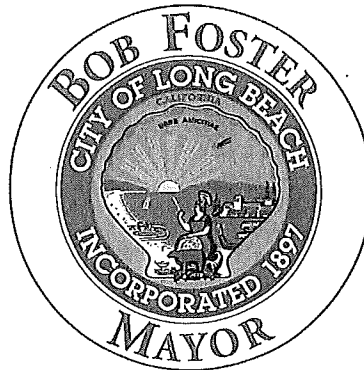


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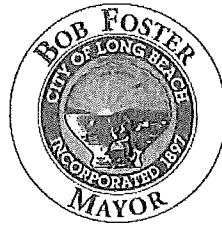
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# Mayor's Budget Recommendations

Fiscal Year 2011

*Presented July 23, 2010*



July 23, 2010

Members of the City Council:

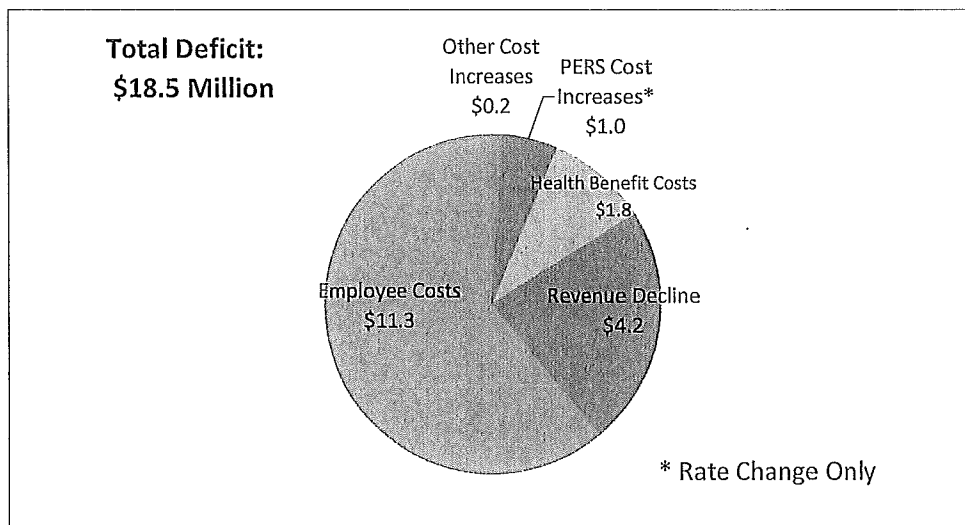
Pursuant to the City Charter, the following letter serves as the transmission of the City budget to the Council.

There are encouraging signs in the national and regional economy that perhaps the worst is over. In that, there is reason for general optimism.

But there are frustratingly persistent unemployment rates and a housing market that while in recovery, is years away from stability, let alone matching its euphoric rates of the past several years. Those two metrics are particularly important to the fiscal health of cities and counties in California.

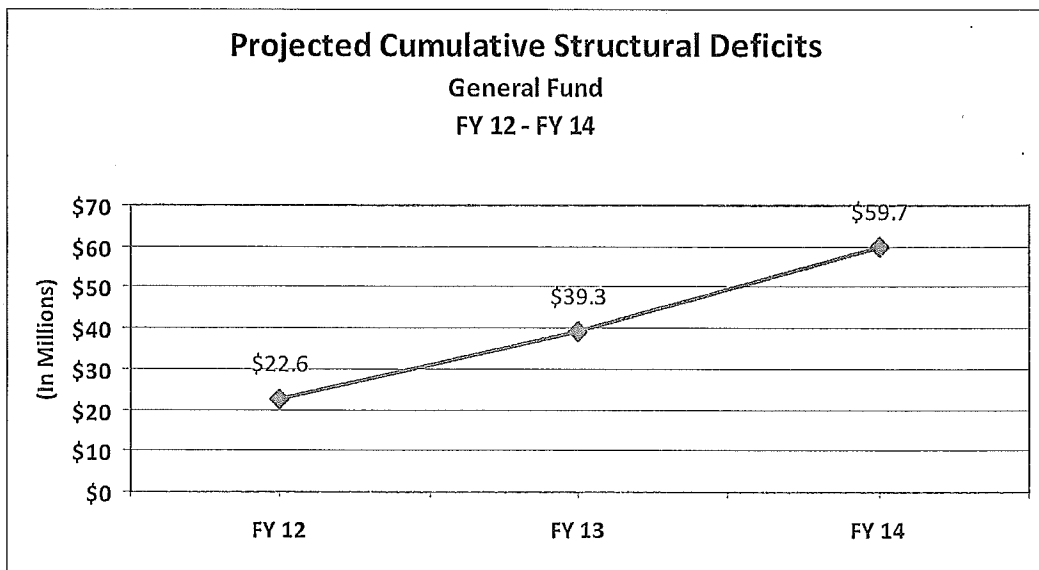
Presently, both metrics continue to under perform and create a tremendous lag on the City's finances; less employment drives down spending and decreases sales tax revenue while property tax returns from a depressed housing market may prove to be the very last to recover from the 2008 financial crisis.

