

## **Proposition D: City of San Diego Proposed “Pension Reform, Financial Stabilization, and Sales Tax Ordinance”**

### **Brief Summary**

SDCTA **OPPOSES** Proposition D. Most of the “reform” conditions outlined within the measure do not guarantee savings to taxpayers, yet they would trigger a \$510 million blank check tax for City politicians. Some of the “reform” measures create an adverse incentive to achieve minimal savings and others are already in process or have been completed.

- The City of San Diego is proposing a 5-year, half-cent sales tax increase which would generate \$102 million annually for five years following the completion of ten items.
- In order for the tax increase to be triggered, the City Auditor must verify completion of the following ten (10) conditions:
  1. Eliminate Employee Retirement Offsets for Elected Officials and Unrepresented City Employees << **This achieves \$386,000 in annual savings.**
  2. Complete Managed Competition Guide << **No savings. This was mandated by voters with the approval of Prop C in 2006. The completion of the Guide alone does not guarantee any savings to taxpayers. The City needs to complete the managed competition process for its major departments.**
  3. Complete DROP Cost Neutrality Study << **No guaranteed savings for taxpayers.**
  4. Solicit Request for Qualifications (RFQ) to Take Over Miramar Landfill Operations/Lease << **No savings. The Mayor had already solicited RFQs for the Landfill. Further, this item does not guarantee any taxpayer saving as it does not require the Council to approve any private sector service provider if the bids come in lower than the current cost of operations.**
  5. Eliminate Terminal Leave for all City Employees << **Expected annual savings of \$120,000 to approximately \$1 million.**
  6. Reduce Retirement Offset for Represented City Employees << **No expected savings. Chief Operating Officer Jay Goldstone has indicated this reform would not generate savings as reduction in the employee pick-up (aka “retirement offset”) will be offset by additional benefits, such as a salary increase. These additional benefits could result in highernet coststo taxpayers.**
  7. Reduce Retiree Health Costs << **Because there is no clear target for reduction level, this item can be determined accomplished if it results in \$1 in savings.**

8. Solicit Proposals to Take Over Information Technology Services << **No savings. This process was started earlier this year and has already been approved by the Council. Further, this item does not guarantee any taxpayer saving as it does not require the Council to approve a service provider if the bid comes in lower than the current provider, DPC.**
  9. Establish Second Tier Pension Plan for Firefighters to match terms of plan in place for new San Diego Police Officers Association employees (3@55 formula) << **\$120,000 in annual savings. It was already anticipated that the City would do this. If the City does not approve the new benefit formula for new firefighter employees, it will result in the re-opening of the lifeguard's contract.**
  10. Adopt Ordinance for Voluntary Defined Contribution Pension Plan << **This is a voluntary plan therefore it does not guarantee any taxpayer savings.**
- SDCTA proposed an alternative measure to the City Council that called for \$102 million in savings to occur from substantial, comprehensive reform resulting from pension and retiree healthcare reform and managed competition/outsourcing before the \$102 million sales tax was triggered – a dollar for dollar match in revenue for savings achieved through structural reform (not cuts to service). This proposal was rejected by the Council.
  - The City's unfunded pension liability and unfunded retiree healthcare liability is \$2.1 billion and \$1.3 billion, respectively.
  - The City is projected to have a \$72.6 million deficit in FY 2012.
  - The City has not completed managed competition for even one department since voter approval of Proposition C in 2006.
  - The City has not met its Budget Principles adopted earlier this year.
  - The City has not provided requested data to SDCTA regarding retiree health reform actuarial study, deferred maintenance and terminal leave.
  - The City appears to have no back-up plan if this measure is rejected by voters. In addition, with increased pension payments looming in the near future, this measure does not comprehensively address the City's structural deficit.

**Proposition D: City of San Diego Pension Reform, Financial  
Stabilization, and Sales Tax Ordinance**

**Board Action:**

**OPPOSE**

**Rationale:**

The City of San Diego Sales Tax Increase measure purports to be a “reform before revenue” measure. In reality, it is a sales tax increase that follows the achievement of 10 measures which do not guarantee significant savings to the taxpayers. Some of the “reform” measures create an adverse incentive to achieve minimal savings and others are already in process or have been completed. The San Diego County Taxpayers Association proposed an alternative measure to the City Council that called for \$103 million in savings to occur from substantial, comprehensive reform resulting from pension and retiree healthcare reform and managed competition/outsourcing before the \$103 million sales tax was triggered – a dollar for dollar match in revenue for savings achieved through structural reform (not cuts to service). If the Council was truly committed to achieving significant, measureable reform they would’ve given the Association’s proposal serious consideration. Instead, the Association was rebuffed.

