Billion-Dollar Budget
City spending to increase 25 percent over five years

By Craig Powell
Inside City Hall

First, there’s the headline number: The city is poised, for the first time in its history, to spend more than $1 billion in the fiscal year that begins on June 30. Total general-fund spending (which pays for police, fire, etc.) is set to hit $450 million next year, while “enterprise” spending (primarily, the utilities department) consumes $584.2 million.

The city expects to employ 4,552 people next year, a slight increase over the current year, but an increase of 720 positions from five years ago. The city expects to employ 130 fewer people than it did in 2008.

City officials are forecasting that the budget will sink into major deficit beginning in just two years, when a general-fund operating deficit of $11 million is expected to grow to $26 million by 2022. You would expect that a city manager, facing the prospect of such red ink, would propose a city budget for next year that calls for major cuts in spending to head off the coming fiscal ditch. But you would be wrong. Fiscal discipline is a very foreign, even suspect concept at City Hall these days. In fact, city manager Howard Chan’s recently released budget forecast anticipates sharp increases in general-fund spending on city operations over each of the next several years, rising from $412.9 million this year to $515.9 million in 2023, a 25 percent increase in operations spending over five years—a spending pace that’s more than twice the inflation anticipated during that period.

But here’s the sobering kicker: The city’s projected spending levels and deficits don’t factor in any increases in employee pay even though all but two of the city’s many labor contracts expire on June 30. Will the city council exercise some budget discipline in the pending labor negotiations? There is no reason to expect it will. Pay hikes agreed to in new labor pacts will not only deepen the city’s red ink in the near term; they’ll deepen the city’s already-ballooning pension liabilities since pension payouts are determined by the salaries of employees in their final few years of employment. (More about the city’s growing pension problems in a minute.)

Further, the city’s budget forecasts assume that Sacramento will avoid any recession during the entire five-year forecast period. Considering that we’re already in the ninth year of the current expansion, staff is assuming that we’ll experience 14 years of uninterrupted economic growth, a feat that would be unprecedented in American economic history. (The longest economic expansion in U.S. history was 10 years, from 1991 to 2001.)

Spend It All

The city council has been on a spending binge this year, approving ad hoc spending as the whim strikes it and paying lip service to the annual budget process that requires making hard choices among competing spending priorities in the face of limited resources. The council has decided it wants to have it all and it wants it all now. There's a substantial budget surplus from the prior fiscal year? Spend it on the mayor's new homeless program. Want a new program to fund entrepreneurial art endeavors? Fund it. Complaints of deteriorating morale in the police department? Fork over $1.3 million in one-time bonuses to police. How about $950,000 more each year for internships for high school students? Good idea. And $300,000 annually on a new legal defense fund for illegal immigrants? Sure, why not?

What's so astonishing (and infuriating) is that each of these spending decisions entailed virtually no discussion of the city's looming budget deficits. By caving in to proponents of the cause du jour, the council has abandoned any claim to budget responsibility. If Sacramento families spent money the way the city council has been spending taxpayer money this year, we'd see families lining up around the block at the federal bankruptcy court downtown.

Why are the city council and staff acting so recklessly in the face of the coming budget meltdown? It has everything to do with the scheduled expiration of the Measure U one-half-percent "temporary" sales tax hike in March 2019. (It was approved by voters in 2012.) The implicit, highly cynical strategy of the council is to make the budget problems of the city so dire without the $43.7 million of revenues that Measure U is currently bringing in that city voters will be stampeded into voting to extend Measure U when the council puts it before city voters next year.

Measure U Strategy

The more the council increases the city's baseline spending, the more painful the loss of Measure U revenues will appear to voters next year. It's one of the reasons the council has consistently rejected city staff's repeated advice to set aside a portion of Measure U's revenues to fund a "transition reserve" that would soften the budgetary impact of Measure U's expiration. The council doesn't want to soften the impact of Measure U's expiration. It wants to double down on it. It's a dangerous political strategy that does a grave disservice to the city voters who trusted city leaders when they were assured that Measure U would be a temporary tax to help the city over the hit to city revenues caused by the recession.

But city tax revenues are booming again and have been for several years. The two major drivers of city revenues—the property tax and the sales tax, which together make up 49 percent of all city revenue—are expected to grow 5 percent and 5.4 percent, respectively, next year, according to city officials. Total general-fund city tax revenues—excluding Measure U taxes—are now 15 percent higher than they were in 2012 when Measure U was approved by voters and are projected to continue to grow at double the rate of inflation. With city revenues from all sources booming, the council is breaking faith with city voters on Measure U and trying to frighten voters into renewing a tax hike that has outlived its original justification.

