
**THE SALT LAKE COUNTY AUDITOR'S
2007 BUDGET MESSAGE**

**Sean Thomas
Salt Lake County Auditor**

to the

Salt Lake County Council

**And To the Mayor and Citizens of Salt Lake
County**

December 5, 2006

Introduction

In accordance with the Uniform Fiscal Procedures Act for Counties (§17-36 of the Utah Code), the *Budget Officer* of the County is charged with preparing a Budget Message to explain the Council recommended budget, and in general, summarize significant changes in the County's financial position; revenues, expenditures, budgets, and additions or changes in policy.

I am pleased to have the opportunity as the Budget Officer of Salt Lake County, to present this Budget Message. My responsibility, acting in this capacity, and as an independently elected official, is to act as an advisor to the County Council and Mayor in financial and budget matters, and, as a guardian of the public trust as it relates to fiscal responsibility and accountability.

Every budget is a reaction to perception of current public needs. In certain cases, a new budget must also respond to prior significant decisions made to meet such public needs. Always, the budget must balance needs that can be met and those that must be deferred.

Economic Outlook

As the Budget Officer for the County, I am responsible for projecting revenues for the upcoming year. Our economy continues to show robust growth throughout 2006. Year-to-date sales tax revenues have increased substantially in comparison with the same period in 2005. Our 2007 revenue projections are included as a part of the Recommended Budget. These projections are based on our research, analysis of economic conditions, review of other governmental studies, and our revenue forecasting models.

To further refine and improve the County's revenue projection process, four years ago our office undertook development of both a coincident composite and a leading composite economic index. The ***Coincident Composite Index*** is a construct of business cycle indicators that is used in describing current general economic conditions. The ***Leading Composite Index*** is a construct of leading business cycle indicators that is used in forecasting economic conditions eight to ten months in advance. The Coincident and Leading Composite Index indicators are listed in Table 1 below.

Coincident Index Components	Leading Index Components
Taxable sales	New vehicle purchases
Manufacturing work hours per week per employee	Total residential construction permits issued
Total non-farm employment	Non-residential construction value
Wholesale & retail trade hours per week per employee	Construction employment
Unemployment rate	Initial claims for unemployment insurance
Aggregate purchasing power	Help-wanted Index
	Local area stock prices
	Local area ten-year yield curve rate

Table 1. *Business cycle indicators included in the Coincident and Leading Indexes.*

In Figure 1 on page 2, the ***Coincident Composite Index*** for the County is summarized from January 1998 to *September* 2006. This index shows that the Salt Lake County economy continues to experience strong growth.

Coincident Composite Index 1998-2006 Salt Lake County

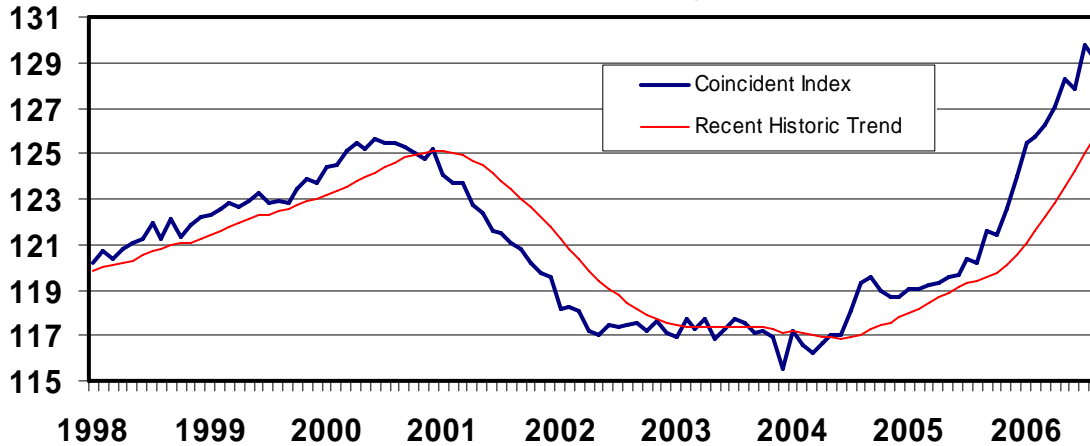


Figure 1. The Salt Lake Coincident Index has been performing above its recent historical trend, and has shown consistent growth since May 2004. 1992 was selected as the base year, where average Index value of 1992 = 100. The “Recent Historical Trend” line is a 12-month moving average for this index.

The **Leading Composite Index** is presented in Figure 2 below. The trend in this index shows that the Salt Lake County economy will continue its rapid growth through the end of 2006. In 2007, we expect the rate of growth to be slower but stable.

Leading Composite Index 1998-2006 Salt Lake County

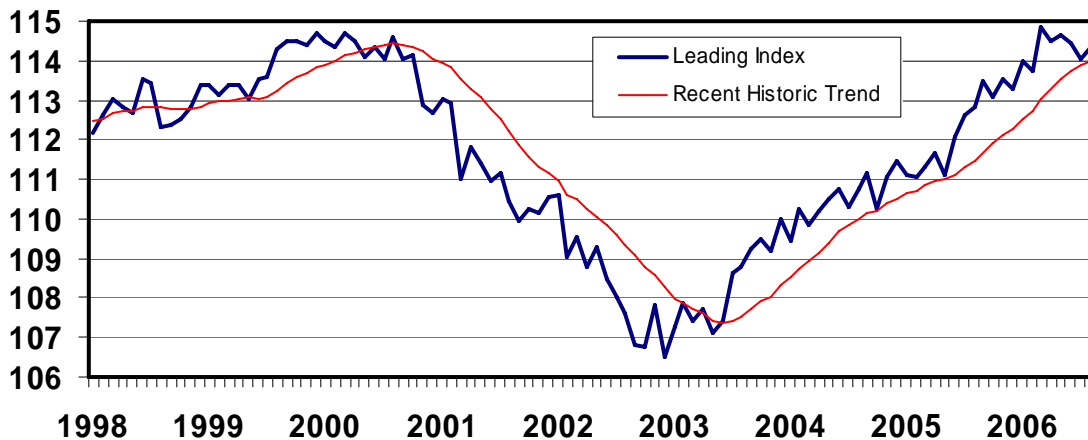


Figure 2. The Salt Lake County Leading Index has outperformed its recent historical trend since June 2003 but the rate of growth is anticipated to be slower but stable in 2007. 1992 was selected as the base year, where average Index value of 1992 = 100. The “Recent Historical Trend” line is a 12-month moving average for this index.

