses and revenues will increase due to implementation of the Affordable Care Act (ACA). The Health Department continues to coordinate with the Auditor-Controller's Office and CAO on the appropriate recognition of trust funds. Those amounts may be identified as fund balance in 2013-14 and later fiscal years.

Behavioral Health has a strong array of community based culturally competent behavioral health contract providers. However, we are challenged with the development of better access to services, more prevention efforts, and even more efficient use of our resources. We will continue to balance integration and transformation of service delivery with quality behavioral health care.

Behavioral Health Fund	Adopted	Year-End Est	Forecast		
	FY 2012-13		FY 2013-14	FY 2014-15	FY 2015-16
Beginning Fund Balance	$ -	$ -	$ -	$ -	$ -
Revenue	$65,314,411	$66,017,361	$ 67,960,678	$ 73,397,565	$ 79,269,403
Cancellation of Designations	$ -	$ -	$ -	$ -	$ -
Expenditures	$65,235,162	$66,017,361	$67,960,678	$73,397,565	$ 79,269,403
Provisions for Reserves/Designations	$ -	$ -	$ -	$ -	$ -
Ending Available Fund Balance	$ -	$ -	$ -	$ -	$ -

Source: Monterey County FY 2012-13 Three-Year Forecast, March 2013

Road Fund

The Road Fund is a special revenue fund established according to state law to account for revenues that are legally restricted for road and bridge construction and related maintenance. The forecast for the road fund shows the erosion of fund balance due to projected road fund contribution towards construction projects for the current year estimate and for each of the forecast years. The road fund is primarily funded by state and local fuel taxes as well as federal and state grants. The general fund provides funding to support the Pavement Management Program, as well as the County's Storm Water Management Program.

Potential risks to the fund include macro-economic factors such as fluctuations in the price of or demand for motor fuel and increases in the cost of construction materials such as concrete and asphalt. All of these factors may affect the expenditure side of the forecast as the project activities performed by this fund are largely dependent on these commodities. Although the forecast does not show any structural gaps in revenues and expenditures, strategies may be required to manage any additional revenue decreases resulting from the downturn in the economy and potential State budget reductions or realignment of funding.

Road Fund	Adopted	Year-End Est	Forecast		
	FY 2012-13		FY 2013-14	FY 2014-15	FY 2015-16
Beginning Fund Balance	$ 3,540,309	$ 3,540,309	$ 2,943,796	$ 2,257,974	$ 2,065,393
Revenue	$28,912,655	$27,949,404	$ 30,048,138	$ 28,974,694	$ 28,974,694
Cancellation of Designations	$ -	$ -	$ -	$ -	$ -
Expenditures	$28,357,766	$28,545,917	$30,733,960	$29,167,275	$ 29,006,845
Provisions for Reserves/Designations	$ -	$ -	$ -	$ -	$ -
Ending Available Fund Balance	$ 4,095,198	$ 2,943,796	$ 2,257,974	$ 2,065,393	$ 2,033,242

Source: Monterey County FY 2012-13 Three-Year Forecast, March 2013

Monterey County Library

The Monterey County Free Libraries (MCFL) is a special taxing authority under the County Library Law of 1911, established to provide a network of information centers that serve the diverse communities of Monterey County. As such, the fund's operations are primarily financed through its own share of property tax.

The forecast for the Library Fund indicates that expenses are projected to exceed the fund's dedicated revenue sources, causing the gradual erosion of fund balance each year until the fund reaches a negative balance in 2015-16. The fund has worked to stabilize expenditures, while seeking to shore up other revenue to offset the decline in property tax revenues since the 2007-2009 recession.

On the expenditures side, salaries and benefits represent approximately 65.0% of the Library's total expenditures. These costs are expected to remain relatively flat in 2012-13 and increase approximately 3.7% in FY 2013-14. The department is striving to maintain all other expenditures at current levels.

With regard to revenues, the department is projecting the property revenue decline has ended and that there will be a slight increase in revenue starting with the FY 2012-13 year-end estimate of $6.3-$6.4 million, an approximately 1.5% increase. The remaining forecast years project relatively flat revenue, at a growth rate of 1.0% in FY 2015-16.

