First 5 LA

FY 2019 – 2028 Long Term Financial Plan
(July 1, 2018 – June 30, 2028)
SUBJECT:
The ten-year Long-Term Financial Plan is presented to the Board of Commissioners for action informed by a discussion and feedback from the combined Budget and Finance and Executive Committees in June 2020.

LONG TERM FINANCIAL PLAN

First 5 LA has annually prepared a long-term financial projection which forecasts future revenues and fund balance, assuming spending trends continue as forecasted and approved. The projection allowed us to test what the future would look like and it helped the Commission establish financial guardrails to inform future budgeting and spending. Given First 5 LA’s declining revenues, fund balance and increased priority on addressing sustainability, First 5 LA staff, with input provided by the September 24, 2019 joint meeting of the Executive and Budget & Finance Committees, is moving to implement a higher degree of fiscal discipline through the adoption of a long-term financial plan in place of the long-term financial projection. While both processes provide important planning and context for the Board on future spending, the Long-Term Financial Plan will change how the organization plans for the long-term, adjusting to the organization’s fiscal reality and 2020-2028 Strategic Plan goals and establishing spending limits for outer years which will help us to better manage our ever-decreasing fund balance. The future spending limits, grounded in an 85%-15% maximum split of total expenditures between programmatic and administrative costs, respectively, will require changing current norms but also promote shared resources and decision making across the organization to leverage and maximize resources and partnerships. Deviations from the established annual limits will require Board review and approval.

I. Introduction: Purpose of the Long-Term Financial Plan

This FY 2020-2028 is the first Long-Term Financial Plan (LTFP) which is a pivot from our former Long-Term Financial Projections. The intent of the process continues to be the support the financial stewardship role of the Los Angeles County Children and Families First Proposition 10 Commission (“Commission”), i.e. First 5 LA, by projecting the long-term implications of fiscal actions taken by the Board of Commissioners (“Board”). This 10-year plan includes a multi-year outlook of current anticipated revenues, as well as established annual administrative and programmatic limits against forecasted revenue.

Each year the LTFP is presented to the Board in advance of the annual budget process in order to provide context in which budget funding decisions will be made. The July 1, 2018 through June 30, 2028 plan period includes one year of historical actual expenditure data with more details provided for the upcoming proposed FY 2020-21 budget year. Resources for years 4 through 10 are reflected at a higher annual level reflecting the future funding direction of an 85%-15% distribution of spending between programmatic and administrative work. The long-term financial plan will be used to strategically plan and manage future year’s expenses and Fund Balance drawdowns.

Specifically, the Long-Term Financial Plan utilizes the following overarching approach:
- Uses the most recent audited fund balance as a starting point (July 1, 2018 - June 30, 2019);
- Includes updated revenue forecasts based on the most current available data from the California Department of Tax and Fee Administration (CDTFA);
- Includes spending in support of Strategic Plan goals;
- Includes project expenditures for all initiatives approved by the Board, including those that have received a multi-year allocation and legacy investments that have received a multi-year award; and
- Forecasts ending fund balance for each fiscal year through June 30, 2028.

The LTFP will formally assign future funds through the end of the term (June 30, 2028). Outside of the LTFP process, funds must be reviewed, amended and formally committed as part of the annual budget process approved by the Board or through a Resolution that specifically commits funds for an initiative or program in a manner consistent with First 5 LA’s Governance Guidelines.

II. Methodology/Approach

Staff used the FY 2018-19 actuals, FY 2019-20 mid-year revised budget, FY 2020-21 draft budget and seven years of forecasted totals through FY 2027-28.

The LTFP was developed using the following approach and methods:

- The baseline year for this Long-Term Financial Plan is the FY 2018-19 audited actual expenditures, as reflected in section A of this memo.
- FY 2019-20 estimates expenditures using the mid-year revised budget estimates of $134,096,358 million, an increase of $379,000 to the anticipated spending for FY 2019-20.
- As part of the action taken to approve the FY 2019-20 Budget in June 2019, multi-year commitments and allocations were reauthorized. This schedule of commitments and allocations, known as the GASB 54 schedule, was approved by formal Resolution and designates funds for those specific purposes as directed by the Board. Final year-end balances for these commitments are available in First 5 LA’s annual official audit, the Comprehensive Annual Financial Report (CAFR), for the fiscal year ending June 30, 2019.
- The Commission’s annual budgeting process has historically authorized expenditures in two areas: Program and Operating. FY 2020-21 is the final year that will reflect this structure. Moving forward, the total budget expenditures will be split – 85% for programmatic needs and 15% for administrative needs, as was determined through the Strategic Plan Refinement process by an assigned Strategic Refinement Team. The designated team assessed short-term and long-term goals and the most effective approaches to financial management. This recommendation was presented to the Budget & Finance Committee for feedback in September 2019. Due to the timing and additional work needed to establish the detailed breakdown, the LTFP is presented at a high-level cost distribution. The LTFP reflects annual totals based on the future structure, as follows:
  - Program Budget – Program expenditures include ongoing multi-year allocations, as well as annually developed, refined approved program funding in support of, and aligned to, the Strategic Plan. This also includes all operational expenses in support of programs, including but not limited to salaries, supplies, consultant services, travel expenses, and professional development. This area has a cap of 85% of annual organization-wide spending.
Administrative Expenses – These costs include salaries of Executive, Directors, Administrative Assistants, Administration Division staff, Communications department staff, expenditures related to the Board of Commissioners and facilities with a cap of 15% with 5% flexibility during transitional years of strategic planning of annual organization-wide spending.

