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San Jose Election Tests Political Risk of Cutting Pensions.

The California city's November election will shed light on whether Democrats can risk the political fallout of cutting a prized union benefit to protect basic city services.

Local government isn't what it once was in San Jose. In 2001, California's third-largest city employed almost 7,500 full-time workers. After 10 consecutive years of spending cuts caused by budget deficits, the number is closer to 5,400. The public library system has lost more than a quarter of its staff, forcing branches to cut operations back from six days a week to four. The parks department has closed all but 11 of its 54 community centers. Public safety has taken a hit, too. The city has 300 fewer police officers and 200 fewer firefighters than a decade ago.

The obvious culprit is the Great Recession, which took its toll on city revenues. But in San Jose, the recession isn't the biggest fiscal problem. Pensions are. San Jose's pension costs currently take up more than 20 percent of the city's general fund, up from 6 percent in 2001. (The national average for big cities is estimated at about 12 percent.) For much of the last decade, San Jose's pension deficit created a depressing cycle in which total city spending rose each year despite annual service cuts. It hasn't mattered that the public workforce has shrunk by 28 percent because the average cost of each remaining employee has grown by 85 percent due to the city's commitments to retirees.

Chuck Reed, the city's Democratic mayor, has been focused on pension problems ever since he first took office in 2007. In 2010, he announced that San Jose had reached a point of "services insolvency" and called for some of the most drastic changes to retiree benefits anywhere in the country. "I wish I had started sooner," he says, "but it's hard to convince people to do something before a crisis."

In 2012, holding together a Democratic majority on the city council, Reed abandoned negotiation with public employee unions and pushed through a pension-cutting ballot measure. Voters approved the referendum with 69 percent of the vote. Two years later, Reed says he has no regrets about the decision, but concedes that "there's a price to pay, especially if you're a Democrat." The passage of the pension measure angered union leaders and prompted the local Democratic Party to question Reed's party loyalty. Now, as he prepares to leave office after two terms, they have an opportunity to hold one last referendum on the mayor and his pension tactics.

In November, voters will elect a new mayor and three city council members — just enough turnover to threaten the benefit cuts that were enacted in 2012. A group of labor-backed candidates who survived the June primary say they'll unravel core elements of the pension measure if voters give them a chance.

The vote on pensions in San Jose will have far-reaching implications in California and beyond. Recently, state and local governments throughout the country have had to contend with unaffordable benefits granted to employees in flush economic times. The majority of places aren't in as bad shape as San Jose, but a February review of state public pension systems by the Brookings Institution found that most hadn't kept up with payments, leaving a nationwide funding gap of \$2.7 trillion. "The political incentives to push funding responsibilities on to future generations were too

tempting to withstand,” the authors of the review wrote.

The San Jose mayoral election will shed some light on what happens to elected leaders who are determined to do something about underfunded pensions. It will also test whether Democrats who have long relied on organized labor to win office can risk the political fallout of cutting a prized union benefit in order to protect basic city services.

Some of San Jose’s pension problems can be traced to decisions by the state of California. During Silicon Valley’s dot-com boom in the late 1990s, the California Legislature and then-Gov. Gray Davis enacted a law that lowered the retirement age for all state workers and elevated the maximum possible benefit for state public safety workers. Under the new law, a retired highway patrol officer as young as 50 could collect a lifetime of annual payments equal to 90 percent of his final year’s salary.

Legislators believed the state could afford to pay more expensive retirement benefits because they used optimistic forecasts of how much their pension fund investments would yield in returns each year. “They thought the stock market would keep going up forever,” Reed told a state commission in 2010. “It’s the greatest financial blunder in the history of California.” The legislature’s decision applied only to state workers, but it put pressure on local leaders to make similar offers to their employees. San Jose and other large cities felt they had to grant similar benefits or risk losing their best workers to jurisdictions with better retirement packages.

To be sure, factors outside city officials’ direct control also contributed to San Jose’s difficulty in keeping up with the rising cost of pensions. Retirees are living longer and collecting extra years of payments as a result. Revenue from property taxes and sales taxes fell far short of projections during the recession as real estate values dropped and residents had less money to spend. Nonetheless, many who have followed San Jose’s pension controversy agree that the onus mostly rests on political leaders who spruced up benefits for public employees during an economic boom without anticipating what would happen if the economy tanked in the future. “The employees who receive the benefits did nothing wrong,” says David Crane, a pensions researcher at Stanford University. “Politicians who curry favor make these promises and then can’t fund them.”

The package that Mayor Reed steered through in 2012, known simply as Measure B, sought to save money by reducing the city’s obligation to spend on retirement benefits for both new and current employees. The part that has already gone into effect targets new hires, delaying their age of retirement, limiting cost-of-living increases and forcing them to cover half of the annual pension costs — up from the 25 percent workers had previously been paying.

A number of jurisdictions at the state and local level have cut the benefits of future hires. The boldness of the San Jose plan lay in its reduction in benefits for current workers as well. That is where the bulk of the projected \$68 million in annual savings was expected to come from. But a county judge ruled in February that the city couldn’t reduce its obligation to pay retirement benefits to current employees because the benefits amounted to a contractual right promised at the point of hiring.

Reed and a narrow majority on the current council want to bring the case before the state Supreme Court, where it is believed they would have a chance to win. The slate of labor-backed challengers running for council seats this year would prefer to settle out of court with the unions. The vote next month will determine whether the next mayor and council decide to continue pressing the pension reform case or forgo some of the biggest savings embedded in Measure B.

After work on a Tuesday night in August, labor’s preferred candidate for mayor of San Jose walked

into a room packed with new campaign volunteers. "We've already changed the entire dynamic of this election," Dave Cortese told them. "We're going to get swept into office with all of you because it's your city hall."

