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POLICY **BRIEF**

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Trouble Brewing in San Diego

BY STUART BUCK

The city of San Diego will face enormous budgetary pressures from the growing deficits in public pensions, both at a state and local level. In this policy brief, I estimate that San Diego faces total of $45.4 billion, including $7.95 billion for the county pension system, $5.4 billion for the city pension system, and an estimated $30.7 billion share of unfunded liabilities for California state retiree benefits. These estimates are made by correcting the state and local pension plans' figures, which use a too-optimistic assumption that their investments will grow by about 8% per year for the indefinite future.

San Diego faces a total $45.4 billion liability for pensions that are underfunded.

Unless state and city pensions are brought under control, these skyrocketing costs could easily force San Diego to limit or forego many other important public expenditures, such as road repair, schools, and healthcare.

BACKGROUND

The San Diego County Employees Retirement Association (SCDERA) covers nearly 20,000 current employees and retirees. As of June 30, 2009, SDCERA's assets amounted to about $6.1 billion, and it admits to an unfunded pension liability of $786 million. The San Diego City Employees Retirement System (SDCERS) covers about 20,000 current employees and retirees. As of June 30, 2008, SDCERS had about $3.1 billion in assets, and admitted to an unfunded pension liability of $1.3 billion.

As an example of how pensions are calculated, county employees can retire at age 50 with 10 years of service, at any age with 30 years of service (20 for safety employees), or at age 70 with any amount of service. Police and fire employees then get a pension equal to 3% of their final average salary times the years of service (i.e., a police officer with 30 years of service will get a pension equal to 90% of his salary for the rest of his life). Other employees who retire at age 60 will also get a 3% multiplier, but that multiplier will be reduced down to 2% if they retire as early as 50.

San Diego's city pension system has been the subject of numerous lawsuits, from the 2005 felony charges against pension board members who voted for increased benefits (most of these charges were ultimately dismissed in 2010)[1], to the 2010 lawsuit by the City Attorney seeking to require city employees to contribute an average of $4,000 more per year to the pension system.[2] Indeed, San Diego's sale of some $260 million of municipal bonds while refusing to admit to its true pension liabilities led the United States Securities and Exchange Commission (SEC) in 2006 to take the nearly unprecedented step of suing a major city for securities fraud, while suing the pension auditor for participating in misleading statements made to investors. In the words of the SEC's director of enforcement:

Given its ongoing underfunding and increasing obligations, San Diego knew that it would probably have difficulty in funding its future pension and health care obligations unless new revenues were obtained, pension and health care benefits were reduced, or services were cut. San Diego's pension issues were well known among city officials, and San Diego repeatedly had to deal with these pension issues. In other words, the pension issue was an elephant in San Diego's living room.[3]

The total is $45.4 billion, which amounts to about $15,129 per person in San Diego, including children.

According to the *Los Angeles Times*, the city of San Diego "is preparing for employee layoffs and a slashing of services to try to close an unanticipated $179-million budget gap created by a jump in pension obligations. Heavy investment losses and an increase in the number of city employees deciding to retire contributed to the increase. The system now has only 66.5% of the money it needs to cover its obligations to retirees, the lowest level in six years."[4]

A main reason for these extravagant pensions lies in the "deals struck by labor leaders and city officials in 1996 and 2002 created a financial windfall for thousands of city workers, some of whom enjoy double or triple the pensions they would have under the previous program."[5] As the *Los Angeles Times* noted, "Most San Diego city employees can retire at 50% salary at age 55 if they have 20 years' service. They also receive health benefits, survivor benefits and a "13th check" in years when the pension fund is booming. . . . Pension payments could consume half the city's annual budget by 2025 unless major changes are made, the San Diego County Grand Jury has warned."[6] In addition to the need to pay for increased benefits, "the city is now also repaying for its previous practice of diverting money from the pension fund to increase the city budget."[7]

The average San Diego city pension is now $45,600,[8] although there has been considerable outrage over the 20 highest-paid pensioners. For example, one former City Attorney collects $144,099 in a yearly pension while earning another $178,800 as a judge; a former police chief gets a $139,747 pension while earning another $191,000 as the Chula Vista police chief. One of the very highest pensions is received by a former chief investment officer for the pension system itself; he takes home $174,445 in a yearly pension.[9]