**Background:**

*Past Positions*

Since 2008, the San Diego County Taxpayers Association (SDCTA) has opposed three (3) sales tax increases placed on the ballot by three (3) different cities: La Mesa, El Cajon, and Chula Vista. SDCTA’s rationale for opposition to these measures has stated, in one form or another, the following:

“The City should make every effort to reduce labor costs (via pension and benefit reductions and outsourcing), streamline operations and demonstrate fiscal discipline prior to seeking additional revenues from taxpayers.”

As well, SDCTA produced a “General Analysis of Sales Taxes”, in which the Association reviewed various economic literature to determine the efficiency of sales taxes and the potential impact of an increase. The study determined that sales taxes are extremely inefficient and regressive, impacting lower-income households more than higher income households when compared to other revenue raising methods.

In addition, on June 8, 2005, the SDCTA Board of Directors adopted the following policy:

“SDCTA is opposed to any tax increase that the City [of San Diego] proposes until they can show that they can balance expenditures and revenues (without use of one-time revenue sources).”

Lastly, SDCTA’s strategic plan places a priority on advocacy against sales tax ballot measures above all other ballot measures.

*FY 2012 Budget*

In December 2009, the Mayor and City Council adopted corrective actions to address what was at the time a \$179 budget shortfall for Fiscal Years (FY) 2010 and 2011. These actions included \$96.5 million in one-time solutions and \$82.6 million in on-going savings. An additional \$24.6 million in revenues were also set aside to help address the expected FY11 budget deficit. The FY2011 budget adopted in June 2010 includes the solutions adopted by the City Council in December 2009, as well as \$28.2 million in additional solutions. These solutions included savings in Fleet costs, reductions in services, supplies and equipment, savings in retiree health care annual costs, and restructuring of the McGuigan pension settlement agreement. Approximately \$14.1 million of the total solutions are considered one-time savings.

On April 19, 2010, the Mayor released an update to the FY2011-2015 Five-Year Financial Outlook (Outlook). Figure 1 outlines the projected budget deficits for the period of this Outlook. The incremental adjustments within the table outline funding for additional costs such as deferred maintenance debt service, maintaining reserve targets, and incremental retiree health care contributions.

**Figure 1: FY11-15 Five-Year Financial Outlook**

	<b>FY11</b>	<b>FY12</b>	<b>FY13</b>	<b>FY14</b>	<b>FY15</b>
<b>Total General Fund Revenues</b>	\$1,092.30	\$1,073.80	\$1,101.70	\$1,134.40	\$1,169.90
<b>Total General Fund Expenses</b>	\$1,092.30	\$1,118.60	\$1,131.60	\$1,145.10	\$1,159.10
<b>Total Incremental Adjustments</b>	\$0.00	\$27.80	\$38.50	\$59.20	\$58.90
<b>Total Surplus/(Deficit)</b>	<b>\$0.00</b>	<b>(\$72.60)</b>	<b>(\$68.40)</b>	<b>(\$69.90)</b>	<b>(\$48.10)</b>

On February 22, 2010, the City Council adopted eleven (11) guiding principles to address the City's structural budget deficit. The adopted principles are as follows:

1. Eliminate the General Fund structural budget deficit through a balanced approach of ongoing expenditure reductions and revenue generation, including identifying new revenue sources.
2. Until the City achieves its targeted General Fund reserve level of 8%, the City should not consider using reserve balances to balance any budget shortfall and should ensure that it does not drop below the current level of 7%.
3. Actively pursue alternative service delivery methods, including managed competition, efficiency improvements and elimination of service duplications.
4. Prepare a 5-year Outlook each year and provide numeric values for alternative budget balancing options based on input from City Council, Mayor, and IBA; be prepared each year to discuss alternative budget balancing options with the Budget Committee or City Council should the Outlook suggest an ongoing structural deficit.
5. One-time resources should be matched to one-time expenditures.
6. Achieve 100% cost recovery for programs and services that are intended to be fully cost recoverable through fees.
7. Reduce pension and retiree health care liability and annual City costs through the meet and confer process.

8. When deciding to construct new facilities or establish new programs, the City must take into consideration ongoing operation expenses and should identify ongoing funding to cover these expenses unless necessary to meet high priority needs.
9. Prioritize City services expenditures based on the City Charter requirements, Citizen Survey and other means of public input, benchmarking studies and departmental goals and performance data.
10. Maintain funding of the full annual required contributions (ARC) for the City's pension obligations in a manner compliant with City Charter and develop a plan to fully fund the Retiree Health Care ARC.
11. Develop a plan to fund deferred capital infrastructure and maintenance needs to reduce the current backlog, identify the level of funding necessary to prevent the problem from growing larger, and to reduce the potential of increasing costs to identify the level of funding. Discuss at Budget and Finance Committee a policy to calculate and identify the level of funding for deferred maintenance budget needs.