The labor market expansion, which is represented in Figure 3 below, continues to play a significant role in the County's economic growth. In the chart below the number of initial claims for unemployment insurance is compared against the Salt Lake Metro-area help-wanted index. The current strong growth is indicated by the sizable divergence between these two leading indicators, starting in October 2003. However, the decline in the help-wanted index, coupled with the increase in new claims for unemployment insurance indicated in the area right of the dashed, vertical line shows that employment growth in the County began slowing in 2006 and may continue to slow during 2007.

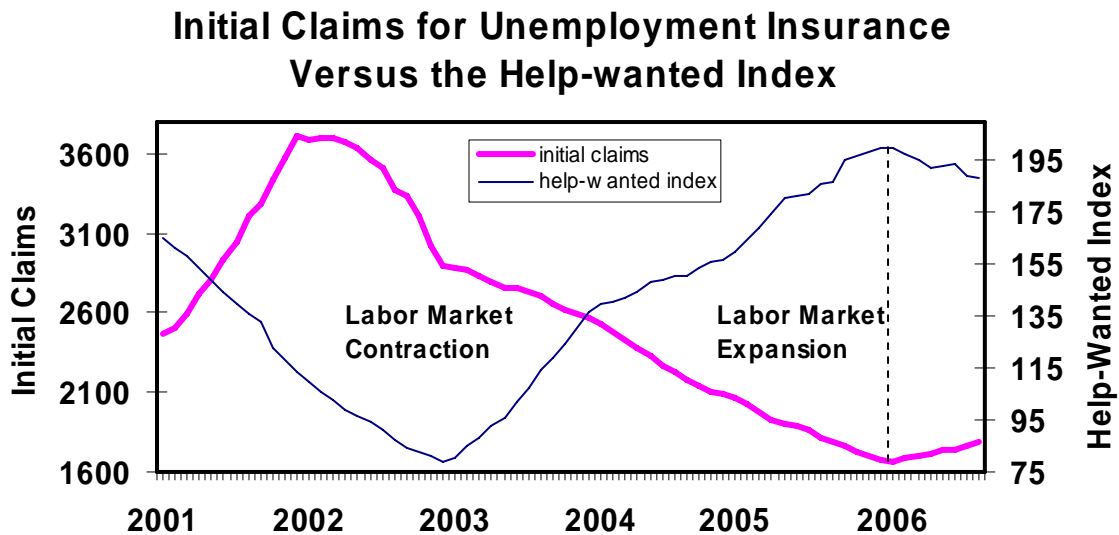


Figure 3. The strong labor-market expansion that began in 2003 has begun to slow in 2006, a trend that will likely continue during 2007.

Budget Overview

After adjusting the overall budget for internal charges and other interfund charges, the total Recommended Budget for 2007 is approximately \$717 million (net budget). Salt Lake County's total Recommended Budget for 2007 for all funds is approximately \$886 million. Included in the \$886 million amount are the budgets for the County's 10 internal service funds which are used primarily to account for the financing of services provided by one County agency to other County agencies (rather than to the general public). These services are provided on a cost reimbursement basis.

The 2007 Recommended Budget includes proposed expenditures for a number of County programs such as public safety, social services, public works, and various other programs. More specific information on the allocation of the County's budget is presented in Figure 4 on page 4. Budgeted revenues are presented by source in Figure 5 on page 4.

2007 Recommended Budget

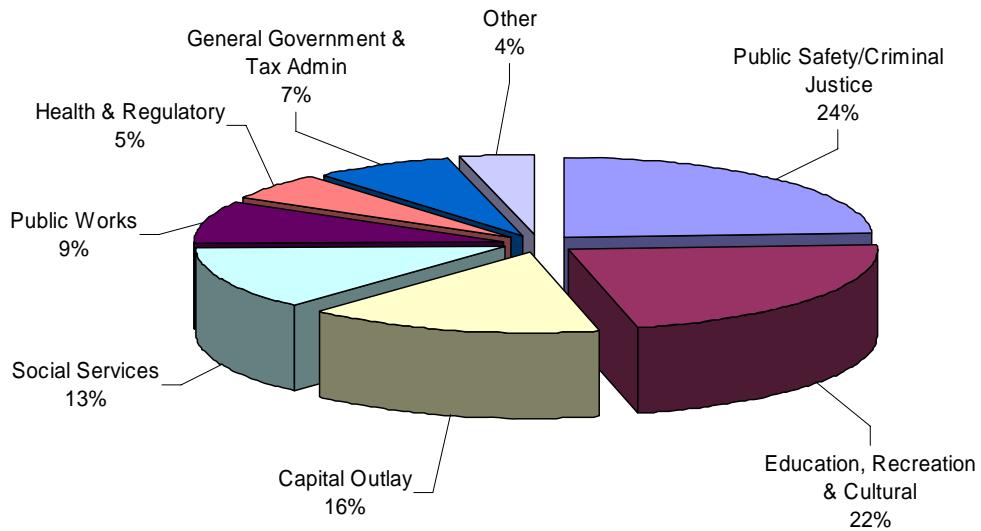


Figure 4. 2007 Recommended Budget allocated to major Salt Lake County program categories.