Keep in mind that Measure U was sold to city voters in 2012 as a measure that was projected to bring in $28 million per year for six years. But within a year of Measure U's passage, local media outlets were reporting on how the city had grossly underestimated how much it stood to collect under Measure U ("Measure U Provides Unexpected Windfall for Sacramento," The Sacramento Bee, Feb. 14, 2015). In the first full year of the Measure U tax hike, the city collected $41.5 million in Measure U taxes—48 percent more than the city had represented to voters. Under the city's proposed budget for next year, Measure U is projected to bring in $46.5 million, 66 percent more than the city had originally projected. Is it any wonder why many people are skeptical of the stories told to them by city officials?

It was an open secret at City Hall, from the day after Measure U was passed in 2012, that the city council would ask voters to extend Measure U in 2018. Councilmembers were overheard joking about it. The only people who believe in "temporary" tax increases anymore are small children and the congenitally gullible.

The City's Pension Nightmare

But it's hard to overstate the problems presented by the city's unfunded pension liabilities. They're huge and growing. With the recent decision of the CalPERS board to reduce forecasted earnings on its portfolio from 7.5 percent to 7 percent, CalPERS has put the city on notice that its pension costs are poised to explode. According to CalPERS, the city will experience a $62 million increase in its pension costs over the next five years, increasing from $67 million currently to an unsustainable $129 million. Given the eight-year phase-in of the CalPERS action, the city's annual pension bill is projected to hit $148 million in 2025. But that's not the whole hoary story. Most pension experts consider CalPERS' 7 percent earnings forecast to be a politically driven estimate that is still grossly overstated. Many believe that a 6 percent earnings assumption is more reasonable. If CalPERS' actual earnings lag 1 percent below its latest 7 percent return assumption, the city's annual pension bill could hit a bankruptcy-inducing $300 million.

Just how big is the city's unfunded pension liability? Well, according to a June 30, 2016, city financial statement, the liability has increased from around $500 million to $650 million, but that was based on a presumed 7.65 percent earnings assumption. Based on the new 7 percent CalPERS earning assumption, the city's unfunded pension liability is probably several hundred million dollars higher than that today. We know that at a 6.65 percent earnings assumption, the city's unfunded pension liability would blow past $1 billion. At a 6 percent earnings level, it would approach $1.5 billion.

Within the next six years, absent pension reform, the city's annual pension bill is expected to increase to 24.2 percent of the city's total general-fund spending (up from 14.9 percent next year), crowding out a huge swath of general-fund services in its wake.

A Reform Plan

Make no mistake: The city is, indeed, facing dire financial straits in future years. But its budget difficulties are, to a large extent, of its own making. There are a number of clear actions the city can take to deal with them without needlessly frightening voters into renewing Measure U. But the actions will require major changes in the ways the city

operates and will take political courage to carry them out in the face of entrenched opposition.

First, the mayor should set aside his philosophical opposition to contracting out government services when to do so would significantly lower taxpayer costs and/or provide higher levels of service. The city's own management consultants have advised the city to consider outsourcing ambulance services and residential garbage pickup. Basic park maintenance, parking operations, convention center and theater operations and fleet management are also attractive outsourcing candidates.

Second, the council must rein in unsustainable increases in salaries, supplemental pay items and overtime until total compensation of employees (salary plus all benefits) comes back into alignment with comparable pay packages offered in the private sector. It's unfair to taxpayers and ruinous to budgets for local government to consistently pay above market labor rates. By adopting a system of "managed competition," selected city departments can be required to compete head-to-head with private contractors for work currently performed by the city, a process that has served to reduce costs in cities where it's been implemented.

Third, the city must, through executive action and tough labor negotiating, finally get a handle on multiple layers of waste in the fire department, including eliminating the costly requirement that all ambulance workers be cross-trained as firefighters, the requirement that a fire engine accompany every ambulance call and overstaffing fire engines outside of the urban core.

Fourth, a pension case currently before the California Supreme Court is expected by many to result in a ruling that would grant cities the flexibility to rein in their currently unsustainable pension costs. The court may repeal the so-called "California rule," which currently prevents governments from modifying future, unearned pension benefits after an employee is hired. If the California rule is repealed, the city should move quickly to reduce pension benefits for its existing employees with respect to pension benefits not yet earned or vested, while preserving reasonable pension benefits at a level the city could afford without slashing public services. Every city labor deal currently being negotiated should permit to reopen negotiations in the event the court repeals the California rule.

Fifth, the city's $363 million liability for retiree health care benefits is coming home to roost as more and more baby boomers retire from the city workforce. A trust fund set up to cover such costs is 93 percent unfunded. The city should phase out such benefits for higher-income retirees, as well as for lower-income retirees who're eligible for subsidies under Obamacare or health care tax credits under Trumpcare.

Sixth, with total city liabilities more than doubling in the past five years, from $1.2 billion to $2.5 million, the city badly needs a time-out on new borrowings. Once existing city debt is paid down and city revenues grow organically to the point where resumed borrowing is prudent, the moratorium on new debt could be lifted.

Finally, the council needs to develop the discipline to "Just Say No" to the endless line of special pleaders who are always, but always, asking for a chunk of the city treasury.

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