Cortese is running as an outsider challenging the city's political power structure. It's an unlikely role considering he has held elected office for the past 14 years, first as a San Jose city councilman and currently as a member of the Santa Clara County Board of Supervisors. He has a long business résumé that includes time as a lawyer, real estate manager and restaurant owner. Yet he has become the champion of public librarians, city electricians and cops who feel alienated by the political establishment and want a change in city hall leadership.

In June, Cortese finished first with 34 percent of the vote in an open primary that pitted him against four incumbent council members who supported Measure B. Cortese is a long-time critic of the measure. His opponent for mayor next month is one of its architects, Councilman Sam Liccardo.

Both are pro-transit, anti-sprawl Democrats and the grandsons of Italian immigrants, but their endorsements suggest different flavors of liberalism. Cortese has won the backing of just about every public employee union in the metro area, plus that of five former San Jose police chiefs. Liccardo counts among his supporters three of the last four mayors, the chamber of commerce and more than 50 CEOs from local businesses.

Cortese interprets his first-place finish in the primary to mean that voters have undergone a change of heart since Measure B passed. By his rationale, voters were more likely to favor cuts to public employee benefits in the years immediately after the Great Recession, when layoffs, pay freezes and furloughs were felt in the private sector as well. Today, with unemployment in the San Jose metro area down to 5.5 percent, Cortese believes the electorate will be more sympathetic to public workers who saw their benefits rolled back during the economic slump.

Cortese is also trying to tie Reed's budget and pension cutbacks to public safety problems in the city. Residents have voiced frustration over slow police response times and the lack of a burglaries investigation unit. Both were budget cut casualties.

Before the recession, the city had about 1,400 patrol officers — already a lean operation for a million residents — but now there are fewer than 1,000. Citizens want more cops on the street, but the police department is shedding officers and struggling to replace them. Case in point: The first class of police cadets hired after the passage of Measure B will graduate this fall. Of the original 50 cadets, only 13 remain. Many have either resigned or left for other departments. "You're not in a bubble," Cortese says. "It's a basic business principle. You can't offer your employees consistently less than everybody else."

It's impossible to discern how much pension reform has to do with police departures, especially since the biggest changes haven't gone into effect due to court battles. But even Measure B's most fervent champions admit that San Jose offers lower pay and benefits than neighboring jurisdictions. Liccardo says he'd like to slowly restore the value of benefits lost under Measure B, but to give them in the form of salary boosts, not long-term retirement funds. To that end, the council passed a 10 percent pay increase for cops last year and Liccardo says he is looking for other ways to build back the police force.

Any recruitment efforts, however, will be in spite of the disgruntled Police Officers' Association. Jim Unland, president of the union, says that since Measure B passed, "there's no one to work with over at City Hall" and his group has turned to campaign tactics in the hopes that by defeating council members who defied the union, they can re-establish some influence. The Police Officers'

Association already singled out Councilman Pete Constant, a former cop who supports Measure B, by calling him a traitor and kicking him off the union's board of directors. "They completely turned against me," Constant says.

The union has also rejected several olive branches from the council, including an offer to pay more to Spanish-speaking officers and to those who earn advanced degrees. Most recently, the council considered asking voters to approve a specialized sales tax for public safety services, but the union rallied enough opposition to keep it off the November ballot. At this point, the union appears to be focused on a significant electoral victory rather than fighting for incremental concessions that Liccardo could tout as proof of his goodwill toward the aggrieved public workers.

The battle over Measure B is often portrayed as unions resisting all cuts to worker benefits, but Unland says that's not accurate. In the failed labor negotiations in 2012, both the police and fire unions offered concessions that look similar to the changes now in place for new hires — they just wouldn't budge on revising benefit packages for current employees.

Police officers recognize that pensions pose a financial problem to the city, Unland says, but they object to Measure B as the solution. Any cuts to retirement benefits, he says, should have been the result of labor negotiations. Instead, he argues, Reed, Liccardo and most of the council made changes to pay and benefits without the typical compromises that come from negotiating with workers.

It's possible to explain Reed, Liccardo and other Measure B-supporting Democrats in San Jose as having turned against the principles of their party, and some critics do make this accusation. "They're Democrats in registration only," says Steve Preminger, chair of the Santa Clara County Democratic Party.

But Liccardo insists that pension reform has to become part of the Democratic agenda. Measure B represented the least painful way to preserve and restore core city services, he says, from paving roads to housing the homeless. Yes, retirement benefits will be worse for city workers going forward, but that sacrifice was the lesser of two evils. Liccardo sees the upcoming election as a choice between prioritizing employee benefits or city services. "I think the future of the Democratic Party hangs in the balance," he says. "Democrats believe that government can be a force of good, but if you've got crippling debt, it renders government ineffectual."

Although Liccardo finished second to Cortese in this summer's primary, the numbers give him some reasons to be optimistic. Liccardo and other mayoral candidates who ran on a pro-Measure B platform collectively won 62 percent of the primary vote. Meanwhile, the city's overall financial health has improved, allowing four new libraries to open, 900 streetlights to be turned on and 76 firefighters to keep their jobs after funding from a federal grant expired. Following a decade of neglected infrastructure maintenance, the city is also spending \$16 million this year on paving roads. The restoration of services and staffing is partially due to Measure B: The portion of the law dealing with new hires, which survived a court challenge, began saving the city an estimated \$20 million a year, starting in 2014.

While Liccardo works to convince voters that he deserves credit for the city's incipient turnaround, Reed is already making plans to expand his pension crusade after he leaves office at the end of the year. He and three other California mayors want to place an initiative on the 2016 statewide ballot that would change the state constitution to give cities greater latitude in controlling pension costs. Until state law changes, he says, the risk of lawsuits is too great for smaller cities to deal with those costs.

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