Long-Range Fiscal Strategy

Fiscal Years 2023-28

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EXECUTIVE SUMMARY

The goal of the Long-Range Fiscal Strategy (Strategy) Fiscal Year (FY) 2023-28 is to ensure the Santa Barbara County Air Pollution Control District (District) has sufficient resources to accomplish its mission and mandates into the foreseeable future. In preparing this Strategy, the District carefully evaluated changes to revenue, impacts to workload, current cost-recovery mechanisms for fee-based programs, existing and projected staffing, and potential cost reductions and/or revenue enhancements.

Five years ago, the District brought before the Board of Directors its FY 2018-19 budget. In preparing that budget, the District conducted its first long-range fiscal outlook. That additional step was spurred by the 2015 Plains All American 901 pipeline rupture, which shut down oil and gas facilities dependent on the pipeline for distribution; as a result, the District's revenue from fees associated with annual emission, source testing, monitoring, and reimbursable labor collected from affected oil industry were reduced. Compounding matters, in 2016, Venoco quitclaimed two state land leases and filed for bankruptcy.

The District, anticipating that continued decreased oil and gas activity would have ongoing revenue implications, assumed a fiscally conservative position and received Board support for organizational changes. Those changes — referred to throughout this document as the FY 2018-19 reorganization — included the following measures: 1) implementing streamlining and efficiency measures, 2) reducing the number of full-time positions from 43 to 34, through a mix of retirements and permanently not filling select vacant positions, 3) restructuring agency leadership and Air Quality Specialist positions to serve multiple functions across divisions, and 4) administering equity pay adjustments to ensure staff are compensated at a competitive rate in the employee marketplace. The District's successful implementation of the FY 2018-19 reorganization resulted in long-term savings with expenditure levels kept relatively flat, while managing continued workload increases.

Through that FY 2018-19 reorganization process, the District committed to evaluating its fiscal stability every five years. This Strategy is the next phase of that commitment. In preparing the Strategy, the District conducted a thorough analysis of historical revenue and expenditures, as well as detailed projections over the next five years. This analysis was performed in the context of keeping in place core programs with existing staffing levels and factoring in reduced revenue due to changes in oil and gas activity. These assumptions forecast a budget deficit of approximately $400,000 (i.e., 4% of the District's annual operating budget) in FY 2024-2025, increasing to a deficit of approximately $1.2 million in FY 2027-2028. Developing this Strategy also involved conducting a Cost Recovery and Fee Analysis Study (Fee Study), to analyze the District's cost-recovery metric for fee-based work. That Fee Study found that the District's fees only cover 47% of the time and materials associated with fee-based work, leaving approximately $2.3 million annually unrecovered by fee-paying sources.

Despite prudent budgeting and prior efficiency efforts, today's challenges require additional measures to safeguard the District's financial health and long-term ability to continue fulfilling its mission. Historically, the District has deferred significant fee increases by adhering to fiscal principles that maximize efficiency and minimize costs. The District has annually adjusted fees only by applying the Consumer Price Index (CPI) and has not required across-the-board fee increases since 1991 — more than 32 years ago.

After careful evaluation of all aspects mentioned above, recommendations in this Strategy will provide the District with a long-term mechanism to stay fiscally sound. The District's recommendations for the next five years include: 1) develop a cost-recovery policy for fee-based programs; 2) implement multi-year, phased-in fee increases; 3) adopt fund balance policy; and 4) implement staff retention measure(s).

Today's Challenges

With the FY 2018-19 reorganization, the District was able to stave off raising fees on regulated industry beyond the annual CPI. Today, the District faces new challenges related to its fiscal stability, with revenues projected to decrease due to changes in the oil and gas sector — in addition to rising costs related to pension contributions and health benefits for staff. Simultaneously, workload and unfunded mandates continue to grow, and the staffing crunch being felt by other agencies is similarly affecting the District. These three overarching challenges are explained in detail below.

Fiscal Stability

The oil and gas industry has historically experienced cycles of growth and contraction due to price volatility, market demands, product transportation methods, and technological innovations. However, in recent years, other factors have contributed to accelerated declines in the District's revenues from local oil and gas activity. The 2015 Plains All American 901 pipeline rupture, coupled with the Phillips 66 Santa Maria Refinery closure in early 2023, has continued to have far-reaching effects on oil and gas production in Santa Barbara County. In the last five years, revenue from fees paid by the oil and gas industry has declined, and the District anticipates a loss of approximately $785,000 in revenue over the next five years.

