Mayor's Budget Recommendations

Fiscal Year 2015

Presented July 9, 2014

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Budget Message for Fiscal 2015

Pursuant to the Long Beach City Charter, I hereby transmit to the Long Beach City Council the 2015 Budget prepared by the City Manager, with my recommendations.

This will be one of my last official acts as Mayor of Long Beach and I consider this transmittal one of the most important Mayoral responsibilities. This City has managed its way through very difficult financial times in the past seven years. As the Manager’s budget points out, we have reduced the City’s General Fund by $134 million and reduced 714 FTEs over that period.

We have done this while still providing quality service to our residents in virtually every area. Major crime is at 41-year lows. We have achieved real pension reform for all our employee groups, saving nearly $250 million over the next decade. We have made real progress on our streets and sidewalk repair and replacement. We have expanded our parks, cleaned our air and water, and worked to bring job skills training into our schools. It has not been easy or without pain, but we have worked well within the resources we were given.

While in FY14 we had the first budget surplus in ten years, we have prudently decided to “roll” the surplus over to offset costs we know are coming in a few years. As the Manager’s budget illustrates, to use this surplus for ongoing programs would be folly and only increase future budget cuts. The urgent issue facing this city is the “certainty” of increased costs for public pensions coming from the State level. Wisely, the California Public Employees Retirement System (CalPERS) has decided to put its system on an actuarially sound footing, and charge its member agencies at a level to eliminate unfunded liabilities over a 30-year period. This will result in an increase in costs for Long Beach of over $35 million a year by 2021.

If the new Mayor and City Council delay action on this issue until the costs come due, it will mean that cuts equaling nearly 10% of the General Fund will need to be made or taxes would need to be increased a like amount. Both of those paths are untenable.

If the City takes action now and over the next two years, it can substantially reduce the impact of this increase with minimal “pain.” The recommendations below are centered on this issue; finding a path to make the coming costs bearable, with as little pain to services and employees as possible. This will be neither “fun” nor pleasant, but the alternative is much worse.

Most of the costs to operate Long Beach are in personnel; nearly 75% of the City’s budget is for salaries and related expenses. All employee contracts will be up for negotiation over the next two years. This will present an opportunity to carefully review each contract and make sure that antiquated, obsolete, and unnecessary provisions are removed.

EMPLOYEE CONTRACT NEGOTIATIONS

The good news is that all of the memorandums of understanding for all employee groups are up for negotiation in the next two years. This is also the bad news. Employees have grown to expect pay increases during these contracts renewals. It is difficult to see how the City can afford any increase in pay for employees with the substantial cost increases coming to meet the obligations for their pensions.

Every 1 percent increase is $2.6 million more in General Fund costs, and those costs will continue every year. We know we will need over $35 million per year in 2021. Any amount we provide employees will increase that amount. The 2001 pension spike is now fully making its impact felt. The truth is we could not afford that decision then, and its full impact is unaffordable in the years ahead.

SKILL PAY

Skill pay is one area ripe for review. In our City, there are about 136 active skills pays. In 2013, those designations were used over 5,000 times and resulted in $19.9 million in additional compensation to employees, with many employees receiving more than one skill pay. These are skill pays for bilingual ability, additional schooling, certificates, and the list goes on. There are simply too many and the number has increased over the years without review as to their necessity or relevance. The number is so large, one could reasonably believe we are hiring unskilled employees.

The Fire Department, for example, has 43 separate skills pays. In some cases, firefighters are earning a substantial part of their salary through skill pays. Perhaps the common sense notion that you hire people for their skill and they have a responsibility for self-improvement no longer applies, but it should. In the modern world you are paid for your skill and you are expected to "keep up" and improve or your job is in jeopardy from those who will seek to improve.

This is not to say that all skill pays should be eliminated. There may be good and sufficient reason to incent employees to advance in specific areas, but many are outdated and compounded, or they are awarded without regard to their relevance to specific jobs. This is an area where substantial reform is necessary and substantial savings can be achieved. I recommend that the City Council initiate a careful review of skill pay with the goal of substantially reducing their number and cost. It would be difficult to cite a specific number, but a reasonable goal would be no more than 30 City-wide. Any cost savings should be "reserved" to meet the CalPERS increases we know are coming.

RETIREE MEDICAL SICK LEAVE CONVERSION

While Long Beach does not offer medical coverage for its retirees, it does allow them to accumulate their unused sick leave hours and use them to purchase medical coverage when they retire. The present program accumulates unused hours and at retirement, the hours are multiplied by the final salary to arrive at a dollar figure (unused sick leave hours x final salary). This figure is then used to purchase insurance for however long the dollars last. This has created an unfunded liability for the City of $119 million.

A more fair way of calculating this benefit would be to calculate the value based of the actual rate of pay when the time accrued, instead of the final salary. This would truly reflect what was earned by the employee, and be a more appropriate and equitable manner to calculate this benefit and reduce the City’s unfunded liability.