III. Assumptions

Compared with the long-term projections prepared and approved in previous fiscal years, this long-term plan incorporates five primary changes to the overall assumptions, each of which is discussed in more detail below:

1. Transitioning away from a long-term projection to a long-term plan which will change how resources are distributed, captured and categorized in the budget between program and administrative.
2. The long-term plan will span a ten-year period of annual estimates, versus the five-year period previously shared through the long-term projections.
3. As indicated in the Methodology/Approach Section II, resources will be classified as “programmatic” costs or “administrative” costs with an 85%-15% split, respectively. Operational resource needs will be budgeted in the appropriate category. These caps are applied from FY 2021-22 through FY 2027-28. Prior to FY 2021-22, the annual budget structure is largely aligned to the 2015-2020 Strategic Plan structure (priority outcome areas in lieu of strategic priorities).
4. For long-term projection and planning purposes, the plan assumes that spending for FY 2021-22 through FY 2027-28 will remain on a consistent annual rate of decline of approximately 6.42% -- 85% of the total will be designated as program costs and 15% will be designated as administrative.
5. **Increasing the reserve from 25% to 50%**

   The increase to the reserve is contingent on Board approval of changes to Policy #A-2301 at the July 9, 2020 Meeting of the Board of Commissioners, included for approval within Resolution #2020-06.

A. **Beginning Fund Balance**

The FY 2018-19 beginning fund balance utilized in the LTFP reflects the most recent audited ending fund balance per the Comprehensive Annual Financial Report (CAFR) for the fiscal year ending June 30, 2019. Beginning fund balance in future years is calculated based on projected revenue and expenditures for the prior year.

B. **Revenue**

The Commission is funded through the Proposition 10 Tobacco Tax, 80% of which is distributed to the County Commissions based on their proportion of statewide births. Los Angeles County receives the greatest share, representing approximately 24-25% of the total County allocations. Tobacco tax revenue, projected to be roughly $71.7 million in FY 2019-20, is anticipated to continue declining in future years based on the most recent estimate from the California Department of Tax and Fee Administration (CDFTA), which forecasts an average annual decline of approximately 3-4% in tobacco tax revenue. Following the decline in revenue in FY 2017-18 due to the first-year implementation of Proposition 56, insufficient information has been shared by the State regarding the backfill calculations and methodologies. As such, the First 5 LA Finance department is taking a cautious approach in the calculation of Proposition 10 and Proposition 56 revenue by adjusting the State’s projections...
downward by an additional 2% for the purposes of this analysis. In accordance with standard practice, staff will continue to monitor and make the appropriate adjustments as information is received. Additionally, staff will continue to monitor actual revenue relative to the projections to analyze the impact these declining resources may have on the organization’s fiscal position.

Interest earnings are projected based off the average rate of return on anticipated cash balances for the first quarter of FY 2019-20 of 1.2%, with assumptions made for consistent market conditions across the years reflected in the LTFP. Interest earnings for FY 2019-20 are projected at approximately $4.7 million. In addition, the Other Revenue category also includes IMPACT funding being received by First 5 LA from First 5 California.

C. Program Expenditure Assumptions

The baseline for the current long-term financial plan is grounded on the assumption that the Board will invest in the implementation of the approved 2020-2028 plan to achieve the strategic priorities outlined through FY 2027-28. The current projections also assume a fixed annual rate of revenue decline for the strategic plan term. Programmatic investments will distribute 85% of the total annual spending limit to carry out activities aligned with our strategic plan that continue to move us in a direction of policy and systems change work in alignment with our values, investment guidelines and desired results. Funding is also assumed for enabling investments—such as Communications, Policy & Strategy, and Integration & Learning—that do not have committed multi-year allocations and support the ongoing and new work of the organization.

Specific investments will be presented to the Board on an annual basis through a refined spending plan based on updated information. Additional detail related to the investment estimates for FY 2020-21 are included in the FY 2020-21 budget materials.

D. Program Expenditure Assumptions – Legacy Investments

The expenditure projections contained in the LTFP were developed based on the following overarching assumptions:

- Consistent with the Governance Guidelines, all initiatives and programs are assumed to end according to the Board-directed timeframe. This includes the following Legacy investments that are projected to sunset in by June 30, 2020: Black Infant Health Program and Parent Child Interaction Therapy.
- Fidelity to existing approved allocations and other funding decisions made by the Board. Funding for Little by Little/One Step Ahead is assumed to fully exhaust the original $30 million allocation award, as approved by the Board in November 2018. The final cycle of Baby Friendly Hospitals is scheduled to end in FY 2020-21.