In addition, on the expenditure side, salary and benefits have increased over the past five years, even with the decrease in the number of full-time employees. From modest cost-of-living adjustments, retirement contributions, and District-paid health benefits, the District has experienced a total increase of $972,500, or 18%, in salary and benefits, and anticipates these trends will continue to increase an average of 4% each year.

In response, the District hired Matrix Consulting Group to conduct the Fee Study to determine the cost-recovery percentage achieved by the District using existing fees for the following programs: permitting, compliance, air quality planning, air toxics, source testing, agricultural diesel engine registration, and the hearing board. The current fee structure was established when the District was created, based upon other similar Air Pollution Control Districts. The purpose of this study was to review the existing fee schedule and ensure that it appropriately captures the variety of services provided by the District.

The results of the Fee Study show that, overall, the District is only recovering 47% of its costs to implement those mandated programs. This is due, in part, to the historical reliance on large sources — such as oil and gas facilities — to shoulder the bulk of the fees, a common practice historically used by other air districts as well. More detailed information on the Fee Study is found in the *Results of the Fee Study* section.

Workload Management

Despite changing and threatened revenue streams, the District's workload continues to grow. When the District was formed in 1970, the primary pollutant of concern was ozone. In the five decades since,

Santa Barbara County has seen great improvements in ozone levels. However, the last 50 years have also brought forth new air pollution challenges, with an increasing focus on particulate matter and air toxics, as well as greenhouse gases, which contribute to climate change. Climate change is expected to lead to more wildfires — resulting in more particulate matter — and higher temperatures, resulting in elevated ozone levels. Underpinning many ongoing and new mandated programs, too, is the growing emphasis on environmental justice. Once the District attains the ozone standard, it must juggle the hard work of maintaining air quality standards while addressing these other challenges.

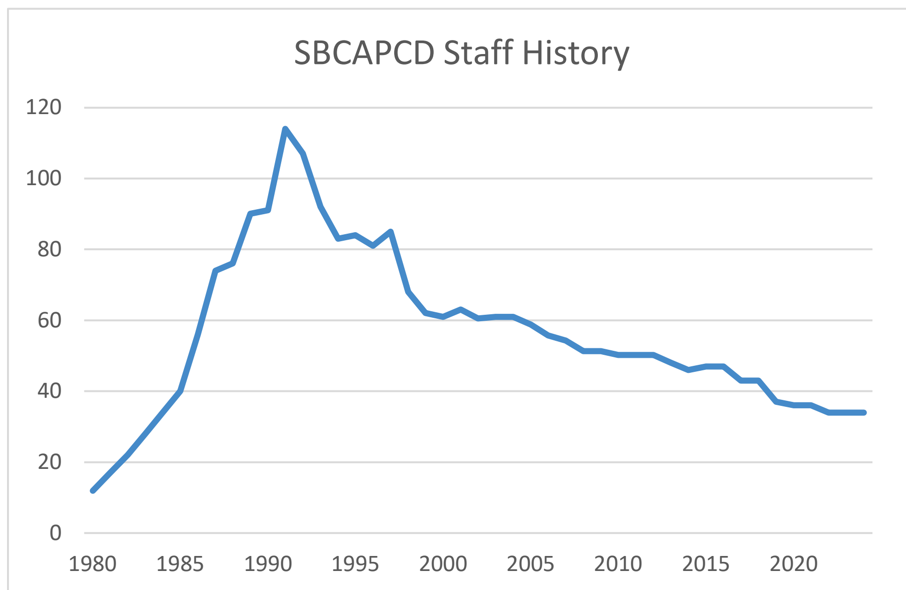
With only 34 staff, each staff member has a full workload with many and varied assignments. While the District has seen decreases in workload for some mandated programs — such as permitting and related ozone planning and rulemaking efforts related to offshore oil platforms — it has not been proportional to revenue decreases. At the same time, there has been a dramatic increase in workload related to, but not limited to, the following mandated State programs: AB 2588 Air Toxics Hot Spots, AB 32 greenhouse gas regulations, and AB 617 Community Air Protection. In addition to increasing mandates, the District's administrative overhead role with grant and incentive programs continues to grow; these programs provide a great benefit to businesses and communities and serve a critical role in reducing emissions from sources outside of the agency's regulatory authority. However, all these workload increases have insufficient funding to cover the associated costs.