EMPLOYEE RETIREMENT CONTRIBUTION

The pension reform recently achieved, required employees to pay more of their retirement costs. Public safety personnel now pay 9% of their salary toward their retirement and most non-public safety personnel now pay 8% of their salary toward retirement. Previously, employee contributions were 2% of salary. This was a key point during the last negotiations, but there is a huge gap in costs and it will get much bigger in the next few years.

While I know that this will not be a popular issue with employees, given the needs of CalPERS and the fact that these funds are applied to the employee’s retirement account, it will very likely be necessary to increase the employee contribution by another 2% or perhaps 3%.

Consider that increased employee contributions of 3% would produce $6 million annually to reduce the deficit. The City Council should begin the MOU negotiations with a specific goal to achieve in this area. To be blunt, it is doubtful the City can achieve the necessary savings for 2016-2021 without larger contributions from employees.

CO-PAYS AND HEALTH INSURANCE

Long Beach offers its employees comprehensive health care with relatively low co-pays and deductible levels. This, too, is an area the City will need to explore to achieve cost savings. Private employers have been moving in this direction for years and while the City has moved forward somewhat, it is time for a more effective cost sharing structure that gives employees more incentive to help control costs.

UPLANDS OIL

The price of oil per barrel has been a perennial issue with certain members of the Council. Long Beach is fortunate to have oil as a revenue source for our city. Currently, we “benchmark” the price of oil at $70 per barrel. Any revenue above that level is considered “one-time” and is used only for discrete, or “one-time” expenditures such as capital improvements. All revenue at or below the $70 is used for “on-going” budget expenses. It is important that the Mayor and City Council continue this policy.

Oil is a volatile commodity and its price can increase or drop rapidly. We witnessed oil move from $140 per barrel down to below $30 per barrel in 2009. Secondly, the bond rating agencies will likely react negatively to such fiscal imprudence and lower the City’s bond rating. Finally, given the known increases in expenses coming soon, it would be wise to hold these funds in reserve if needed in the 2017-2021 time period.

Please note that this is not the “pot of gold” some claim. Our revenue only increases $1.2 million for each $5 increase in the benchmark price. So even if the Council wished to increase the benchmark to $90, very risky with such a volatile commodity, it would produce $4.8 million for the General Fund and leave the only option of draconian mid-year cuts if the price or production levels were to drop. Similarly, that is $4.8 million in street, sidewalk, park improvements that don’t get done.

ONE-TIME NON-RECURRING REVENUE

We have been very disciplined in our use of one-time revenue using it for one-time or capital expenditures. We also reserve 5% of this revenue for unfunded liabilities. I recommend that we now take another 5% of this revenue and place in the CalPERS reserve. While this will not be recurring, it can soften the blow in the next few years when increase in costs will hit hard.

INCREASE PARTNERSHIP WITH PRIVATE SECTOR

Over the past several years I have made, and the Council has adopted, several recommendations to increase our use of the private sector to perform some of our services. Many of the recommendations have not yet been fulfilled. Everything from fleet services to information technology should be examined for savings. If enough can be saved in the next two or three years, we might be able to prevent the more draconian measures necessary to meet the budget numbers in 2017 to 2021. The Council should hold management's feet to the fire on this issue. Management Partners has identified potential opportunities that should be formally brought before the Council for deliberations on the FY 15 budget.

LOOKING FORWARD

I know that some of the elected officials want to "restore" previously reduced services. If they were to do that, they will actually be making matters worse and increase the amount that will need to be cut in the future. Spending the surplus in FY 15 means instantly creating a deficit of $2.5 million in FY 16 we will have to solve. Conversely, saving that surplus means no deficit in FY 16.

I also know that some employees will claim that the budget is being balanced "on their backs". As noted earlier, nearly 75% of the budget is personnel. Where else can the City look for revenues to make ends meet if personnel costs and the expenses go up faster than revenues? The difficult reality is that there are few, if any, other places to turn.

You have a good base to work from and a roadmap to continuing the build the financial strength of this City. It is my hope you will follow it. Achieving the reductions necessary for 2017 and beyond will require attention to detail and discipline. I would encourage each of you to always think long term, well beyond the normal 3 to 5 years. That is not an easy thing to do when you sit down on that dais every week.

All of the above are intended to frame the FY 15 budget as an opportunity to take action now to lessen the impact of what will be very difficult and painful cuts in the near future. A less surgical approach would be to simply cut the budget 2% across the board; this would produce about $8 million to be put aside for future years.

But I would leave you with this concluding thought. If the City can set a course now to meet the problems head on, it will build confidence and respect in our leaders. If we fail, and don't maintain our fiscal discipline, if we increase services or provide unaffordable compensation, and ultimately paper over the real fiscal issues, it will overwhelm the City and its elected officials.

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