I applaud the City Manager for developing a plan that balances economic challenges and the impact on services to our residents. In particular, protecting the Budget Stabilization Fund is a prudent and sound long-term financial decision. But of no surprise, the City is faced with increasing expenses and we will again have to cut costs to balance our budget.



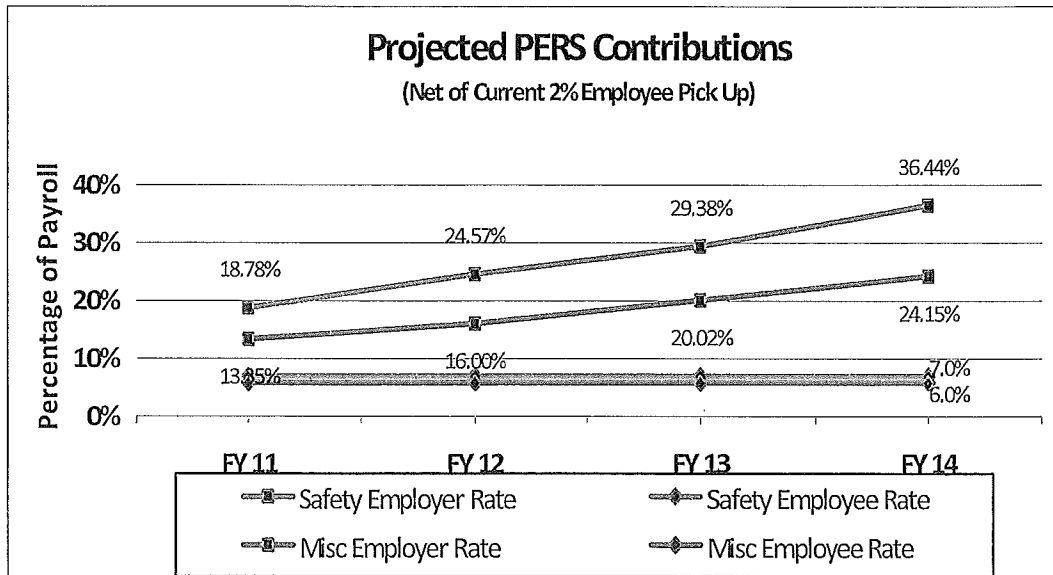
In reviewing this year's proposed budget over the past three weeks and in open session for the past several months, it has become increasingly clear to me that there is little choice left in the General Fund to curb expenses and erase the \$18.5 million deficit – with all cost elements considered, we currently spend over 80¢ of every dollar on labor costs and that number will likely grow to 90¢ by 2014.

In more detailed review of those personnel costs, the market losses suffered by the California Public Employees Retirement System (PERS) over the past two years, \$72.2 billion or 30% of its assets, will profoundly increase the City's expenses over the next several years, leading to cumulative annual deficits over the next four years of \$60 million.