At current staffing levels, growing mandates have prevented completion of lower-priority work that could provide important local air quality benefits. For example, the District's surveillance inspection program — an important tool to ensure a level playing field for compliance — is not mandated, requires a lot of staff time to equitably apply, and is easy to be pushed aside when staff resources are tight. The District prides itself on providing excellent customer service to the public and regulated businesses, but current staffing levels sometimes mean unavoidable delays. For example, over the last five years, while the District has remained within its performance parameters for completing permit actions, the overall time it takes for these actions has increased.

The District has undertaken extensive efficiency measures over the past several years to increase productivity with reduced staff, such as in-house database automation and paperless systems. The District will need to expand additional streamlining and automation tools to keep up with anticipated workload increases. However, implementing additional efficiency measures also requires substantial staff time and investment before the benefits are realized.

Staff Retention

The District is currently operating with its leanest workforce since the 1980s. In the last five years, the District has also been challenged with a high rate of staff turnover: each year, almost four full-time employees — approximately 11% of its workforce — leave the District.



This turnover consumes the agency's time and resources for recruitment and training, and due to the small size of the District, detracts from the entire agency's ability to accomplish the workload. It takes a year to evaluate whether a new employee will pass probation. Over the last five years, the average tenure of staff who pass probation but leave the District for other opportunities has been two years.

The District's current workforce also has a lower average tenure than what the District has historically experienced, due to retirements of long-serving staff and those positions being filled by individuals starting their careers. Since the FY 2018-19 reorganization, the District has seen eight retirements totaling more than 200 years of service, with an average District tenure of 25 years. Looking forward, 15% of District staff — who each have more than 30 years of experience — are of retirement age. The average number of years of service is currently nine, with 41% of staff having less than five years of service.

In the wake of the COVID-19 pandemic, the cost of living in Santa Barbara County has skyrocketed above what were already-high levels compared to other areas of California. U.S. News & World Report recently named Santa Barbara the fifth-most expensive place to live in the nation[1]. Average home prices have increased by 26% in Santa Maria and 16% in Santa Barbara in the last two years[2]. As of April 2023, the median home price was $597,500 in Santa Maria, and $1,785,500 in Santa Barbara. The rental market is seeing even more drastic increases; in the last two years, the average rent for a two-bedroom apartment has increased by 45% in Santa Maria and 40% in Santa Barbara[3].

Those economic realities present another complication for staff recruitment and retention. Together, all issues mentioned above emphasize the importance of both succession planning and maintaining and enhancing retention measures so that the District can remain a competitive employer, minimize turnover and the associated workload disruption, and encourage continued service by staff as their institutional knowledge and experience grows.

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[1] 25 Most Expensive Places to Live in the U.S. in 2023-2024 | U.S. News (usnews.com)
[2] Santa Maria Housing Market: House Prices & Trends | Redfin and Santa Barbara Housing Market: House Prices & Trends | Redfin
[3] Average Rent in Santa Barbara, CA and Cost Information - Zumper and Average Rent in Santa Maria, CA and Cost Information - Zumper

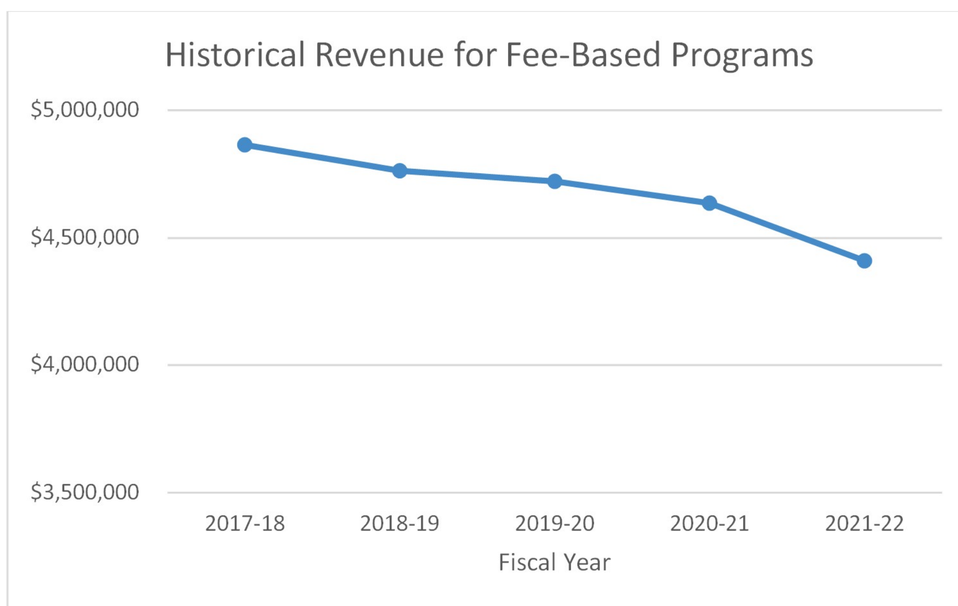
Despite numerous cost-cutting measures implemented by the District in the past five years, further strategies are now needed to address the expected impacts from decreasing revenues, increasing mandates, and ongoing staffing challenges.