2007 Revenues for Recommended Budget

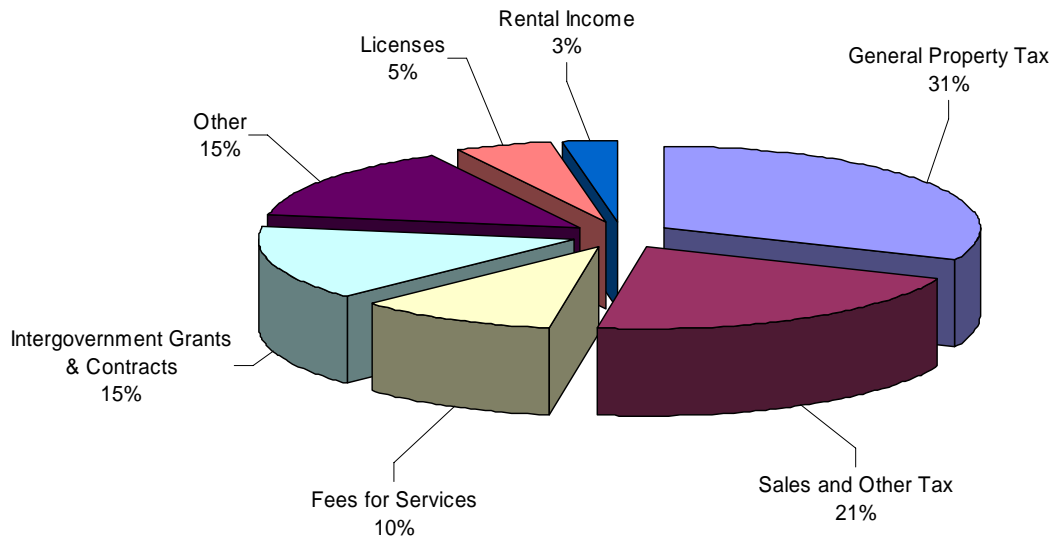


Figure 5. 2007 Recommended Budget - Revenues by major source.

Major Issues and Initiatives

The 2007 Recommended Budget is the culmination of several on-going initiatives and includes the following:

- 1. Jail Budget and Alternatives to Incarceration.** The Sheriff's 2007 budget request for the Jail was \$65 million (in the Tentative Budget), which in addition to maintaining existing operations at the Adult Detention Center, included requests to reopen the Oxbow Jail Facility and two existing units at the Adult Detention Center that were previously closed in 2006 for the purpose of limiting the types of prisoners accepted by the Jail. The Council approved funding in the 2006 budget for the Mayor's Alternatives to Incarceration initiative in Criminal Justice Services, Mental Health, the Sheriff's Office, and Substance Abuse Services. This initiative is ongoing.

The Mayor's proposed budget would have funded the opening of only one of the two currently closed units in the Adult Detention Center and did not include any funding to reopen the Oxbow facility. The Council chose not to restore the Sheriff's requested funding in the recommended budget, including not funding the opening of the Oxbow facility, nor either of the two currently closed units to ensure that the alternatives to incarceration initiative would continue to be supported. The Council recommended budget for the Jail is \$58 million.

- 2. Zoo, Arts, and Parks Projects.** The citizens of Salt Lake County approved Proposition 1 in the November 2006 election, which authorizes the County to issue up to \$65 million in general obligation bonds for Zoo, Arts and Parks (ZAP) projects. These projects include construction of new recreation facilities and renovation and capital maintenance projects for many existing facilities. In addition, proceeds from these bonds are budgeted for improvements to parks and development of trails. The five largest projects, totaling an estimated \$41.4 million, are the Southwest Recreation Center – new facility, the Northwest Recreation/Senior Center – new building and renovations of the existing building, the Vista Park in Taylorsville - Baseball Complex, the Holladay Lions Recreation Center – various additions, and Copperview Community Center – various additions.
- 3. Open Space.** The citizens of Salt Lake County also approved Proposition 2 in the November 2006 election, which authorizes the County to issue up to \$48 million in general obligation bonds for the purpose of financing the acquisition and preservation of open space, natural habitat, parks and community trails. The Council recommended budget includes funding for a new Open Space staff employee and a small operating budget to administer this program. A major 2007 initiative for Open Space is to develop an Open Space Master Plan in order to effectively utilize the authorized funds.
- 4. Planning for the West Bench.** In cooperation with Kennecott Land, Salt Lake County is undertaking a planning process for the development of the West Bench. Kennecott Land owns approximately 75,000 acres of developable land in Salt Lake County along the Oquirrh Mountains west bench and it is anticipated that it could become the home of as many as 500,000 people over the next 75 years. For this effort, Kennecott Land has agreed to fund 5 time-limited County employees for the 2 to 3-year start up period of the West Bench Development. These positions that make up the project team consist of a project manager, planner, attorney, financial analyst, and coordinator.

It is anticipated that in 2007 this new project team will, among other duties, help achieve the adoption of a West Bench General Plan and a Salt Lake County and Kennecott Master Development Agreement. It is also anticipated that the first Community Structure Plan will begin in the fall of 2007.

