



AGENDA ITEM: 15
DATE OF MEETING: April 21, 2010
ACTION: X
INFORMATION:

SMALL POPULATION COUNTY FUNDING AUGMENTATION

SUMMARY OF REQUEST

Staff will present a proposed equitable and sustainable funding mechanism for the allocation of funds to small population counties beginning in fiscal year 2011-12, and beyond, for adoption by the State Commission.

BACKGROUND

Over ten years ago, during implementation of Proposition 10, it became clear to the Commission that the statutory funding formula for counties did not provide adequate funds for low birth rate counties to operate effective First 5 programs. In order to ensure that Proposition 10 was truly a statewide effort, and to recognize the importance of implementing First 5 geographically across the state, the Commission has provided additional funding to small population counties since fiscal year (FY) 1999-2000.

Over the last nine years, the Commission has simultaneously implemented up to three different funding mechanisms for small population counties, and through a Small Population County Workgroup that consisted of representatives from large, medium, and small counties, considered many other funding options. To date, none of these attempts to resolve the small population county funding problem has been successful. The status quo funding approach for small population counties has been maintained for these nine years, not because either First 5 California, or county commissions, was satisfied with this approach, but because there has never been an agreed upon and/or viable alternative. Additionally, the current State Commission authorization for small population county funding is insufficient to fully implement the existing funding mechanism.

First 5 California contracted with NewPoint Group (hereafter referred to as "NewPoint") in November 2009, to develop an equitable and sustainable funding mechanism for the allocation of funds to small population counties beginning in FY 2011-12. The information represented in this agenda item is based on work performed and recommendations developed by NewPoint.

DISCUSSIONS WITH FIRST 5 COUNTY COMMISSIONS

The Commission first established a small population funding mechanism in October 1999. Since then, First 5 California has continuously sought input from the First 5 Association of California and county commission representatives on the various small population county funding proposals.

In January 2007, the Commission established a Small Population County Workgroup (Workgroup) to further explore a long-term funding solution. The Workgroup included representatives from small, medium, and large counties, the First 5 Association of California, and First 5 California staff. Between February 2007 and October 2007, the Workgroup convened almost monthly for half-day and full-day meetings. In addition, county commission representatives dedicated a significant amount of time between scheduled meetings surveying small population counties and developing and testing funding options. The Workgroup considered at least ten different funding scenarios. These funding approaches were based on various assumptions about small population county administrative costs, expected contributions from the counties, and the expectation of a shared funding solution. Many of these proposals were costly and complex, and the Workgroup never agreed on a specific funding approach. After almost one year of meetings, the Workgroup did not agree on a single funding approach. At the end of 2007, with no consensus on a solution to small population county funding, the Commission approved the status quo funding approach through FY 2010/2011 with State Commission direction to continue to seek out a long-term solution.

In November 2009, NewPoint Group began work on the new model development. First 5 California reconvened the Workgroup in February 2010 to review a preliminary report of findings developed by NewPoint with various funding scenarios. The Workgroup provided feedback to First 5 California in person and in writing. The Workgroup was again reconvened in April 2010 to review and make decisions on several of the funding allocation factors in the funding mechanism proposed in this agenda item. Additional information regarding Workgroup contributions is detailed in the Discussion section of this agenda item, beginning on page 5.

STAFF RECOMMENDATION

The recommended funding mechanism, described in more detail in this agenda item and in the attachments to this agenda item, is as follows:

1. Provide small population county funds to 16 small population counties with a percent of State births equal to, or less than, 0.10 percent;
2. Provide total small population county funding, each fiscal year, equal to 32 percent of First 5 California's Unallocated Account revenues for the previous fiscal year;
3. Allocate these funds between counties based on a two-component formula algorithm utilizing normalized inverse birth rates and normalized service populations;

4. Include a built-in mechanism to promote small population county accountability and performance.

This recommended approach requires no changes in legislation or bylaws governing First 5 California; the recommended approach requires only a change in First 5 California small population county funding policy accomplished through Commission action on this agenda item.

DISCUSSION

The information that follows provides a summary of the methodology used by NewPoint to develop its recommendation, justification for the recommended approach, and an assessment of the relative merits of the recommended approach, as compared to the current small population county funding mechanism, and to other options considered by NewPoint in their review and analysis of project work. The accompanying *Small Population County Funding Report of Findings* provides additional supporting background information and analyses.