Revenue Overview

The purpose of this FY 2023-28 Long-Range Fiscal Strategy is to evaluate the existing and projected future staffing and financial resources of the District, and to identify potential revenue enhancements and/or cost reductions to ensure fiscal stability and continued capacity to accomplish the agency's mission and mandates.

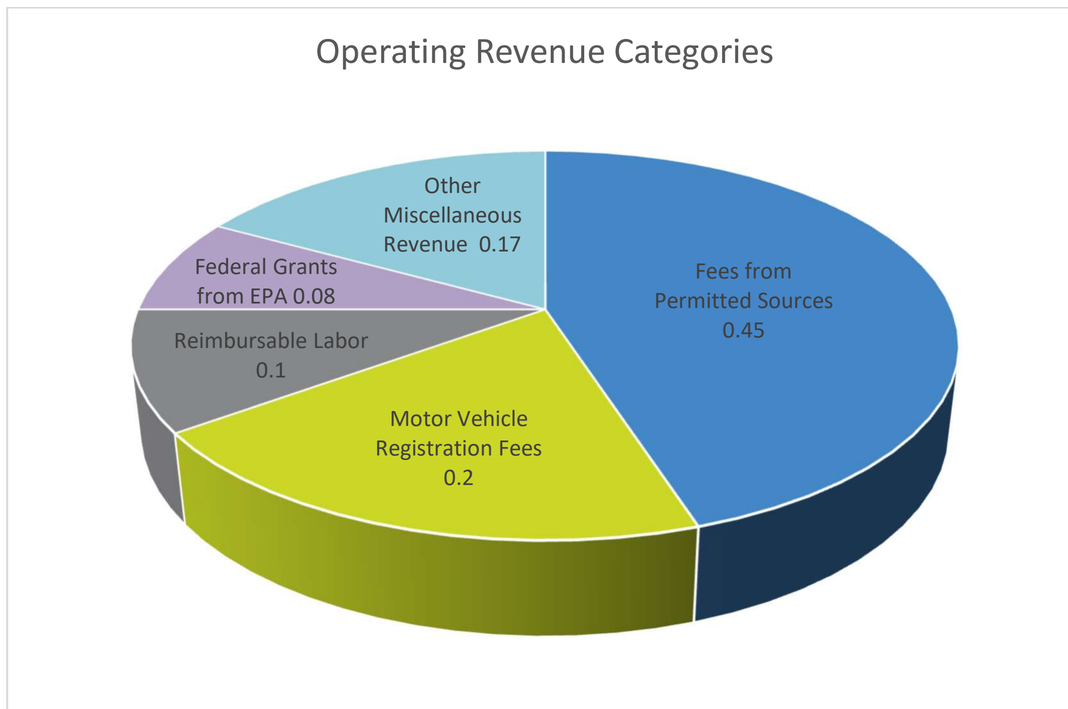
Long-Term Revenue Trends

California law and the Health and Safety Code provide the District with the ability to fund its activities through a combination of Permit Fees, which are the scope of the Fee Study; Grants; Subventions; Penalties; and Vehicle Registration surcharges. All revenue streams cover mandated programs and non-mandated programs that provide public health benefits and contribute to local communities.
Below is a graph that shows the revenue trend over the last five years for many of the District's fee-based programs, including permitting and compliance, air quality planning, air toxics, source testing, and hearing board fees — all of which were analyzed in the Fee Study. The chart shows that, over the last five years, the District has experienced an overall reduction in fee revenue of approximately 10%. This is mainly due to the decrease in oil and gas activities. Due to this decrease, over the next five years, the District's conservative projection is a continued revenue reduction of approximately $785,000.



This expected revenue reduction is two-pronged: 1) reduced oil and gas activity, and 2) as further explained in the *Results of the Fee Study* section, the District is under-recovering fee-based revenue. Looking at the District's operating revenue, fees from permitted sources typically provide approximately 45% of the District's total operating revenue. Motor vehicle registration fees comprise another 20% of

the operating revenue, reimbursable labor work account for 10%, and various other revenue streams account for the remaining 25%.



