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Commentary: How Pension Costs Clobbered One Small California City.

When Santa Cruz, a picturesque and funky coastal city, first started to feel the pinch of rising retirement costs for city workers, it took several steps to limit the fiscal pain.

As recommended by the League of Cities and other authorities, Santa Cruz issued a bond to pay down its rising pension liabilities, set aside funds to cover increasing demands from the California Public Employees Retirement System (CalPERS), shifted some employees into lower-benefit pension plans and made sure that its workers paid significant portions of pension costs.

Nevertheless, the impact on the small city's budget continued to grow, leading City Manager Martin Bernal to tell the city council in his 2016 budget message that "our biggest challenge is the skyrocketing increases in health and retirement costs. These costs have gone from 28 percent of general fund salary in 2004 to 43 percent of salary in 2015, to an anticipated 58 percent of salary in 2020."

With operating costs, particularly for pensions, continuing to outpace revenues, even during a generally upbeat economy, city officials projected budget deficits growing to more than $20 million a year by 2021.

Santa Cruz is not alone. Throughout California, city governments are facing budget shortfalls as CalPERS cranks up mandatory contributions in a somewhat desperate effort to make the gigantic trust fund healthy enough to cover pension promises to millions of state and local government workers.

It has only about 70 percent of the money it says is needed to cover pension obligations – and that assumes that its investments will return profits that many experts believe are unrealistic. CalPERS lost about $100 billion during the Great Recession a decade ago and has not fully recovered, while payouts to retirees grow due to demographic factors.

City officials have repeatedly appeared before the CalPERS board to seek relief, contending that some cities will be driven to insolvency. But for the most part, CalPERS officials have taken the attitude that making the fund actuarially healthy is their highest priority.

In February, the Santa Cruz City Council unanimously declared a fiscal emergency, preparatory to placing a quarter-cent sales tax increase on the June ballot.

Santa Cruz isn't alone on that approach either. Throughout California, cities have taken, or are planning, sales tax increases.

However, cities rarely cite pension costs as the specific reason for the tax increases, because doing so might generate more opposition. Typically, they just say the money is needed for "police and fire services," which is a half-truth since police and fire pensions are the biggest drivers of rising retirement costs.

Also, a general sales tax increase ballot measure requires only a simple majority vote, while one dedicated to a specific purpose, such as pension costs, would require a two-thirds vote.

“We’re in a brave new world of public finance and our community values its municipal services and we do want to be able to fulfill those expectations,” Santa Cruz Councilwoman Cynthia Mathews said as the state of fiscal emergency was declared.

Whether those expectations can, in fact, be fulfilled is questionable even if Santa Cruz’s voters endorse the sales tax hike.

The $3 million a year it would generate is just a fraction of the extra $9-11 million that the city calculates it’s paying to cover CalPERS shortfalls and even a smaller slice of the $20 million annual deficit city officials are projecting.

California’s municipal finance crisis is likely to get worse before it gets better – if it ever does.

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By Dan Walters | March 18, 2018