5. **Funding for 100,000 Immunizations.** The Council recommended budget includes \$400,000 in new County funding for a childhood immunization program. The funding would allow the Health Department to provide immunizations to WIC eligible children up to two years of age and any children using Salt Lake County immunization services who are identified as being at risk of not receiving vaccines due to inability to pay.
6. **Recycling Program.** The Council recommended budget includes approximately \$4.5 million for implementation of a new recycling program in the unincorporated area. Approximately \$4.1 million is for the initial purchase of 65,561 containers and 3 new vehicles. The previous recycling program had roughly 25% participation; the new program will provide 100% of unincorporated area residents with a recycling container. The monthly fee will be adjusted from \$9 to \$11 for a user that receives the standard 1 garbage and 1 recycling container. The Mayor projects that the program revenues will cover the additional cost after approximately 8 years of service.
7. **South Towne Exposition Center.** The 2007 Recommended Budget includes \$21.2 million for the construction of a multi-story parking structure and other improvements at the South Towne Exposition Center. The parking structure will provide parking for approximately 1,000 vehicles.
8. **Performance Measurement.** A comprehensive performance measurement system is intended to improve the accountability of government to citizens and provide meaningful information to elected officials on program results and effectiveness. Performance measurement systems are used to identify and track output, outcome, and other measures that are relevant to the goals and objectives of each program. In a performance measurement environment, agencies will have the opportunity to demonstrate the results they are achieving towards meeting the needs of this community with the financial resources they have been allocated in their respective budgets.

At the direction of the County Council, the County began a "pilot" implementation of performance measurement in Aging Services and the Surveyor's Office in 2004. During 2005 and 2006, the Mayor's Office has implemented performance measurement in the Administrative Services, Community Services, Human Services, and Public Works departments. These performance measures have been reported in their applicable budget reports provided to the Mayor and Council. I am pleased to report the progress achieved to this point is very encouraging.

I believe implementation of performance measurement represents a strategic step forward for the County. However, for this initiative to be successful on a long-term basis, sustained political support from the Council, Mayor, and other independent elected officials is critical. Expectations must be realistic. In addition, effective performance measurement systems include periodic audits of results and the outcomes being promulgated by divisions across the County. Also, the Council must commit to utilizing the performance data in the appropriation process.

Employee Compensation

County employees are our most important asset. We currently have a hard-working, competent career employee group. We need to retain these employees to continue providing citizens with the quality service they deserve. To attract and retain qualified employees, history shows our compensation structure must be competitive.

Employee compensation and benefit costs represent 58% of the total 2007 recommended operating budgets (includes only those budgets with operating programs). The 2007 Council Recommended Budget includes the following compensation package for employees:

- 2% Structure/COLA adjustment
- 2.75% merit increase for eligible employees
- 1% longevity payment to 401(k) accounts of merit employees not eligible for a merit increase

This compensation package will cost approximately \$7.3 million in 2007. In addition, the budget includes a 2.75% increase for Sheriff deputies at a cost of approximately \$1.2 million. In addition, a 4.5% increase for employee health insurance is included in the 2007 budget which will cost an additional \$1.1 million.

The Bureau of Labor Statistics West Urban Consumer Price Index (CPI) increased 3.63% for the 12 month period ending in September 2006. After adjusting the CPI for "substitution bias"¹ the actual cost-of-living increased by 3.13% during this period. The difference between the Council's approved structure adjustment and the calculated increase in cost-of-living represents lost purchasing power for employees. It should be noted this difference could eventually lead to requests for reclassification of employees in various divisions across the County in order to remain competitive with the market. This could result in grade inflation.

One could argue the annual merit increase, while intended to be an incentive for performance and longevity, can provide some mitigation of these pressures. However, to the extent it provides such mitigation, it ceases to be an incentive, and simply becomes another adjustment to recognize economic forces. The decision rests with the Council, to weigh and consider these issues in determining appropriate services, service levels, FTE levels, and protections provided by this government for our constituency versus compensation packages for our most valuable resource, our human resources.

Property Taxes

Property tax revenues for all funds are projected at \$190.5 million for 2007 and are summarized by fund in Table 2 on page 8. Property tax revenue increases in Table 2 represent additional revenue for "new growth" anticipated to occur in the County and does not imply an increase in the tax rate above the certified rate.

¹ The CPI measures only the change in fixed prices over time but does not account for the impact of price changes on the willingness of consumers to substitute among goods and services. In order for the CPI to reflect the true cost of living, an adjustment must be made to offset substitution bias. Empirical research has found that subtracting 0.50 percent from the percent change in the CPI appropriately adjusts for substitution bias.

Fund	2006 Property Tax Budgeted	2007 Property Tax Projected
General	\$87,377,304	89,636,737
Municipal Services	6,867,794	7,100,000
SL Valley Fire Service	16,394,586	18,400,000
Flood Control	4,667,713	4,850,000
State Tax Administration Levy	14,629,294	14,500,000
Library	24,109,401	25,000,000
Health	9,676,965	10,000,000
Governmental Immunity	113,847	118,000
Bond Debt Service	15,540,068	16,000,000
Capital Improvements	0	913,263
Planetarium	2,276,933	2,360,000
Municipal Svcs Judgment Levy	60,547	62,600
State Tax Adm Judgment Levy	170,770	175,000
Library Judgment Levy	117,798	122,000
County-wide Judgment Levy	1,252,313	1,296,000
Total Property Tax Revenue	\$183,255,333	\$190,533,600

Table 2. 2006 & 2007 Property Tax Revenue by Fund

The Financial “State of the County”

As the chief accounting and budget officer of Salt Lake County, I am also including in this budget message my comments and observations on the financial “state of the County”.

Bond Ratings. Bond ratings are one of the most important indicators of government financial performance. Salt Lake County has the highest possible bond rating (for general obligation debt issues) and the lowest cost of borrowing in the nation. From a total of 3,033 counties, Salt Lake County is one of 22 counties in the nation that have a simultaneous triple ‘A’ credit rating with Moody’s Investors Service, Standard & Poors, and Fitch Ratings. The County’s exemplary bond rating translates into significantly reduced interest costs for our taxpayers.

Minimum Financial Reserves. Maintaining a minimum reserve in County funds is a financial management “best practice” and is critical to retaining the County’s AAA bond rating. The 2007 Recommended Budget includes sufficient reserves for the General Fund, Municipal Services Fund, and several of the County’s other governmental funds.