The intent of the aforementioned principles is to submit a structural budget elimination plan to be submitted to the City Council for adoption in June 2011, prior to the adoption of the FY2012 budget.

#### *Increase in Pension Costs*

As of June 30, 2009, the City of San Diego has a \$2.1 billion unfunded liability. The City's FY2011 Annual Required Contribution (ARC) for the City's pension is \$231.7 million (\$180.1 million from General Fund). The city-wide ARC payment amounts to a \$77.5 million increase over the FY2010 ARC, and a \$55.2 million increase in the General Fund payment. According to the San Diego City Employees' Retirement System (SDCERS), the City's pension fund payment is expected to grow to \$511.6 million by 2025 before steadily declining.<sup>1</sup>

#### *Retiree Healthcare Liability<sup>2</sup>*

As of June 30, 2009, the City of San Diego has a \$1.3 billion retiree healthcare Unfunded Actuarial Accrued Liability. The City's retiree healthcare ARC payment for FY2011 totaled \$120.3 million (\$84.03 million<sup>3</sup> from the General Fund), yet the City provided \$57.8 million in total payments (\$32.8 million in PAYGO<sup>4</sup> and \$25 million in prefunding of future benefit payments). Of the \$57.8 million payment, \$40 million came from the General Fund.

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<sup>1</sup> Cheiron Presentation to the City Council, City of San Diego. March 8, 2010

<sup>2</sup> Please review SDCTA's Retiree Healthcare 101 Policy Brief for background information regarding retiree healthcare

<sup>3</sup> Assumes General Fund portion is 69.85% of Citywide expense

<sup>4</sup> PAYGO means pay-as-you-go payments to cover the retiree healthcare costs of current City of San Diego retirees. The City is not obligated to pay the retiree healthcare ARC but beginning FY2008 an accumulated liability based on unpaid ARC amount must be booked on the financial statements.

## **Proposal:**

On August 4, 2010, the City Council approved placing a measure on the November 2010 ballot asking voters to approve a temporary five-year, half-cent sales tax increase to become effective upon completion of ten (10) conditions outlined within the Ordinance. The City Auditor would determine whether these conditions have been met, then notify the State Board of Equalization, thereby triggering the tax increase.

The ballot question that will be put before voters will read as follows:

“To help offset severe state cuts and help restore essential services, including police, fire and street resurfacing, shall the City of San Diego enact a temporary one-half cent sales tax for up to five years, only if the independent City Auditor certifies conditions have been met, including pension reforms and managed competition?”

### *Conditions*

In order for the tax increase to become effective, the City Auditor must approve completion of the following ten (10) conditions:

1. Eliminate Employee Retirement Offsets for Elected Officials and Unrepresented City Employees: An ordinance has been adopted to eliminate retirement offsets for elected officials and those City employees who are not represented by a labor organization. “Retirement Offsets” means the amount of an individual’s retirement system contribution which the City agrees to pay on behalf of the individual.
2. Complete Managed Competition Guide: The City has adopted a Managed Competition Guide, by ordinance, to allow the City to implement a managed competition process pursuant to the San Diego Charter section 117(c) involving services such as, solid waste collection, print shop and publishing services, auto and fleet maintenance, landscaping and facilities operations and maintenance.
3. Complete DROP Cost Neutrality Study: The Mayor has completed a Deferred Retirement Option Plan (DROP) cost neutrality study, presented the Mayor’s findings to the City Council and, if said findings are that DROP is not cost neutral, the City will initiate “meet and confer” to make DROP cost neutral. Cost neutral means that the present value of the City’s share of costs for all compensation and benefit programs of the City of San Diego with DROP included is less than or equal to 102% of the present value of what those costs would be in the absence of DROP.
4. Solicit Request for Qualifications (RFQ) to Take Over Miramar Landfill Operations/Lease: The Mayor has solicited Requests for Qualifications from qualified bidders to assume the operations of the Miramar Landfill.
5. Eliminate Terminal Leave for all City Employees: The City has adopted an ordinance eliminating terminal leave for all City employees. Under the ordinance, upon separation from the City, an employee may only cash out accrued leave.
6. Reduce Retirement Offset for Represented City Employees: The City has reduced the total cost of Retirement Offsets existing as of June 30, 2010, for employees represented by labor organizations. “Retirement Offsets” means the amount of an