E. Operating Expenditure Assumptions

The Revised FY 2019-20 Operating Budget of $22.83 million included assumptions related to staffing, salary and benefit costs, and other operating costs. The FY 2020-21 Draft Budget proposes $22.80 million in operational costs to support the organizational needs. Beyond FY 2020-21, the long-term plan methodology assumes that operational costs in support of program activities (including staffing) will be included in the overall 85% programmatic cost cap and administrative costs, including organization-wide communication needs, will be included within the 15% of the total annual budget cost cap. Restructuring how operating expenses are captured and categorized in the annual budget
will provide the agency with a clearer system to track administrative versus programmatic expenses and also help us “live within our means.”

Overall, we do anticipate all operational costs will increase slightly from year to year due to standard salary increases (estimated at 3.2%), benefit increases (estimated at 1%), as well as inflation of the cost of goods and services (estimated at 1%). As we are in a transition year, shifting from one Strategic Plan to another, the resources needed to support the next strategic plan period will be further developed and refined as additional information is made available following the SPR4 implementation process which will be instrumental in mapping the path for meaningful progress in support of our north star, that “All children in Los Angeles will enter kindergarten ready to succeed in school and life.”

IV. Analysis: The Multi-year Outlook

Consistent with previous years, the LTFP continues to reflect declining resources, including both incoming revenue and existing fund balance. As previous projections have demonstrated, this is primarily driven by the fact that spending has outpaced revenue, requiring the Commission to depend on existing fund balance to cover the difference. The new long-term plan approach will allow us to manage the outer years better by establishing annual resource caps based on known and projected revenues and existing and projected fund balance. This will also help us decide the extent to which we utilize the fund balance through the end of the revised strategic plan period to offset expenditure needs above and beyond the Proposition 10 tax revenue dollars and any other known revenues. This analysis does not include any revenues that have not been confirmed. The plan will be updated on an annual basis to capture any new information related to additional funding, both restricted and unrestricted, outside of the Proposition 10 and the Proposition 56 backfill dollars.

*Chart 1: Revenue vs. Expenditures through FY 2027-28*
The Commission’s primary source of revenue, Proposition 10 tobacco tax revenue, has been steadily decreasing since FY 2004-05, and is projected to decline an additional 22.8% by FY 2027-28, from the $71.7 million anticipated to be received in FY 2019-20 to an estimated $55.4 million for FY 2027-28, not including the 2% internal downward adjustment to Proposition 10 tax revenue to account for possible Proposition 56 backfill shortfalls or changes. At the same time, expenditures had been steadily increasing through FY 2013-14, exceeding incoming revenue for the first time in FY 2008-09. With the transition from *projection* to *plan* First 5 LA is planning for a gradual path toward expenditure alignment with revenues as we continue to move in a direction toward sustainability and systems change with the new 2020-2028 Strategic Plan.

As previously projected, spending is estimated to peak in FY 19-20 in alignment with the 2015-2020 Strategic Plan activities, some of which took a longer time than originally anticipated to develop a framework or establish relationships. The total impact of the costs in FY 19-20 is approximately $134.1 million, or 35.6% above the estimated incoming revenue (including the internal adjustment to Proposition 10 tax revenue in response to the Proposition 56 backfill revenue shortfall), an excess level of spending which results in a commensurate decline in fund balance. The total impact of the proposed costs for FY 20-21 is $124.3 million, or 37.0% above the estimated incoming revenue, which also adjusts for the 2% internal adjustment to Proposition 10 tax revenue. The ongoing variance between projected revenue and the established expenditures results in a 98.8% decrease in fund balance from the July 1, 2019 beginning fund balance of $353.6 million to $4.2 million by June 30, 2028. Of this $4.2 million, amounts would need to be set aside for subsequent fiscal year operating costs and the fund balance reserve, which is currently calculated as 25% of the projected annual fiscal year budget per Board-approved policy but is anticipated to increase to 50% effective FY 20-21, pending Board approval.

Staff will continue to monitor the changing environment and political landscape—both at the State and Federal level—that can have potential implications to the revenue so that we may adjust our longer-term plans, accordingly.

V. Summary

We are taking the opportunity to transition from a projection to a plan so that we can, to the extent possible, take control of our future spending. It will no longer be utilized solely as a forecasting tool. Pivoting from “projection” to a “plan” will reduce staff time devoted to budget development and improve long-range and strategic planning, particularly as the organization places a higher emphasis on policy and systems change, and doing more with less, as our revenues continue to gradually decline. This approach also allows the organization to manage the transition to a more sustainable spending plan in light of an ever-decreasing fund balance.

In the coming year, First 5 LA will be working internally to continue to use the current Strategic Plan Refinement (SPR4) process to identify the appropriate level of resources for distribution in support of the 2020-2028 Strategic Plan strategic priorities to support programmatic success and long-term system outcomes. This will require changes to current policies, development of new policies and the possible establishment of resource allocations. Any changes to the proposed long-term plan costs will be shared with the Board for approval through the next long-term financial plan update.