Long Range Revenue and Expenditure Projection. In Salt Lake County for a number of years our budget decisions have included not only the current year impact, but a **five-year view** of the consequences of our decisions. A multi-year financial forecast alerts elected officials and executive management of potential budget stress which may result from projected revenue and expenditure imbalances. Multi-year budget and revenue planning is another financial “best

practice” tool the County should continue to utilize and in fact, is a significant factor cited by both Standard & Poors and Fitch Ratings in evaluating state and local government credit worthiness.

Certified Property Tax Rate. The certified property tax rate is intended to allow local governments to collect the same amount of revenue as was received in the prior year plus additional revenue for “new growth” which occurs as new homes are built or new businesses move into the area. Property tax revenue collected from new growth is intended to assist in paying for the cost of services provided in the areas where the growth occurred. However, under current law governing property taxes in Utah, the certified tax rate is not adjusted for the effects of general inflation. Over time, the purchasing power of property tax revenues collected is diminished and it may become necessary to eliminate selected programs and reduce service levels in others or “raise” taxes to keep up with inflation. This “downward bias” in the certified property tax rate is illustrated in a hypothetical example in Figure 6 below and Figure 7 on page 10.

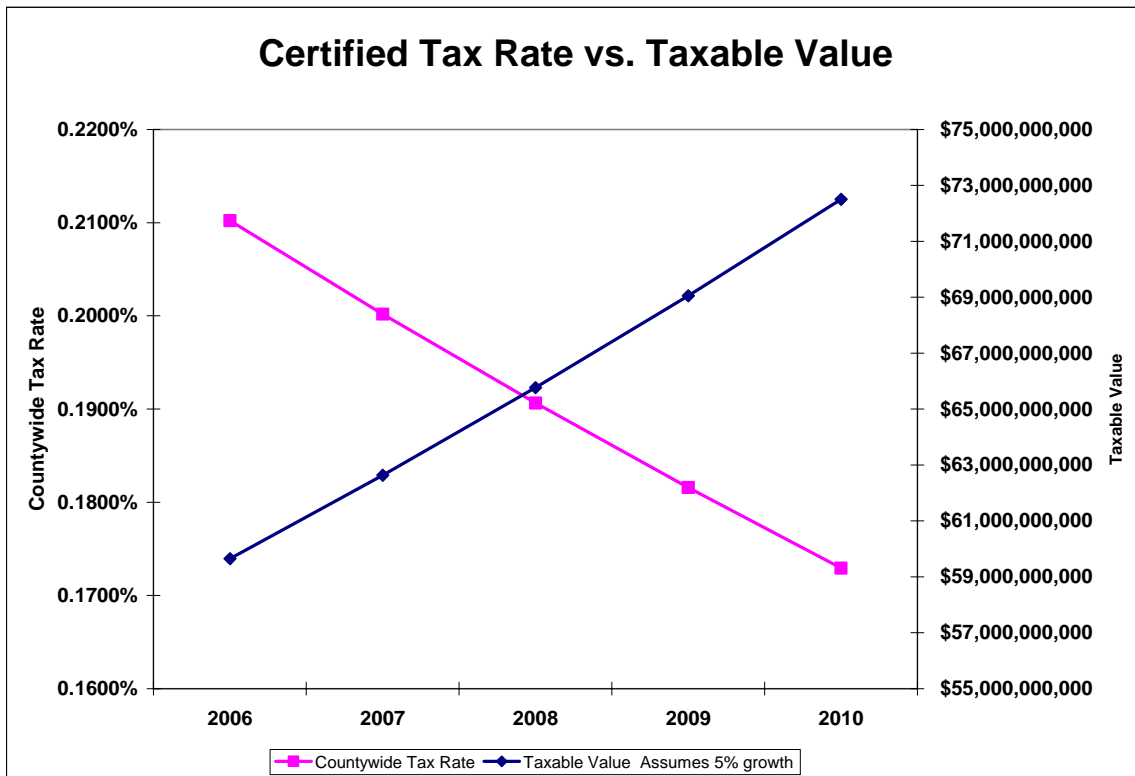


Figure 6. As taxable value increases, certified property tax rates decrease in order to ensure that in aggregate no additional tax revenue is collected. This hypothetical example ignores the effect of new construction growth on taxable value and further assumes taxable values on existing properties will increase annually by 5%. Property taxes collected can only grow as a result of new construction and/or a property tax increase implemented in accordance with statutory requirements (Truth-in-taxation).

Ultimately, we must recognize that political and social philosophy, or rather, the services, protections, and or facilities, that the representatives of the people, the Council, deem necessary, appropriate, or prudent to provide through County Government to its constituents, drive the need for funding and matching fiscal operations and philosophy. When the average citizen hears the term “tax increase” they are left with the impression that their government has determined to provide additional services, an increased level of services, or additional protection.

In Utah that is not necessarily the case. Under Utah law, adjustments for inflation are considered a tax increase, and it is incumbent on us to notify the public of such. This has led to a historical philosophy in the County of conducting major inflationary and/or service level adjustments every five to ten years, resulting in what become large and disruptive property tax increases. To be fair, Truth in Taxation has resulted in relatively low property tax rates when compared to national averages. These low property tax rates undoubtedly stimulate local economic activity in addition to heightened liquidity in our real estate sectors. If the economy in 2007 does not realize the same level of robust growth as 2006, thereby shoring up fund balances, in order to avoid large and disruptive property tax increases in the next five years and balance the budget with reasonable levels of reserve, starting in 2008, the County should either cut expenditures or minimally begin adjusting the certified property tax rates to compensate for inflation and expenditure increases.