The various other revenue streams used for operations, captured under "Other Miscellaneous Revenue" and "Federal Grants from EPA" in this chart, include:

- Federal EPA Section 103 and 105 grants;
- Portable Equipment Registration Program (PERP) monies from the State;
- Subvention grant funds from CARB; and
- Smaller grants that help fund specific programs. (Examples include Prescribed Burns, Oil & Gas regulation, E-BAM cache, and the AB 617 program implementation.)

These other revenue streams are only received when funds are available through the state or federal governments. Over the last five years, these revenue streams have contributed approximately $3 million annually to the District.

Despite the cost-recovery shortfall in fees, the District has operated with a balanced budget because other revenue sources have filled the gaps in our various fee-funded programs. Ultimately, this practice is not sustainable, and the District should not be relying on these other revenue sources to subsidize permitting and compliance work. Of note, the California State Auditor has stated that while Air Districts have the discretion to utilize vehicle registration revenues for fee-related services, they should utilize those funds to help offset mobile emissions and improve air quality through those programs rather than subsidize permit holders.

The last noteworthy revenue category is pass-through grant funds, which are received by the District to distribute to third parties for voluntary emission-reduction projects. The grant funds help local businesses and organizations replace old diesel engines with cleaner technologies. Grant funds are also used to expand electric vehicle (EV) infrastructure and technologies, and for incentive programs to

replace gas-powered landscaping equipment with electric options. These funds have specified uses and are not eligible to cover District operations. These pass-through grants come with administrative funds to help with the District's implementation, yet these funds are often not enough to fully cover implementation costs. On average, over the last five years, the District has received approximately $275,000 annually for grant administration; however, it costs the District approximately $520,000 annually to administer the programs.

Results of the Fee Study

The District issues permits for stationary sources of air pollution, and charges fees for those permits. For long-term fiscal stability, these permit fees should cover the costs related to staff's work in the permitting program and not be subsidized by other revenue sources. This Fee Study, finalized in May 2023, was conducted to determine the cost-recovery percentage of the District's existing fee schedule. The Fee Study did not evaluate all sources of District revenue for cost recovery. Specifically, the Fee Study excluded annual emissions fees, DAS and monitoring fees, reimbursable labor charges, the asbestos program, and revenue from various grant sources.

The Fee Study analyzed the cost-of-service relationships that exist between the District and the regulated community in relation to facility/equipment fees for the permitting and compliance programs, air quality planning, air toxics programs, and source tests. The results of the study provide a tool for understanding current service levels, the cost recovery for those services, and what fees for service can be legally charged.

The Fee Study shows that the District is not fully recovering costs for implementing the various fee-based programs and is under-recovering costs for these programs by approximately $2.3 million per year — a cost-recovery percentage of only 47%. The largest contribution to the deficit is fees related to permitting and compliance programs. Detailed Fee Study results by fee schedule are shown below.

Annual Cost Recovery Analysis Provided by Matrix Consulting

Fee Schedule	Revenue at Current Fee[4]	Total Annual Cost	Annual Surplus / (Deficit)	Cost Recovery %
A – Equipment / Facility	$1,157,439	$1,923,856	($766,417)	60%
B-1 Air Quality Planning	$344,135	$428,347	($84,212)	80%
B-2 Air Toxics	$113,970	$259,352	($145,382)	44%
C – Source Testing	$105,321	$178,882	($73,561)	59%
F - Miscellaneous	$327,537	$1,525,322	($1,197,785)	21%
Agricultural Diesel Engines	$24,360	$70,701	($46,341)	34%

[4] The Revenue at Current Fee is calculated by taking the 3-year average of workload information (FY19, FY20, and FY21) and multiplying it by the FY22 fee rate.

TOTAL	$2,072,763	$4,386,460	($2,313,697)	47%

Other notable findings from the Fee Study include:

- $628,000 annual shortfall from Fuel-Burning Equipment fees,
- $468,000 annual shortfall from Minimum Permit Reevaluation Fees, and
- $485,000 annual shortfall from Gasoline-Dispensing Facility fees.

Many air districts' fee schedules work, by design, in a progressive fashion. Larger sources of air pollution — such as oil and gas industry sources — pay higher fees than smaller sources, based on the size and quantity of equipment they install and the mass of pollutants they emit. In some cases, the fees collected from larger sources may have historically offset some cost-recovery shortfalls from the fees collected from most smaller sources. Therefore, the recent and projected loss of several larger sources is anticipated to create a disproportionate loss of revenue due to the progressive nature of the District's fee structure; other air districts have experienced similar disruption in recent years. If the agency's fee schedules are maintained at current levels, the District will continue to experience even larger fee revenue shortfalls and more difficulty balancing budgets in the future.