As of June 30, 2009, the city of San Diego owed some $1.3 billion for retiree health benefits, while "it has funded only 3 percent of that amount and doesn't pay enough to keep the liability from increasing each year."[10]

FINDINGS

Unfortunately, San Diego's financial situation is even worse than reported. The current estimates of pension liabilities have been made on the assumption that San Diego will earn 8.25% on its investments in perpetuity (San Diego lowered that assumption to 8% in May 2010). If we use a more conservative assumption that San Diego's investments will earn about 5.19% -- which is the corporate bond rate that private pension plans currently use – SDCERA actually has an unfunded liability of about $5.7 billion ($3.9 billion for SDCERS).

On top of that, if we look at the actual market value of SDCERA investments rather than the "actuarial" value (which doesn't yet fully take into account all of the market losses in 2008 and 2009), the unfunded liability rises again to about $7.9 billion ($5.4 billion for SDCERS). That figure may change from month to month as the value of SDCERA investments changes, but it is still much higher than anything that SDCERA currently admits.

We should also take into account San Diego's share of the unfunded pension and healthcare liabilities incurred by the California state government, as those unfunded liabilities will also affect San Diego taxpayers. In a separate report, I estimate that California's unfunded liabilities are around $378.4 billion. San Diego's population in July 2008 was 3,001,072, while California's population was 36,961,664 in July 2009, according to the U.S. Census Bureau. San Diego's pro rata share of the state's unfunded liabilities is therefore roughly $30.7 billion.

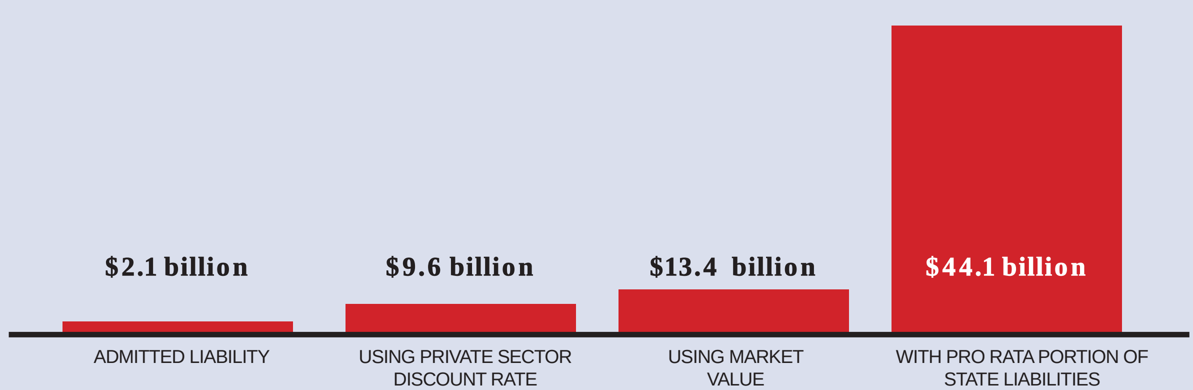
Adding it all up, San Diego is facing a $7.95 billion liability for its county pension system, $5.4 billion for the city pension system, $1 billion for its retiree healthcare benefits, and $30.7 billion for its estimated share of California state pension and healthcare benefits. The total is $45.4 billion, which amounts to about $15,129 per person in San Diego, including children.

As a subset of the above figures, San Diego teachers make up exactly 2.61% of the membership of the California teachers' pension plan, which is underfunded in the amount of $101.5 billion. San Diego teachers are therefore likely responsible for an estimated $2.65 billion in underfunding.

CONCLUSION

The prospects for reform are growing. San Diego city employees recently started paying higher contribution rates as required by the pension commission.[11] And on a statewide level, the *Los Angeles Times* recently reported that "Gov. Arnold Schwarzenegger recently reached tentative deals with six state workers' unions to reduce benefits and hike employee retirement fund contributions for new hires. He has also vowed to veto any budget for the current year — now almost three weeks overdue — that does not roll back retirement benefits to 1999 levels and require workers to contribute an additional 5% of pay toward retirement."[12] On the other hand, a pension reform bill "intended to curb pen-