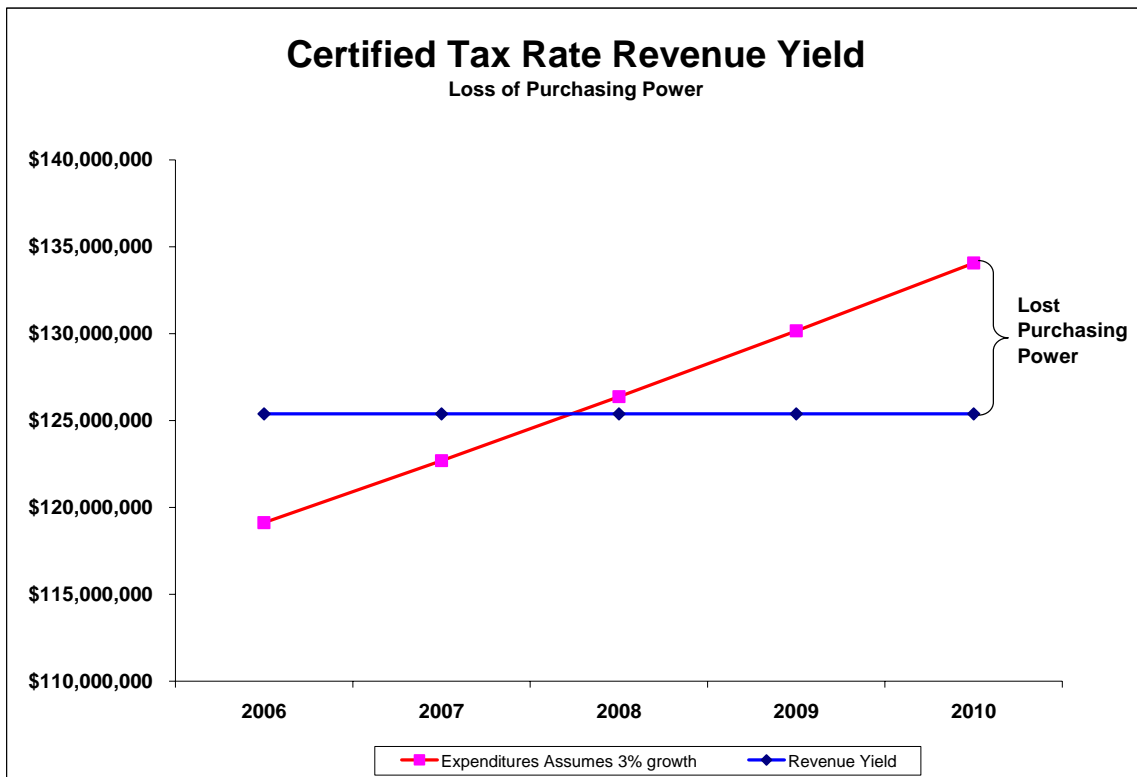


Figure 7. Over time expenditures tend to grow by natural inflation while revenues remain flat (in accordance with current property tax law). This hypothetical example disregards the effect of new construction growth on taxable value.

Structural balance in the General Fund. In 2003 and 2004, actual revenues and recurring incoming fund balance transfers have exceeded expenditures and recurring fund balance transfers out in the General Fund. This structural balance is important to the long-term fiscal health of the County and is a direct result of conservative budgetary and other financial policy decisions made by the Mayor and Council. However, for 2005 through 2007, current year expenditures (2006 and 2007 are budgeted figures) and recurring fund balance transfers out exceed current year revenues and recurring fund balance transfers into this fund (see Figure 8 on page 11). This trend is not readily apparent because of a large fund balance transfer to the Grant Programs Fund each year from the General Fund. For the 2007 Recommended Budget, the budgeted transfer from the General Fund is \$24.2 million which is the planned level of county funding to be included with specific grant revenues received by the County (for delivery of human

services programs). However, this budgetary imbalance should be substantially mitigated by budgetary underexpend.