For the District to ensure ongoing fiscal equity and sustainability, it is important that the fees charged cover — but not exceed — the costs for implementing the services provided. The results of the Fee Study show the District is not adequately recovering fees for the cost of its work across the majority of its fee-funded programs, and changes to both fee schedules and operating practices are necessary.

EXPENDITURE OVERVIEW

District Workforce and Workload

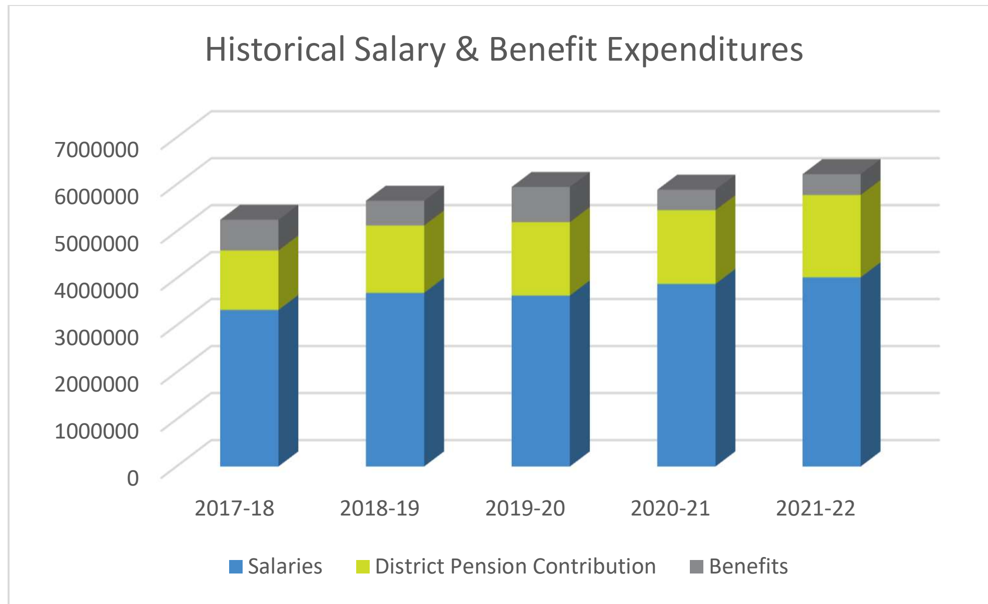
District operating expenditures pay for goods and services needed to run the District efficiently. Examples of these expenditures are employee salaries, retirement contributions, medical benefits, and worker's compensation insurance. Services and Supplies is another expenditure group and includes things such as utilities, rent, legal fees, training, travel, office expenditures, and repairs and maintenance to equipment. Lastly, there are "other expenditures," covering the District's fleet costs, liability insurance premiums, and any other miscellaneous expenditures that might not be captured in the categories above.

The District currently employs 34 permanent, full-time staff, plus temporary part-time college interns and extra-help employees who work on specific projects. In implementing the FY 2018-19 reorganization, the District streamlined all program areas to accommodate the rising workload amid ongoing budget constraints. These efforts have significantly improved efficiency, but staff workload remains high. Further staff reductions would mean significant impacts to the execution of core programs and customer service and place the District in a precarious position during unexpected air pollution challenges.

Long-Term Expenditure Trends

Each year, District expenditures are programmed to match revenues, making a balanced budget. Therefore, planned revenues cover all operational expenses. Periodic expenses (e.g., capital improvements) are paid through fund balance accounts (i.e., savings) specifically designated for those items.

Salary and benefit expenditures have increased over the past five years, even with the decrease in staff. Salaries have increased by approximately 11% due to modest cost-of-living adjustments, and the District's retirement contribution has increased almost 40%. District-paid health benefits are also on the rise — a 17% increase over the last five years. The District anticipates these trends to continue, where salary and benefit expenditures continue to increase, on average, 4% each year.