- individual's retirement system contribution which the City agrees to pay on behalf of the individual.
7. Reduce Retiree Health Costs: The City's future unfunded retiree health care liability existing on June 30, 2010, has been reduced. For purposes of this section, "future unfunded retiree health care liability" means the actuarial accrued liability based upon the retiree health care plan in effect on June 30, 2010.
  8. Solicit Proposals to Take Over Information Technology Services: The Mayor has solicited proposals from qualified bidders to provide information technology services to the City which are provided by the San Diego Data Processing Corporation.
  9. Establish Second Tier Pension Plan for Firefighters: The City has established a second tier pension plan for new employees represented by San Diego City Firefighters, International Association of Fire Fighters, Local 145 comparable to the terms of the plan currently in place for new employees represented by San Diego Police Officers Association as set forth in San Diego Municipal Code section 24.0403(i).
  10. Adopt Ordinance for Voluntary Defined Contribution Pension Plan: The City has adopted an ordinance creating an alternative Defined Contribution Plan intended to reduce City costs from the current City retirement plan. The ordinance would allow all City employees to voluntarily select or switch from a current City retirement plan to the alternative Defined Contribution Plan, which may be subject to IRS and other governmental agency approvals, but obtaining such approval is not part of this condition.

### **Policy Discussion:**

#### *Managed Competition*

In November 2006, the City of San Diego placed a measure on the ballot to create a managed competition program whereby City workers would compete with the private sector for the most "economical and efficient" delivery of services. This measure, Proposition C, passed with 60% of the vote. SDCTA endorsed this measure due to the potential for cost savings and efficiencies in the delivery of City services.

On October 27, 2009, an impasse hearing occurred in which both the City and labor representatives presented each of their respective offers before the City Council. The City Council, on a 6-2 vote, rejected the Mayor's last, best and final offer and directed both sides to restart negotiations. Some of the points of contention include: bid leveling for healthcare costs, inflation factor pertaining to Non-Personnel Expenses and the time period between when a function has implemented efficiencies and when they can be competed.

The condition in this measure relating to managed competition requires the Council adopt the managed competition Guide, allowing the City to implement a managed competition process on services such as solid waste collection, print shop and publishing services, auto and fleet maintenance, landscaping and facilities operations and maintenance. The condition does not require the completion of any competition of the services outlined within the Ordinance prior to the tax increase becoming effective.

### *Retiree Healthcare Reform*

The City currently has a \$1.3 billion retiree healthcare unfunded liability. Item #7 of the conditions requires the reduction of the City's future unfunded retiree health care liability existing on June 30, 2010. The City and its labor organizations are conducting a joint study of retiree health care that will analyze how reductions in the current benefit will reduce the City's unfunded liability as well as the annual required contribution. Employees hired after July 1, 2005 are currently not eligible to participate in the City's retiree medical defined-benefit plan.

### *Reform Efforts Currently Underway*

A number of conditions that have been placed within the proposed measure are currently underway or are required to be completed. Currently, the DROP Cost Neutrality Study (Item #3) is being prepared and is scheduled to be completed prior to the end of the current fiscal year. Second, the Mayor has solicited an RFQ to take over operations of the Miramar Landfill, thus completing Item #4. Likewise, the Mayor has already stated his intent to pursue Item #8 regarding solicitation of proposals from qualified bidders to take over the operations of the City's IT services. Finally, the recently approved labor agreement with Teamsters Local 911 (Lifeguards) requires the City to establish a second-tier, 3% @ 55 retirement benefits formula for firefighters prior to the beginning of FY2012. If this commitment is not met, the Lifeguards will have the right to re-open discussions with the City on the proposed implementation date of the 3% at 55 retirement calculation.

### *SDCTA Alternative Proposal*

On August 3, 2010, SDCTA submitted an alternative ballot measure proposal, the "Dollar for Dollar Proposal", to the City Council for consideration. The proposal stated that not only must the ten (10) reforms be completed prior to the sales tax increase becoming effective, but these reforms must result in annual savings of \$103 million over the FY2011 adopted budget.

The SDCTA proposal outlined that the Mayor, Independent City Auditor and Independent Budget Analyst shall each provide verification that \$103 million in aggregate savings over the baseline FY 2011 General Fund Council-approved budget has been achieved prior to the tax being levied. The savings calculation associated with retiree healthcare shall use the FY 2011 General Fund budgeted payment of \$40 million as the baseline. The City Council shall not delegate its authority to any public officials to determine when the tax is triggered. The City Council shall make the required findings that the \$103 million in cost savings has been met, upon receiving written verification from the Mayor, Independent City Auditor and Independent Budget Analyst and shall trigger the tax via ordinance and provide said ordinance to the Board of Equalization.