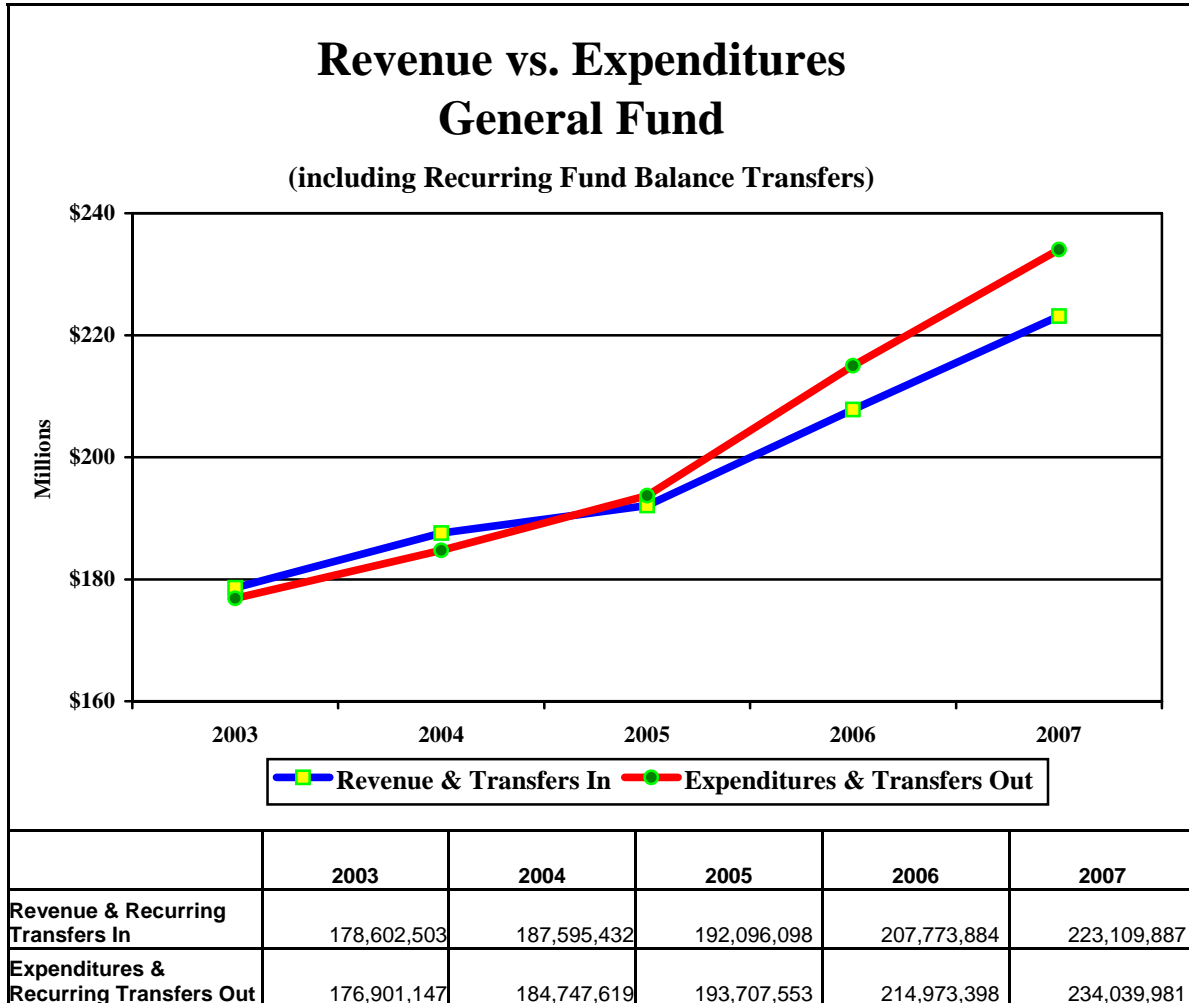


Figure 8. Actual revenues and recurring fund balance transfers in have exceeded actual expenditures and recurring fund balance transfers out in 2003 and 2004. Expenditures and recurring fund balance transfers out slightly exceed revenues and recurring fund balance transfers in during 2005. For 2006 and 2007, budgeted revenues, expenditures, and fund balance transfers were used.

Matching current year expenditures with current year revenues on a budgetary basis is difficult. The downward bias in the certified property tax rate will invariably reduce the weighted average revenue growth rate to an amount that is often less than historical expenditure growth. This effect is particularly exacerbated during an economic downturn as sales tax revenues level off. However, based on our most recent **Long Range Revenue and Expenditure Projection** for the General Fund, the current revenue and expenditure trend should be sustainable through 2009 without invading minimum reserves and jeopardizing the County's bond rating. Projected ending undesignated fund balances and minimum reserves are summarized in Figure 9 on page 12.

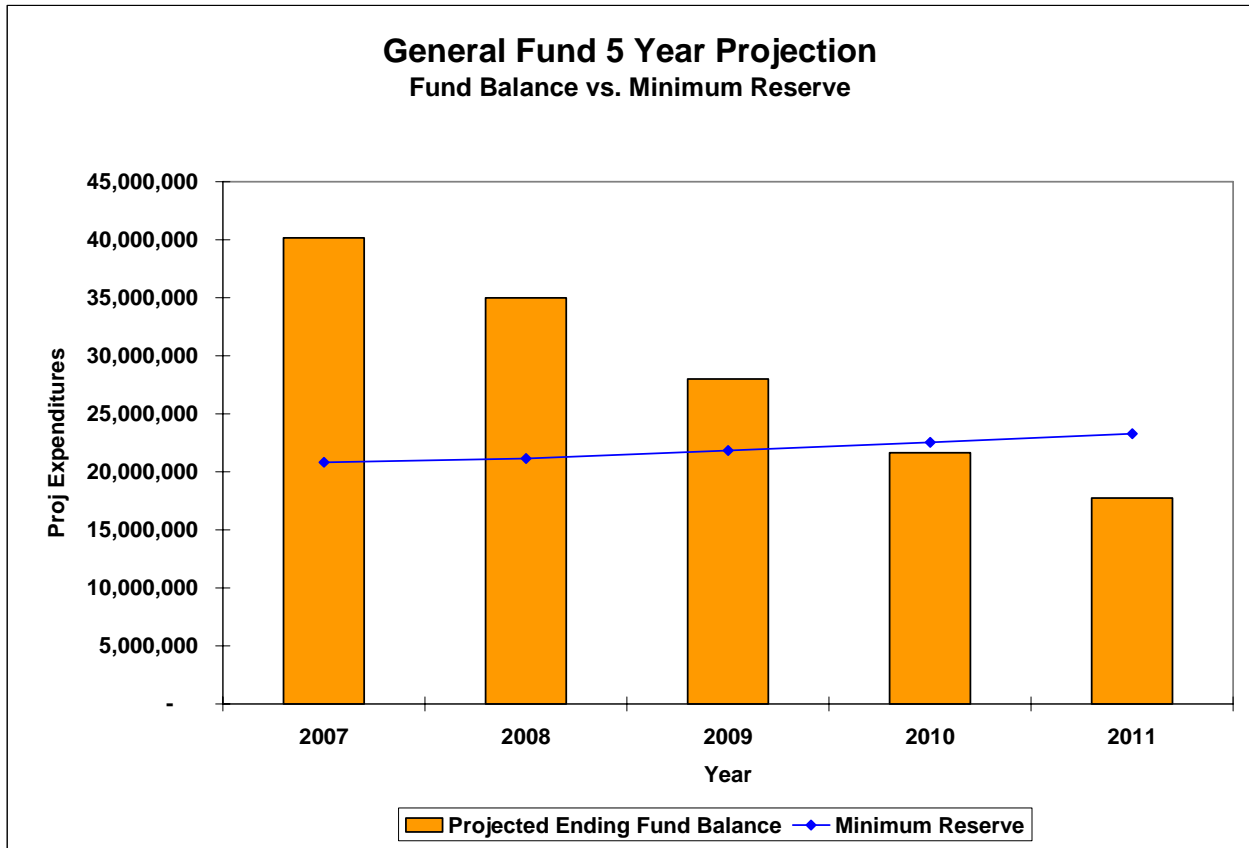


Figure 9. 5-year projection of General Fund year-end fund balance compared to the required minimum fund balance to maintain the County's triple AAA bond rating. Fund balances are projected to dip below the minimum reserve in 2010 without management action.