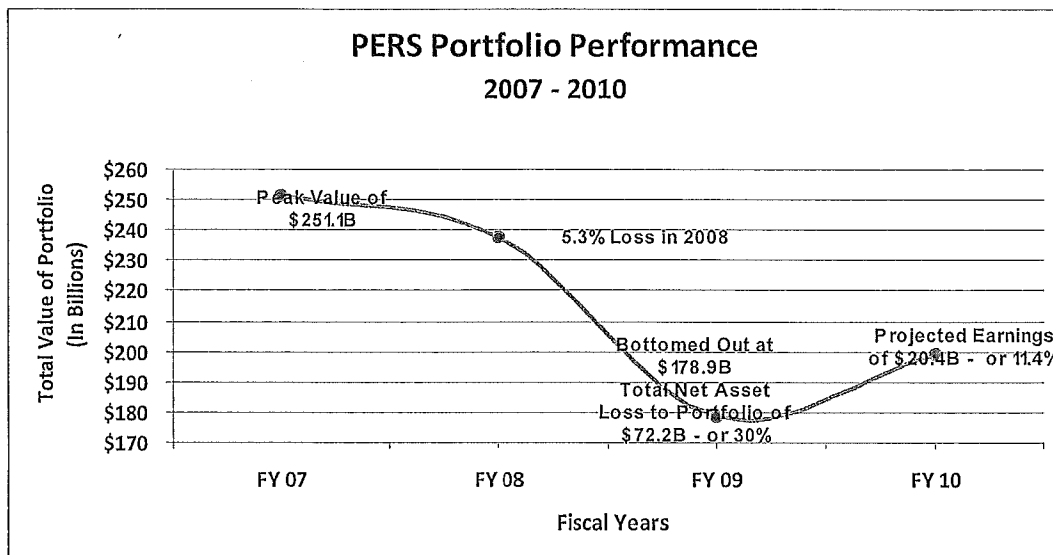


The statewide PERS formula makes up for any market loss by increasing the employer share of the pension costs.

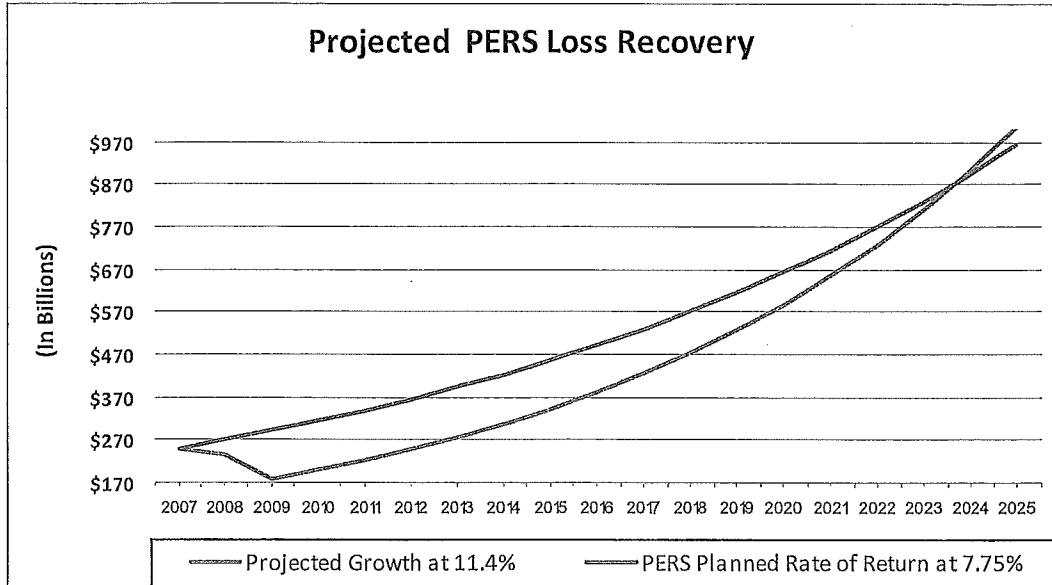
Public safety pension costs, if un-addressed by reform, will rise from 26.6% to over 45% of the City's police and fire payroll costs by 2014. No organization, including this City, could sustain these cost increases. We will soon have no capacity in our General Fund beyond paying for personnel expenses. It is neither right nor fair to make public employees the scapegoats but the current benefits are generous and the numbers are very clear: these pensions are not sustainable.



PERS' 11.4% preliminary earnings for the year are encouraging, but it is unreasonable to expect that consistent level of growth year after year.



The red line below demonstrates PERS required rate of return (7.75%) to meet their obligations before their investment losses. Given the depth of those losses, even with the unrealistic growth rate from 2010, as shown by the blue line, PERS will not break even until 2024. It is a long, steep climb indeed.



It is time to get back to taking a three or four year look at our finances and devise a plan that brings reasoned austerity and longer term stability that will allow all of us, employees and policy makers, to plan for the future. Going through this process year in and year out and somehow expecting that there will be a different result is nothing short of fiscal insanity.

I am concerned that the negative impacts of continuing to budget on an annual basis is increasing frustration for employees and debilitating the capacity of policy makers to plan over a significant time horizon.

The annual ritual is emblematic of death by a thousand cuts and has the added consequence of perpetuating what I have often referred to as the "armed camp" scenario: as structural reductions disproportionately fall on non-public safety programs and departments, an ever-increasing percent of the general fund is diverted from parks, libraries and street repair; the quality of life programs that provide the foundation for a safe community. At nearly 70% of the budget, left unchecked, public safety costs run the risk of debilitating every other function of city government.

So, what can we do to change our present course? We must find a way to build a framework for stability.

First, most experts believe this will be a slow recovery and potentially a jobless recovery. We cannot "wait" for the economy to improve.

Second, because of a lag in revenues, even a recovery will not result in substantial increases in revenue for some time. Finally, any increases will be more than erased by increases in PERS costs to cover in large part for the losses of the last two years.

