

# Pension costs put San Jose in dire fiscal straits

By Daniel Borenstein

The city of San Jose faces a fiscal death squeeze as it tries to fund ballooning costs of employee retirement benefits.

To pay the bill, it must lay off workers. Whereas 10 percent of general fund expenditures went toward pensions and retiree health care in 2007-08, this year it's 22 percent. In the same four-year period, the city has eliminated 1,592 jobs, or 23 percent of the workforce. It's going to get worse.

To be sure, other factors contribute to workforce reduction. But retirement costs are the most significant. And of the two key components driving those costs — pensions and health care for retirees — the former accounts for about 85 percent of the bill.

On Dec. 6, the City Council will consider asking voters to approve the state's most far-reaching public employee pension reforms. The problem is particularly severe in

San Jose but not unique to the city.

Those who resist change parrot the myth that a strong economic recovery will fix this. They're wrong. Market losses since 2008 have exacerbated the problem, but they are just one of many factors driving the costs.

To understand why, consider the components of pension costs. For this exercise we'll use San Jose's police. The pension costs for general city workers are expensive, but the price for police and firefighters is nearly double.

Pension costs are typically calculated as a percentage of payroll. For San Jose police, the total payment is about 85 cents for every payroll dollar. Of that, the city pays 75 cents and workers pay 10. The 85 cents is divided into payment for newly earned pension benefits and payment on the debt for miscalculations of the past.

For each year employees work, they earn additional future pension

benefits. Newly earned police pension benefits currently cost 38 cents on the dollar. The city contributes 28 cents and employees pay their 10 cents. These payments, after future investment earnings, should theoretically cover the benefits when those people retire. It's important to understand that past market losses do not affect these numbers.

But what happens when retirees live longer than anticipated? When employees are retroactively granted larger pension payments that had not been previously funded? When employees are guaranteed cost-of-living adjustments when they retire that had not been factored into the cost? When projections about future investment returns are revised downward? And, yes, what happens when past investment earnings don't meet expectations?

Suddenly, there's not enough money in the pension system. It's what accountants call an "unfunded

liability." It's essentially a debt.

Two key points about that debt: First, it's solely the responsibility of the employer, the taxpayer. Second, it's a debt for retirement benefits that have already been earned, benefits for labor that has already been performed. Yet pension systems amortize it like a home mortgage. San Jose stretches payments over 16 to 20 years, passing on to the next generation a major cost of current labor.

It's the installment payment on that debt that comprises the second part of pension costs. That's 47 cents on every payroll dollar for San Jose police.

To make matters worse, the pension system has yet to fully account for the investment losses of the Great Recession. In San Jose, those losses are eased into the accounting over five years. So look for payments on the unfunded liability to increase in coming years. Moreover, as the city reduces its

workforce, it has fewer employees over which to spread the cost of the unfunded liability. That has driven up the cost per employee.

Adding the current 75 cents in city costs to every dollar of payroll just to pay for pensions is unsustainable. By city projections, it will be roughly 84 cents next year. Add in retiree health care and the city cost for police post-employment benefits will reach 96 cents on the dollar. (It's nearly 99 cents for firefighters.)

Without change, the city forecasts, San Jose in four years will be spending 30 percent of the general fund budget just for retirement benefits.

This is a fiscal emergency.

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