Sales Tax Revenue Growth. January through September 2006 sales tax revenue has increased dramatically in comparison with the same period in 2005. For example, county option sales tax revenues have increased 13.36% (see Figure 10 on page 13). Growth of this magnitude is unprecedented and substantially exceeds the long-term average growth rate for this revenue source.

Sales tax revenues are highly elastic and fluctuate with economic conditions. When the general economy is doing well, more sales tax revenue will be collected and when the economy is doing poorly, sales tax revenue collections level off and in some instances may decline. Currently the Utah economy is experiencing record growth (see Economic Outlook on page 1) and consequently the County is reaping the benefit of record sales tax revenue. This record growth has helped to mitigate the impact that inflation has had on the County's budget.

One area of concern relates to the amount of local option sales tax revenues the County is receiving. Local option sales tax is imposed on all taxable retail sales occurring in the unincorporated County only. However, in reviewing these revenue distributions, we discovered that the County is receiving a disproportionate share of revenues from the Utah State Tax Commission. The issue relates to the allocation of local option sales tax revenues from telecommunication companies and the accuracy of information provided to the Tax Commission on sales tax returns filed by these companies. We have brought this issue to the attention of the cities and the Tax Commission which recently took action to correct the problem.

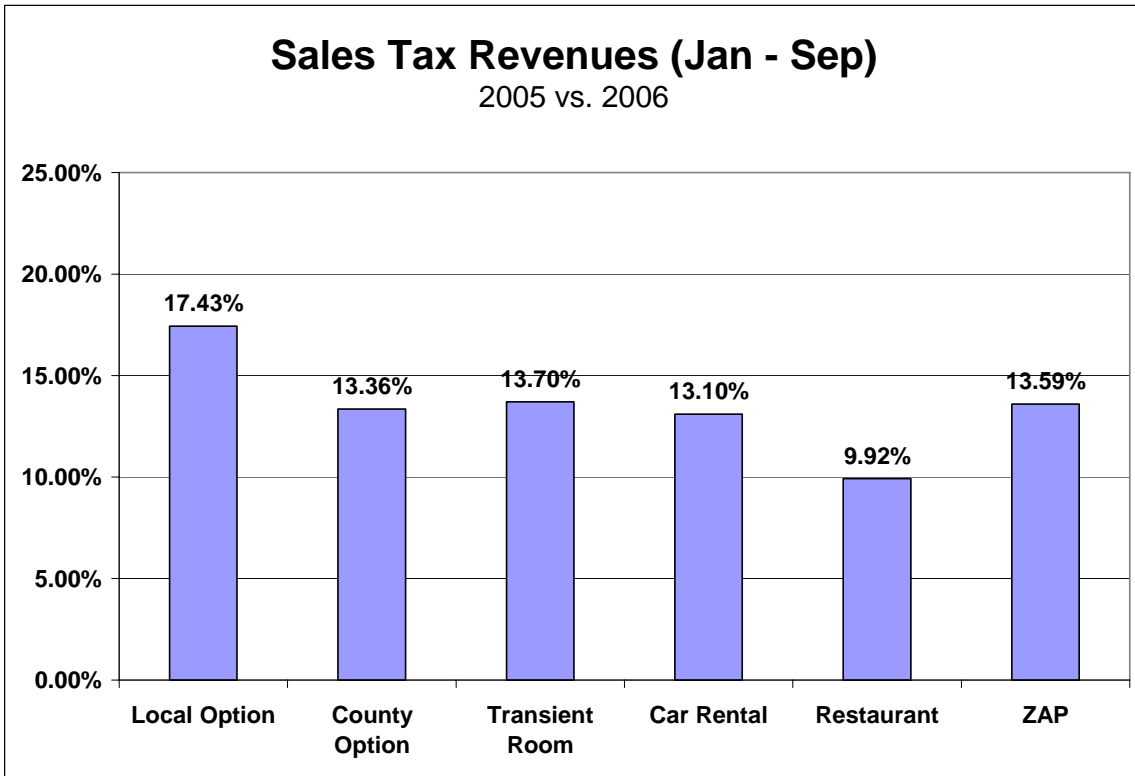


Figure 10. Sales tax revenue has increased dramatically for the 9 month period January–September 2006 as compared to the same period in 2005. The Local Option Sales Tax is applicable to all taxable sales occurring in the unincorporated county and the County Option Sales Tax is applicable to all taxable sales occurring in all unincorporated and incorporated areas of Salt Lake County.

Summary and Closing Remarks

The financial state of Salt Lake County is sound. Our fund balances are healthy and we have the highest possible bond rating for our general obligation debt. Implementation of the Council’s performance measurement initiative has and will continue to improve the quality of information available to policy makers and will ultimately improve the accountability of this government to citizens as long as those systems are duly audited. We continue to move towards a robust and open dialogue between the Auditor, Mayor, and Council on fiscal matters. This public airing of budget issues is one of the benefits citizens can expect to receive from this form of government.

I will be happy to provide further documentation, information, or to answer any questions from the citizens here this evening.