A. Approach to Developing the Recommendation

In developing the recommended small population county funding approach, NewPoint worked closely with First 5 California and the Workgroup. NewPoint conducted an extensive review of (1) the history of First 5 small population county funding, (2) literature on state and federal funding allocation methods, and (3) federal definitions of “rural.” NewPoint analyzed prior First 5 California funding distributions to counties, tobacco tax revenues, county birth rates, and reviewed First 5 county commission audits for the nine smallest counties.

Given the challenges inherent in developing viable solutions to small population county funding, NewPoint’s approach was to first establish a set of guiding principles and assumptions to direct development of specific alternatives. NewPoint developed these principles and assumptions after reviewing Commission meeting minutes (including input from Commission members, First 5 California staff, and small population county representatives), Workgroup proceedings, the California Children and Families Act, and other state and federal funding allocation approaches. The guiding principles and assumptions, outlined below, also incorporate recommendations from the Small Population County Workgroup:

1. New small population county funding mechanisms should meet existing statutory guidelines. There should be no new legislative solutions.
2. New small population county funding mechanisms should be aligned with First 5 California’s mission and vision.

3. The First 5 California revenue stream should not be intended to cover all of a county's needs for young children and families, and counties should seek opportunities for leveraging funds.
4. There should be potential for improved efficiency and/or economy of scale by combining some administrative and/or program functions of small population counties.
5. The definition of "small population county" should be clear and congruent with broader State and/or federal programmatic definitions of small and/or rural counties.
6. While a shared funding approach with large counties is theoretically attractive, there are no existing statutory mechanisms to effectively administer and enforce such an approach. As a result, small population county funding approaches should utilize First 5 California Unallocated Account funds.
7. Use of First 5 California's Unallocated Account to support small population counties at the statewide level should not preclude counties from developing an additional voluntary funding solution to augment State small population county funding, through the First 5 Association of California, or other mechanism.
8. A new small population county funding approach should be simple, equitable, transparent, and consider program needs.
9. It is the intent that First 5 be a statewide program, and that First 5 services should be available in all counties that wish to provide a program.
10. The existing statutory funding allocation approach does not provide adequate funding necessary for small population counties to operate effective programs. Small population county funding should help ensure that there is sufficient capacity and infrastructure in these counties to achieve the goals of Proposition 10.
11. Small population counties may confront unique operating challenges, as compared to large counties, due to increased geographic distances, inclement weather, reduced economies of scale, and lack of infrastructure. These challenges may result in different costs for small population counties.
12. Small population county First 5 programs are especially important locally due to the limited number of other support systems for children ages 0 to 5 in rural areas.
13. The tobacco tax revenues that support First 5 at the State and county levels are declining; new small population county funding solutions should reflect this declining revenue source.
14. First 5 California and county commissions should maximize dollars allocated to programs over administration.

15. A revised small population county funding approach should be flexible and sustainable over the long term.
16. A revised funding approach should provide performance incentives, create incentives to reduce administrative costs, and provide built-in accountability for small population counties. There is no need for an administrative line-item funding guarantee, but counties should receive adequate revenues to cover both program and administration, at their own discretion.
17. Small population counties should be able to provide more hands-on and direct services to children and families because there are fewer children ages 0 to 5 in these counties.
18. Small population counties with a significant fund balance should utilize those resources and not require supplemental small population county funding from First 5 California.

To accomplish the goals of this project, any proposed small population county funding mechanism must reflect these principles and assumptions. NewPoint used these principles and assumptions as guidelines in their development and analysis of various small population county funding mechanisms.

The recommended funding approach reflects input from the Workgroup. NewPoint met twice with the Workgroup to obtain input on the recommendation and received written input from the Workgroup during meetings. During the first meeting, on February 26, 2010, the Workgroup provided input on the baseline principles and assumptions, four funding components, and formula alternatives.

At the second meeting, April 8, 2010, the Workgroup reviewed several formula options and selected among them to determine:

1. Whether to base small population county funding on actual revenue data from the prior year, or projected revenue data for the current fiscal year,
2. The small population county eligibility definition based on percentages of State births, and
3. The final small population county funding formula.