SAN DIEGO'S UNFUNDED PUBLIC PENSION OBLIGATIONS



sion spiking has become so watered down that it would now do little to prevent California public employees from boosting their end-of-career pay-checks, critics say, prompting reform advocates and bill sponsor state Controller John Chiang to withdraw support."[13]

Absent significant reform at both the city and state level, San Diego's staggering pension and retiree health benefit liabilities will constrain the city's ability to engage in any other public spending in the foreseeable future. As David Crane, a Schwarzenegger appointee to the California teachers' pension system, has said, "All of the consequences of rising pension costs fall on the budgets for programs such as higher education, health and human services, parks and recreation, and environmental protection that are junior in priority and therefore have their funding reduced whenever more money is needed to pay for pension costs."[14]

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[1] Jonathan Heller and Jennifer Vigil, "Aguirre's suit seeks cutback in pensions," Sign On San Diego.com, 8 July 2005, available at http://legacy.signonsandiego.com/news/metro/pension/20050708-444-aguirres.html; "Five ex-San Diego pension board members cleared of felony charges," San Diego News Network, 25 Jan. 2010, available at http://www.sdnn.com/sandiego/2010-01-25/politics-city-county-government/five-ex-san-diego-pension-board-members-cleared-of-felony-charges.

[2] Liam Dillon, "Lawsuit Could Bring Radical Shift to City's Pension Payments," Voice of San Diego.org, 6 May 2010, available at http://www.voiceofsandiego.org/government/article_98416a88-5953-11df-8580-001cc4c002e0.html.

[3] Linda Chatman Thomsen, "Speech by SEC Staff: Lessons Learned from San Diego," 11 Dec. 2007, available at http://www.sec.gov/news/speech/2007/spch121107lct.htm.

[4] Evan Halper and Marc Lifsher, "Government pensions in cross hairs," *Los Angeles Times*, 23 April 2010, available at http://articles.latimes.com/2010/apr/23/business/la-fi-pension-reform-20100423/4.

[5] Danielle Cervantes and Craig Gustafson, "Sales-tax hike's roots lie in pension increases," Sign On San Diego, 21 Aug. 2010, available at http://www.signonsandiego.com/news/2010/aug/21/Pension-decisions-more-than-doubled-payouts/.

[6] Tony Perry and Marc Lifsher, "Municipalities take aim at public pensions," *Los Angeles Times*, 18 July 2010, available at http://www.latimes.com/news/local/la-me-pensions-20100719,0,898989.story?track=rss.

[7] Vlad Kogan, "What Caused San Diego's Ballooning Pension Payment," Voice of San Diego.org, 2 Aug. 2010, available at http://www.voiceofsandiego.org/peoplespost/vkogan/article_03b773ba-9dca-11df-90fd-0016353c402a.html.

[8] See graphic at http://media.signonsandiego.com/img/photos/2010/08/22/pension_t593.jpg ; "Top 20 pensioners cite city service," Sign On San Diego, 23 Aug. 2010, available at http://www.signonsandiego.com/news/2010/aug/23/top-20-pensioners-cite-city-service/.

[9] Danielle Cervantes, Lily Leung, and Jeff McDonald, "Top 20 pensioners cite city service," Sign On San Diego.com, 23 Aug. 2010, available at http://www.signonsandiego.com/news/2010/aug/23/top-20-pensioners-cite-city-service/.

[10] Liam Dillon, "San Diego's Easiest Financial Fix is Its Most Complicated," Voice of San Diego.org, 10 Jan. 2010, available at http://www.voiceofsandiego.org/government/article_72770f02-fe58-11de-83b1-001cc4c002e0.html ;"Fact Check: San Diego a Lone Wolf on Reform?," Voice of San Diego.org, 18 Aug. 2010, available at http://www.voiceofsandiego.org/fact/article_11e35e36-aa4f-11df-b38c-001cc4c03286.html.

[11] "City Bows to Retirement System Request," Voice of San Diego.org, 9 Aug. 2010, available at http://www.voiceofsandiego.org/government/the-hall/article_66b02c68-a3ed-11df-995c-001cc4c002e0.html.

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[13] Catherine Saillant, "California pension reform effort loses support," Los Angeles Times, 18 Aug. 2010, available at http://articles.latimes.com/2010/aug/18/local/la-me-0818-pension-reform-20100818.

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