SDCTA felt this was an equitable proposal that would result in a \$1 tax increase for every \$1 in general fund savings achieved through reforms.

### *Fiscal Impact*

The half-cent sales tax increase is expected to generate approximately \$102 million annually over the five-year period the increase would be in place. The conditional reform measures that must be met do not require a savings target, either individually or collectively, be met.

In addition, it is difficult to determine the potential savings from each of the ten (10) conditions because implementation of these reforms requires negotiations with the City's labor unions.

<b>Figure 2: Retirement Offsets</b>		
<b>Classification</b>		<b>Number of Employees</b>
<b>Unrepresented &amp; Elected Officials</b>		693
Unrepresented	0.40%	
Unrepresented Lifeguards	1.30%	
Elected Officials	5.89%	
Council Staff	3.40%	
<b>Represented</b>		<b>Number of Employees</b>
MEA	3.40%	4,523
Lifeguards	5.30%	123
Police	0%	
Fire	0%	

A savings range is available for Item #1, the elimination of the retirement offsets for elected officials and unrepresented City employees. For FY2010, the City's General Fund budget consisted of \$4.8 million for retirement offsets (\$7.9 million Citywide). Figure 2 outlines the current retirement offsets provided to elected officials and unrepresented employees.

The fiscal impact statement developed by the City's Chief Operating Officer, Jay Goldstone, indicates elimination of this benefit will result in \$386,000 in annual savings. This savings is projected to increase to \$.93 million over the first five (5) years, then increase to \$3.86 million over the first ten (10) years.

There is the potential for savings from other conditions listed within the measure, but those amounts are not quantifiable until further action is taken to define the benefit level. For example, Item #6 calls for the reduction of the retirement offset for represented employees. Until the benefit level is negotiated and agreed upon by both employee groups (MEA and Lifeguards), and approved by the Mayor and Council, the total amount of savings is unknown. It is worth noting though that the Lifeguards approved a two-year agreement that ends June 30, 2011, and the current MEA contract prevents the Mayor and Council from imposing a reduction in the offset through FY2012. A reduction in this benefit could be negotiated during FY2012. Mr. Goldstone has further acknowledged in a Voice of San Diego article<sup>5</sup>, the reduction of retirement offset for represented City employees, "will probably end up being a negotiated trade off for something else they had given up." The City would have to give employees something back, such as a salary increase, to make up for taking away the benefit. The net impact could result in increased costs to taxpayers as a salary increase would also cause pension payments to go up.

The elimination of the terminal leave benefit for employees would produce a minimum of \$120,000 in annual savings per the fiscal impact statement. The actual amount saved though would depend on the number of employees that retire and the age of retirement. Furthermore, the establishment of a second tier pension plan for new firefighters is expected to generate \$120,000 in annual savings. This amount though is dependent upon the number

<sup>5</sup> Dillon, Liam. "Giving Back the Ballot Measure's Savings". August 18, 2010. [www.VoiceofSanDiego.org](http://www.VoiceofSanDiego.org).

of new firefighters that enter the new pension plan, as well as the amount that leave the current plan.

Lastly, a number of these conditions could result in zero savings for the City. For example, Items #2, 3, 4, and 8 do not require further action by the Mayor or Council beyond the solicitation of bids, proposals, qualifications or the adoption of processes, and thus would not produce savings for taxpayers. Once these items are completed, there could be further delays in the implementation of the outsourcing and competition of City departments and services.

#### *Election Costs*

In approving the FY 2011 General Fund Budget, the Council established an Appropriated Reserve of \$4.1 million to address November ballot expenses and potential reinstatement of budgetary reductions. The City Clerk has estimated the City's costs for placing a measure on the November 2010 ballot at between \$220,000 and \$252,000. The Council has committed using up to \$1.2 million from the Appropriated Reserve for November ballot measures.

#### **Proponents:**

- Mayor Jerry Sanders
- Councilmember Todd Gloria
- Councilmember Donna Frye
- San Diego Police Officers Association
- San Diego Local Firefighters 145
- San Diego AFSCME Local 127

#### **Opponents:**

- Asian Business Association of San Diego
- Building Industry Association of San Diego
- California Restaurant Association
- Lincoln Club of San Diego County
- Republican Party of San Diego County
- San Diego Association of Realtors
- San Diego County Apartment Association
- San Diego Neighborhood Market Association
- San Diego Tax Fighters