NewPoint incorporated these Workgroup decisions into the staff recommendations for the revised small population county funding mechanism.

The accompanying *Report of Findings* provides further background and support for the recommended approach. The *Report* is organized as follows:

1. *Section 1: History of Small Population County Funding* – Provides an overview of the current small population county funding mechanisms and Commission efforts related to small population county funding.
2. *Section 2: Project Need and Challenges* – Summarizes problems with the current small population county funding mechanisms and key challenges of developing a new funding mechanism.
3. *Section 3: Baseline Principles and Assumptions* – Provides guiding principles and assumptions to direct development of specific funding alternatives.
4. *Section 4: Components of Funding Mechanisms* – Describes project research and discusses the four basic components and various options considered in developing the recommended approach.
5. *Section 5: Recommended Funding Approach* – Provides a detailed description and analysis of the recommended approach.

B. Small Population County Funding Allocation Recommended Approach

The recommended approach for small population county funding includes four components: (1) eligibility for small population county funding, (2) total funding available for small population counties, (3) distribution of small population county funds between small population counties, and (4) small population county accountability. Summarized below are these four components:

1. **Eligibility** – Eligible small population counties are defined as counties with a percent of State births less than, or equal to, 0.10 percent (county births/State births \leq 0.10%). Using this definition, there will be 16 counties eligible for small population county funding: (1) Alpine, (2) Amador, (3) Calaveras, (4) Colusa, (5) Del Norte, (6) Glenn, (7) Inyo, (8) Lassen, (9) Mariposa, (10) Modoc, (11) Mono, (12) Plumas, (13) Sierra, (14) Siskiyou, (15) Trinity, and (16) Tuolumne. Because the percentage of State births for a given county is relatively stable over time, we do not project that these 16 eligible counties will change over the next ten years.
2. **Total Funds Available** – Each fiscal year First 5 California will establish the amount of small population county funding based on 32 percent of the tobacco tax revenue in the Unallocated Account (not fund balances) from the prior fiscal year. Because funding is based on a percentage, the actual dollar amount of small population county funding will adjust over time, in exact proportion to the overall tobacco tax revenues (with a one year lag). Because total available small population county funds are based on prior year tobacco tax revenues, small population counties will know their actual yearly allocations close to the beginning of each fiscal year. However, assuming declining tobacco tax revenues, the amount of small population county funding in any given fiscal year will actually exceed 32 percent in a current year.

3. **Distribution** – The total funds available to small population counties will be allocated between the 16 eligible counties based on a mathematical formula that includes the most recent actual (not projected) calendar year data for each county's number of births and the service population (number of children ages zero to five). The formula is needs-based, addressing the concern that counties with a low number of births receive inadequate monthly tobacco tax revenues, while still considering the size of the population to be served. The formula includes a normalized inverse birth rate proportion to provide more funds to eligible counties with lower numbers of births. The formula also includes a normalized service population proportion to provide more funds to eligible counties with a greater number of children ages zero to five. Appendix A to the *Report of Findings* attached to this agenda item, documents the exact algebraic allocation equations.

The two formula factors are weighted so that 60 percent of a county's funds are allocated based on their inverse birth rate proportion, and 40 percent of a county's funds are allocated based on its service population proportion. While these equations may initially seem complex, they are actually fairly simple, logical, and straight-forward. The information that follows outlines a summary formula and provides example calculations for FY 2011/12 for both the smallest and largest of the 16 small population counties based on their estimated respective proportions using projected calendar year 2010 data and 32 percent of the Unallocated Account in fiscal year 2010/11 estimated at \$3.10 million.*

Formula

- Total available funds = TAF (*First 5 Annual Tobacco Tax Revenues x 20%*) x (*10%*) x (*32%*) = *0.64% of First 5 Annual Tobacco Tax Revenues*)
- Normalized inverse birth rate proportion for County X = NIBRP_X
- Normalized service population proportion for County X = NSPP_X
- County X funds = TAF [(60% × NIBRP_X%) + (40% × NSPP_X%)]

Example Calculation

Alpine County First 5 CA funds = \$3.10M [(60% × 13.87%) + (40% × 0.39%)]
Alpine County First 5 CA funds = \$262,818
Alpine Tobacco Tax Revenue = \$7,966 (Projected .0021% of state births)
Total Projected State and County funds = \$270,784

Siskiyou County First 5 CA funds = \$3.10M [(60% × 2.34%) + (40% × 8.54%)]
Siskiyou County First 5 CA funds = \$149,420
Siskiyou Tobacco Tax Revenue = \$335,249 (Projected .0902% of state births)
Total Projected State and County funds = \$484,669

* This example utilizes projected data in the mathematical formula for demonstrative purposes whereas, in actuality, the Commission will utilize the most current actual data.