The MCFL has implemented its "Financial Plan" to meet the guidelines set forth in the Monterey County Financial Guidelines in regards to financial performance. The plan includes maintaining a positive fund balance, reserves and contingency, while incorporating any anticipated major repair/renovation costs during the forecast period.

Monterey County Free Libraries	Adopted	Year-End Est	Forecast		
	FY 2012-13		FY 2013-14	FY 2014-15	FY 2015-16
Beginning Fund Balance	$ 1,244,110	$ 1,244,110	$ 1,149,112	$ 467,434	$ 35,125
Revenue	$ 6,927,537	$ 7,091,337	$ 7,153,402	$ 7,083,034	$ 7,145,388
Cancellation of Designations	$ -	$ -	$ -	$ -	$ -
Expenditures	$ 7,896,166	$ 7,186,335	$ 7,835,080	$ 7,515,343	$ 7,689,922
Provisions for Reserves/Designations	$ -	$ -	$ -	$ -	$ -
Ending Available Fund Balance	$ 275,481	$ 1,149,112	$ 467,434	$ 35,125	$ (509,409)

Source: Monterey County FY 2012-13 Three-Year Forecast, March 2013

Natividad Medical Center

Natividad Medical Center (NMC) is a County "enterprise fund," defined as a governmental fund that provides goods and services to the public for a fee, which makes the entity self-supporting. In recent years, NMC has continued to experience improvement in its financial performance. The strategic decisions on the part of the Board of Supervisors, the Board of Trustees and NMC management continue to prove effective, with the hospital having experienced four years of improved fiscal performance.

The forecast for NMC shows that the fund is balanced through the forecast period based on the following assumptions on revenue, operating expenses and their efficiency ratio.

Volume: Net patient revenues are expected to continue to experience slight growth. Fiscal Year 2012-13 is anticipated to be 9.8% under the adopted budget due to managed care contract re-negotiations, but revenue in subsequent fiscal years is projected to increase in the range of 1.8% to 3.8%. The average annual net patient revenue growth is approximately $3.5 million.

Government revenues are expected to decrease over the forecast period. The 2012-13 year-end includes an increase of approximately 8.2% followed by a decrease of approximately 5.0% in 2013-14. The projection for 2014-15 includes a significant decrease of 24.0% followed by 3.7% decrease in 2015-16. Government revenue will see an average annual decline of 10.2% over the forecast period. The decrease is based on the anticipated impact of Health Care Reform.

Operating Expenses: The FY 2012-13 year-end estimate is 5.1% under the adopted budget. An increase of 4.2% is projected in FY 2013-14, followed by reduction of 6.5% in FY 2014-15 and an increase of 1.0% in FY 2015-16.

Operating Revenue: The 2012-13 year-end estimates is 5.7% under the adopted budget. An increase of 0.1% is projected in 2013-14, followed by reduction of 3.0% in 2014-15 and an increase of 1.2% in 2015-16.

Net Results: The forecast (including capital expenditures) shows a use of $13.3 million in 2012-13 followed by use of $13.5 for the last two years of the forecast. This reveals a consumption of $40.3 million in operating and capital expenditures over the forecast period that operations are unable to fund.

Natividad Medical Center	Adopted	Year-End Est	Forecast		
	FY 2012-13		FY 2013-14	FY 2014-15	FY 2015-16
Net Patient Revenue	$142,773,989	$128,843,916	$131,191,691	$136,204,275	$139,313,105
Government Revenue	$ 41,118,000	$ 44,481,445	$ 42,263,844	$ 32,101,039	$ 30,928,117
Other Revenue	$ -	$ -	$ -	$ -	$ -
Total Revenue	$183,891,989	$173,325,361	$173,455,535	$168,305,314	$170,241,222
Operating Expenditures	$175,230,966	$165,144,422	$169,483,975	$165,673,033	$168,925,873
Capital Expenditures	$ 21,442,471	$ 21,442,471	$ 24,970,655	$ 16,170,706	$ 14,792,680
Total Expenditures	$196,673,437	$186,586,893	$194,454,630	$181,843,739	$183,718,553
Use of Fund Balance	**$ (12,781,448)**	**$ (13,261,532)**	**$ (20,999,095)**	**$ (13,538,425)**	**$ (13,477,331)**

Source: Monterey County FY 2012-13 Three-Year Forecast, March 2013