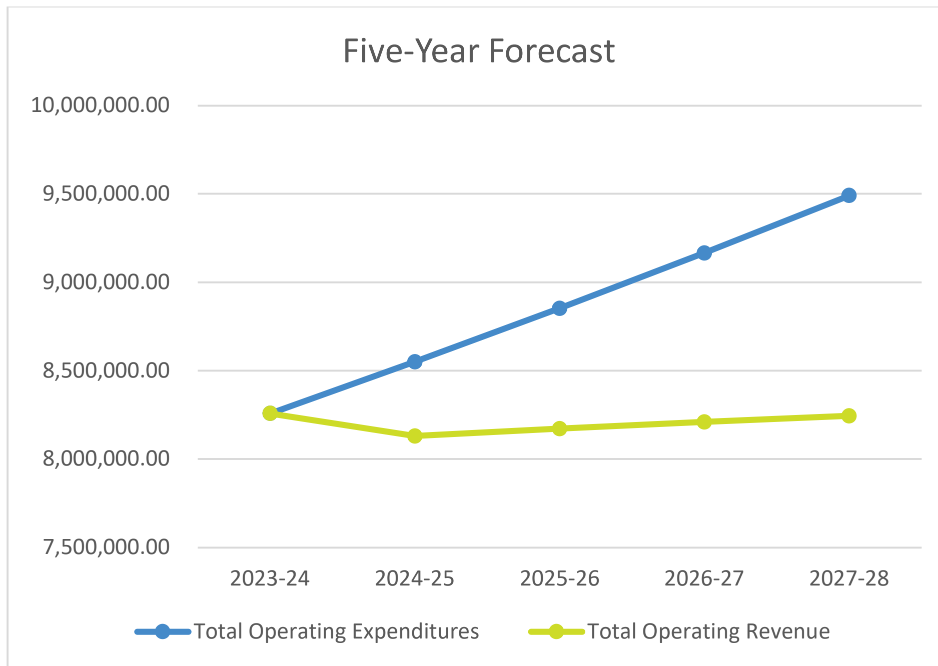


The Services and Supplies (S&S) category has remained steady over the last five years, with a minor increase of less than 1% and an average total of $3.8 million per year, which includes pass-through grant funds. When looking solely at operating expenditures over the last five years, the District has decreased S&S expenditures by almost 15%. The District anticipates ongoing expenditures to remain steady over the next five years with minor fluctuations (including a 2% increase factor to capture any utility increases). For the implementation of future efficiency measures, additional S&S funds will be needed.

However, even with ongoing streamlining and cost-cutting over the past several years, the District finds itself reaching the point of diminishing returns where further significant cuts would seriously impede the agency's ability to accomplish its mission, comply with mandates, and meet its customer service goals. While the District is committed to continuing to explore additional efficiency measures, embarking on such measures requires significant up-front staff time and resources, and efficiency measures alone would not be sufficient to prevent future budget shortfalls. Moving forward, consideration of any further significant expenditure reductions should take the following into account: 1) Air quality and public health protection must be maintained consistent with state and federal mandates and in alignment with the District's Strategic Plan, and 2) Essential facilities, infrastructure, and equipment must be maintained at reasonable levels.

STRATEGIES TO ENSURE FINANCIAL & OPERATIONAL STABILITY

As summarized in the two sections above, it is anticipated that the District will face a shortfall in operational revenue in the near future. The chart below represents the forecasted revenue and expenditures over the next five years. This is considered a base case scenario that incorporates projected reductions in oil and gas activity associated with the known decommissioning of some of the oil and gas platforms off the coast of Santa Barbara County.



Expenditures were calculated using the following assumptions:

- Maintaining the existing 34 full-time staff,
- 4% increase annually for salaries, pension costs, benefits,
- 2% increase for Services and Supplies, and
- 3% increase in all other expenditures, which covers insurance premiums and fleet costs.

Assumptions for revenue were based on historical values related to general revenue increases (1.24%) as well as annual CPI increases (2.92%). Illustrated in the chart above, if the District continues to operate without any fee increases, operating expenditures will surpass operating revenue by approximately $400,000 in FY 2024-25 (i.e., a deficit of 4% of total operating budget) and will grow to a shortfall of more than $1.2 million by FY 2027-28.

As the District moves forward, the District will continue to place high reliance on expanded use of efficiency strategies, such as electronic permit application submittals and annual emissions inventory data. The District also plans to expand cross-training of staff to better address workload demands within and among divisions. In addition to continued efficiency efforts, the proposed strategies outlined below will be integral to the District's financial and operational stability.