I believe that by working with our employee groups and our management we can make the necessary reforms to change our course and put us on the path to healthy finances. We can also provide employees with certainty and stop the constant cycle of renegotiations that has had the effect of rendering their contracts largely meaningless. We can create a framework to increase public confidence in their city government and institute true reform more in line with the realities we face.

What I propose is the following:

First, all contracted salary increases due over the next three years will be applied to the employee's share of their pension costs. Instead of money in a paycheck now, it's money in their PERS bank for later.

Those contracts include compensation from the City in the form of a "pick up" on the majority of the employee's share of pension costs. The City, as the employer, picks up the rest.

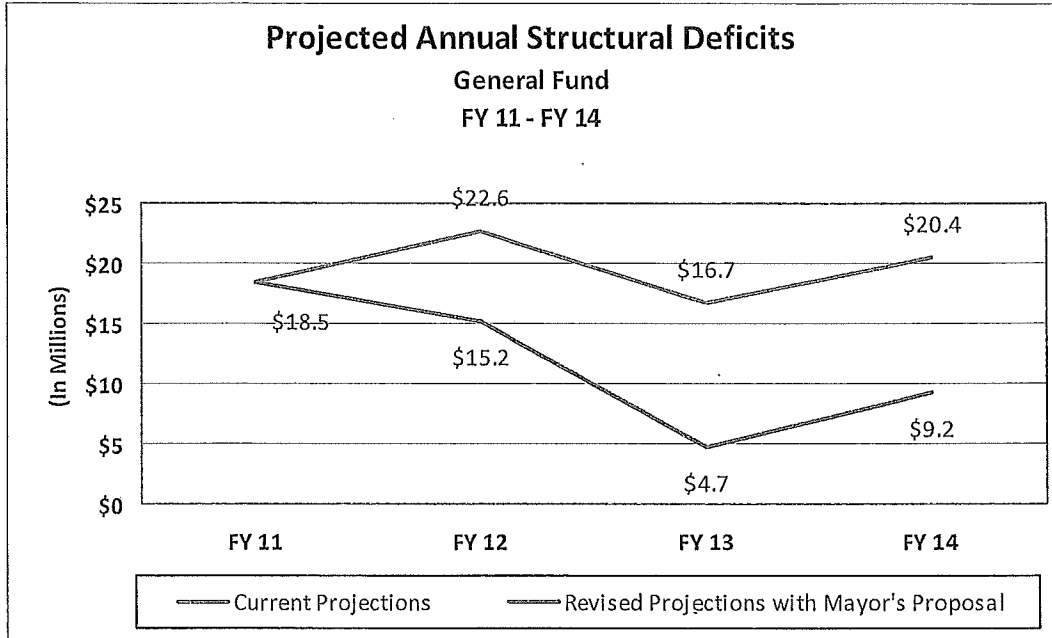
For example, an employee pays 2% of the 8% that PERS determines as the "employee share;" the City covers the other 6% in addition to the entire "employer" portion. In the proposal I am outlining here, the contractually obligated raises would be applied to the employee share of the pension costs until the full 8% is achieved. In short, their raises pay for their PERS costs.

Secondly, any negotiated salary increases beyond the maximum employee share would be frozen through 2014.

Finally, while benefits for existing employees cannot be altered under state law, we must institute less generous benefits for new employees to provide fair, albeit less generous, pension formulas.

Current and Proposed PERS Tiers for New Employees		
	Current	Proposed
Safety	3% @ 50	2% @ 55
Non-Safety	2.5% @ 55	2% @ 60

If these reforms begin in FY11, we would not only bring next fiscal year into balance but also reduce the projected deficits in the out-years to more manageable levels.



Slow revenue growth and increasing costs will mean there are still shortfalls, but these are far more manageable levels that I would look to achieve without further concessions from employee groups.

It will build public confidence that our fiscal and retirement house is in order, maintains public safety as our top priority, stems the erosion of the core quality of life programs delivered through parks, libraries and infrastructure improvement while setting the stage to hand a sound budget to the next City Council in FY15.

This plan does not solve every problem we face, and there is still much work to do to balance our finances. It does, however, make it possible to produce balanced budgets and get our future costs under control. I am more than open to other ideas and plans, insofar as they solve for more than the current year and gain measurable reforms to our pension system to address our unsustainable cost growth at the source.

This is not the job we all envisioned when we ran for public office or signed on to serve the residents of this City. But it is our responsibility to make significant reforms and produce a framework of stability and a future bright in a prudent and workable financial structure. In that will be the true measure of our service to the public.