California cities not prepared for growing retiree health care costs

By Corey G. Johnson, California Watch

Most major California cities are failing to address the growing health care costs of government retirees, which have ballooned to more than $1 billion in some areas and soon could threaten municipalities' ability to pay other expenses, according to a recent financial analysis by a nonprofit research group.

Eleven of 20 California cities with the biggest budgets do not set aside funds for future health care costs, the study by California Common Sense found.

Those cities – San Francisco, Oakland, Sacramento, Redding, Santa Ana, Long Beach, Glendale, Fresno, Riverside, Pasadena and Santa Monica – work under pay-as-you-go systems, meaning they pay benefits from their current operating budgets and do not accumulate funds for future payments.

Combined, all 20 cities have promised $16 billion in future non-pension benefits, and $12 billion of that remains unfunded. The 11 pay-as-you-go cities are losing $2.2 billion in savings by not setting aside money, the analysis found. The $2.2 billion figure is derived from an estimate of each city's potential investment earnings at the 7.61 percent return rate set by the California Public Employees' Retirement System.

San Francisco, which is obligated to pay $4.4 billion for its current and future retired public workers' health care costs, is the state's biggest city that doesn't set aside money to help finance benefit payments.

Los Angeles, on the other hand, puts close to 59 percent of its future costs in a trust to begin drawing interest. Other cities that pay toward future costs include San Jose, San Diego, Anaheim, Roseville, Palo Alto, Bakersfield, Burbank and Santa Clara.

The analysis also concluded that retiree health care costs are consuming more of municipalities' operating budgets and aren't likely to decrease because retirees are living longer and fees for medical services are rising. Since 2008, retiree benefit costs have increased by 36 percent.

Such costs are beginning to have an impact. San Jose, for example, spent close to 8 percent of its operating budget on retiree benefits last year – a dramatic 43 percent jump from what it spent three years ago.

The city of Stockton didn't put funds aside, so it didn't earn additional funds to help pay its retiree health benefit debts. Two years ago, Stockton faced a $410 million tab for current and future health care costs for its retired public workers. This came as the city was struggling to pay down a long-term pension debt of $1.3 billion.

Eventually, the financial strain became too much for Stockton, which has been hit hard by the state's housing crisis and economic downturn. After filing for bankruptcy last month, Stockton officials announced that they will end all retiree health care benefits after 2013.

Study author Adam Tatum said more cities could be forced to make similar choices if they fail to make policy changes now.

"Most people agree with us that this is a serious issue," Tatum said. "These benefits have already been promised to employees. To take them away will go back on that promise."

William Statler, former city treasurer and finance director for the city of San Luis Obispo, said the factors related to setting aside money for future retiree benefits are complex. When examined over 30 years, retiree set-asides will typically be much less expensive than paying when benefits are due. However, in the short term, paying for current and future health costs is far more costly than just paying cash as you go —which is why so many governments aren't prepaying, Statler said.

"In fact, those that do usually have pretty modest obligations to begin with," Statler said. "That's why they can afford to prefund, while those agencies with the largest obligations — and thus the even bigger wake-up call in the not-so-distant future — can least afford to prefund in the early years."

In addition to set-asides, the study urges government officials to consider alternative approaches to reduce costs, including increasing the amount of employee contributions and restricting eligibility for full benefits. The city of Beverly Hills has shaved $13 million from a $58 million retiree health care tab by giving employees a sizable cash payment in exchange for giving up their city-financed health care benefits upon retirement, Tatum said.

"Fifty percent of the employees agreed," Tatum said. "That's actually a pretty significant reduction."

California Common Sense's study, based on data from the state comptroller and reams of annual financial reports from each city, is the latest of several to warn about out-of-control retiree health benefits.

Senate President pro Tem Darrell Steinberg, D-Sacramento, said last week that legislators are examining employee benefits this month. According to the *Sacramento Bee*, Steinberg expects major legislation to be completed by month's end that would change how state and local governments handle retiree payouts.