4. **Accountability** – There will be a built-in accountability mechanism to help ensure that counties spend their small population county funds to support effective First 5 programs. As part of the Local Area Agreement mechanism to distribute small population county funds, First 5 California will include specific contract conditions to restrict certain uses of small population county funds, and to require accountability of small population county fund expenditures.

C. Justification for Recommended Approach

The State Commission has authorized the current funding mechanism for small population counties through FY 2010-11. This funding approach has been essentially unchanged for almost ten years. During this time, First 5 California, county commissions, and the State's economic climate have changed significantly. The number of counties that are eligible for small population county funds, and the amount of funds they should receive based on the current formulas, are increasing every year, even as tobacco revenues decline. This fiscal year, First 5 California has had to implement an across-the-board reduction in small population county funding allocations to avoid exceeding the Commission-approved \$3.5 million cap on total small population county funding.

The current funding mechanism has no clear eligibility criteria, and more than one-half of the State's counties are now eligible for "small population county" funding. The current funding mechanism is unstable, and it is not actuarially sound.

Because of the long history of small population county funding and the many challenges inherent in changing status quo funding, NewPoint followed a comprehensive and rational approach for developing potential small population county funding allocation alternatives. NewPoint maintained this comprehensive and rational approach in analyzing and selecting between the various small population county funding allocation alternatives considered. Once NewPoint narrowed down the specific funding approach choices, it sought input from the Small Population County Workgroup in selecting a final recommended funding approach. As NewPoint developed, refined, and selected small population county funding options, it considered several overall criteria, including whether:

- The allocation method followed the guiding principles and assumptions
- The allocation method reflected program need
- The allocation method included an accountability mechanism
- The overall funding level (percentage of Unallocated Account) was based on logical and rational factors
- Eligibility was based on a clear definition of "small population county"
- Eligibility was linked to need and small population county challenges
- The allocation formula was based on logical and rational factors
- The allocation formula normalization ceiling (cap) levels were based on logical and rational factors.

The various allocation methods considered by NewPoint, including the recommended approach, generally met these overall criteria. NewPoint also compared the recommended approach against the five original objectives of this Small Population County Funding Assessment Project. These objectives were to develop a funding mechanism for small population counties that can:

1. Be funded over the longterm – reflecting declining tobacco tax revenues
2. Provide additional funds to counties with low birth rates that do not receive sufficient funds under the statutory birth rate allocation to operate effective First 5 programs
3. Provide resources to assist small population counties in addressing costs associated with the small population county rural characteristics
4. Meet, to the maximum extent possible, the project's baseline principles and assumptions
5. Be simple to understand, equitable, transparent, and easy to implement.

D. Consideration of Various Funding Approaches

In developing the recommended funding approach, NewPoint considered a number of options for each of its four components: (1) eligibility, (2) total funds available, (3) distribution, and (4) accountability. These options are described in more detail in the *Report of Findings*. NewPoint provided the following information to describe its rationale for selecting the recommended approach, as compared to the other options considered.

Because there is no statutory or regulatory definition of "small population county," and in fact no clear definition of the more commonly used term, "rural," NewPoint had to create its own small population county eligibility criteria. Various federal definitions of "rural" generally reflect the smallest California counties in terms of birth rates. However, NewPoint decided that utilizing birth rates within its small population county definition more closely fit the application (i.e., lack of adequate tobacco tax funds for low birth rate counties). The 0.10 percent birth rate threshold that NewPoint selected provides small population county funding to 16 counties with the greatest need, provides a reasonable demarcation between the smallest counties, and will adjust over time as total State births rise or fall.