Adopt and Implement Cost-Recovery Policy for Fee-Based Programs

To ensure the District's time and materials are accounted for when processing permits and working with sources, the implementation of a cost-recovery policy will ensure that the District has a long-term mechanism to stay fiscally sound. The District's historical approach for only implementing the CPI has not provided the necessary cost-recovery mechanism. Prior to conducting the Fee Study, the District's intent was to secure cost-recovery close to 100% for the services and time required to manage the permit and compliance programs. The Fee Study showed that the District's operations currently fall well below the target of 100% cost-recovery. For many air districts, a standard policy is to reach 85% cost-recovery. While 100% cost recovery would be ideal, it could be difficult and burdensome to achieve.

The California Health & Safety Code provides air districts with the authority to adopt fee schedules to cover the costs to implement a stationary source permitting program. Increases in fees are required to be capped at 15% per year. With that Health & Safety Code restriction, continued application of CPI adjustments, and the significant gap between the current cost-recovery of 47% to the recommended metric of 85%, it will take a multi-year, phased-in approach for the agency to reach its cost-recovery goal. This phased-in approach would also ease the transition for regulated industry.

The goal of reaching an 85% cost-recovery could be accomplished by applying a certain percent increase over multiple years. The higher the percentage, the sooner the target of 85% could be achieved (e.g., 15% increase per year would reach 85% over 5 years, 10% increase per year over 10 years, and 5% increase per year over 15 years).

District staff are recommending a phased-in fee increase of 10% per year over the next 10 years. Over the five-year outlook of this Long-Range Fiscal Strategy, the cost recovery would increase from the current 47% level to 66% cost recovery in FY 27-28.

Consider Potential Changes to Rule 210

In analyzing the District's Fee Rule (Rule 210), it became clear that there are several areas where the current fee schedule does not provide a mechanism for the District to recover costs for associated work. To address these shortfalls, the following new fees are currently being evaluated and will be presented during a public workshop prior to adoption: Part 70 application filing fee, minimum permit evaluation fee, partial permit transfer fee, confidential information handling fee, Interim Permit Approval Program (IPAP) fee, annual emergency standby diesel-engine fee, annual gas station fee, cannabis facility/equipment fees, Health Risk Assessment (HRA) screening fee, school notice fee, ERC processing fee, and CEQA fees. In addition, expansion of applicability to the existing Air Toxics fees and Air Quality Planning fees is also being evaluated to ensure these fees allow the District to recover its costs for implementing the associated programs. By modifying Rule 210 to include new fee categories, and expanding the applicability for two existing fee categories, the District would be able to secure fees from sources whose work is currently subsidized by other non-permit revenue sources. The estimated increase in revenue from these potential changes to Rule 210 is approximately $700,000 in FY 24-25, increasing to approximately $770,000 in FY 27-28 due to the application of CPI adjustments.

Adopt Fund Balance Policy at 15% - 20% of Operating Budget

The District proposes to create and adopt a fund balance policy. A fund balance policy establishes minimum reserve levels to ensure stable services, meet future needs, and protect against financial instability. According to the Government Finance Officers Association (GFOA), the recommended best practice is the general fund reserve account should be no less than what will meet the average cash flow needs of the District for no less than 60 days. Based on this best practice, a policy set at 15 - 20% of the District's operating budget, approximately $1,500,000 - $2,000,000, will establish an appropriate level to meet the demands of the District during periods when revenues are not available. This policy is important to continue the fiscal health of the District.

Approve Staff Retention Measure

Due to the District's size and structure, there are limited promotional opportunities after a certain point of employment. The District proposes to evaluate longevity strategies for employees who reach milestone years of service with the goal of retaining staff who have grown in their position and become efficient at carrying out essential workload. The implementation of the staff retention measure could add additional expenditures in FY 2025-26, increasing the overall deficit.

STAFF RECOMMENDATIONS

These above-mentioned strategies will be brought before the District Board of Directors for consideration according to the following timelines:

- **Adopt Cost-Recovery Policy for Fee-Based Programs**: By January 2024, bring a policy back to your Board for consideration that would be phased in over a number of years. If approved, Rule 210 fee increases would occur over 10 years and be included in the annual budget process.

- **Consider Potential Changes to Rule 210**: A public workshop and Community Advisory Council meeting would occur before changes are brought to your Board. Two Board meetings will be required and are expected to occur within Fiscal Year 2023-24.

- **Adopt Fund Balance Policy at 15-20% Operating Budget:** Within Fiscal Year 2023-24, a policy will be brought back to your Board with the proposed budget for FY 2024-25.

- **Approve Staff Retention Measure(s):** To be determined; measure(s) will need to be negotiated with the District's represented employee bargaining units during the normal collective bargaining process, which is scheduled for early 2025.