All of the funding options considered by NewPoint included a set percentage of the Unallocated Account to determine total available funds. NewPoint believes that this approach is the most equitable and actuarially sound mechanism to balance small population county funding needs with the reality of a declining revenue source. NewPoint calculated the recommended 32 percent of the Unallocated Account figure by averaging nine years of small population county funding.

NewPoint also considered several different allocation formulas, included a fixed-rate formula, and variable formulas with one, two, or three variables (and different weightings between the variables). Through extensive analysis of these formulas, NewPoint provided the Small Population County Workgroup four balanced and equitable formulas to consider. The Workgroup selected a two component formula from among the four choices that included two variables, with greater weighting for inverse birth rates and less weighting to service population. The one-component variable formula considered was less robust, and generally provided too much funding to the smallest counties. The three-component formula considered was more robust, more complex, and resulted in more funding for the smallest and least populated counties. However, the Small Population County Workgroup did not select a three-component approach because the Workgroup was concerned that the third formula component, inverse population density, did not always accurately reflect on-the-ground operating challenges in rural counties.

Finally, NewPoint considered several different performance incentive and accountability mechanisms. Incorporating these mechanisms into the recommended small population county funding approach presents many challenges. While the concept and intent are straightforward, actually determining reasonable and viable mechanisms is not. One key concern is developing meaningful metrics that could gauge whether small population counties are using their small population county funds to provide effective programs. Another concern is to develop metrics that will not be overly burdensome to either small population county staff preparing the metrics, or to First 5 California staff evaluating the metrics. Metrics should be seen as tools to ensure accountability and stimulate program improvements and metrics should not result in counties devising programs to simply meet numerical performance targets (i.e., numbers versus quality outcomes). First 5 California agreed to work with the Small Population County Workgroup to develop and document the performance incentive and accountability mechanisms.

The recommended funding approach generally meets the guiding principles and assumptions, overall objectives, and selection criteria, as compared to the other options considered. This recommended approach reasonable meets the needs of the 16 smallest population counties. Based on current projections, in the first three years of the recommended approach, total small population county funding for the 16 eligible counties is greater than total small population county funding for those same 16 counties in FY 2008-09. In addition, in FY 2011-12, 14 of the 16 small population counties will receive approximately the same or more small population county funding than they received in FY 2008-09.* In FY 2012-13 and FY 2013-14, 13 small population counties will receive approximately the same or more small population county funding than they did in FY 2008-09. This is possible because the recommended approach focuses available small population county funding on those counties with the greatest need. NewPoint believes the recommended approach offers a vastly improved solution for long-term, sustainable, small population county funding.

* Alpine County and Sierra County will each receive approximately \$40,000 less in small population county funding in FY 2011-12, as compared to FY 2008-09.

FISCAL HISTORY

Since the inception of First 5 California through FY 2010-11, the State Commission authorized, and First 5 California will disburse, approximately \$39 million in small population county funding (this includes the annual \$200,000 minimum guarantee to the smallest population counties, administrative augmentation, and travel allowance to approximately 31 eligible counties).

In the last two years, First 5 California funds authorized for small population counties have been insufficient to fully implement the current funding mechanism.

State Commission authorization to disburse small population funding augmentations will end on June 30, 2011. County commissions receiving funding augmentations from First 5 California requested one-year advance notice of any changes to the funding augmentations.

The proposed recommendation to set a percentage of the Unallocated Account to determine total available funds for the augmentation (32% of the tobacco tax revenue directed to the Unallocated Account in a given year) provides a sound strategy to address funding changes over time and is sustainable.

The percentage factor establishes a commitment of funds in the Unallocated Account by the State Commission for the small population county funding. The 32% revenue limit against the funds transferred from the Children and Families Trust Fund to the Unallocated Account will not be affected by any transfers that may be directed to the Unallocated Account from other accounts or cash balances from prior years to accomplish First 5 California's mission and vision.

For FY 2011-12, 32% of revenue projected represents an approximate \$400,000 decrease in funds from the \$3.5 million authorized for FY 2010-11, yet increases the total amount of funds to the 16 neediest small population counties, compared to FY 2010-11 disbursements.

ATTACHMENT

A. *Small Population County Funding Report of Findings*