SACRAMENTO BUSINESS JOURNAL

From the Sacramento Business Journal:
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Sacramento faces hard choices over $363 million in unfunded retiree benefits

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May 5, 2016, 7:06am PDT **Updated: May 5, 2016, 7:17am PDT**

When the Sacramento City Council adopts a budget next month, it will confront a little-discussed problem that promises to grow in size every year: the increasing cost of providing medical benefits for retired city employees.

DENNIS MCCOY | SACRAMENTO BUSINESS JOURNAL
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The city has an unfunded liability of $363 million in retiree medical payments, also known as other post-employment benefits. Of that sum, $309 million must be paid from the general fund over the next three decades.

In coming years, Sacramento residents “will likely be asked to put up with budget cuts or tax increases a bit at a time as the annual payments grow,” said Don Boyd, director of fiscal studies at the Rockefeller Institute of Government, a New York-based public policy think tank. “There’s no easy way out.”

Sacramento faces a greater challenge than other comparable cities when the unfunded liability is compared to the size of the general fund. According to city documents, Sacramento's unfunded liability is the second-highest in the state behind San Jose.

To reduce the liability and make it more manageable, the city in 2013 created a trust account that would work like a pension fund, earning interest over time to reduce the annual cost to the city.

But the city hasn’t met the yearly goal it established for funding the trust. The goal next year calls for putting $23.8 million into the trust, but the city manager has only proposed a deposit of $1.5 million.

Next year's budget does include $10.7 million to pay benefits for current retirees. But if the city continues to shortchange the trust, future retiree medical costs “will continue to grow, consuming resources that would otherwise pay for vital programs and services,” according to city documents.

And plugging the gap is about to get harder. The city is expecting the budget to go into deficit beginning in 2018 — before even considering obligations to the trust.

“We can’t afford another $22 million right now,” said Leyne Milstein, the city’s director of finance. “We want to avoid a phenomenon where the cost of salaries and benefits are crowding out (city) services. That is the overall concern.”

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If the city tried to immediately meet its self-imposed goal of fully funding the trust fund, “I don’t think anyone wants to talk about the cuts we would need to make to do that,” said Milstein.

Sacramento is not alone in this daunting fiscal obligation. Cities across the U.S. are grappling with rising costs for retiree medical benefits. Simply by creating a trust account and outlining a plan to solve the problem, Sacramento is actually ahead of most cities, said Andrew Ward, director of public finance for Moody's.

"Most cities haven't gotten very far on this. I think Sacramento is a little ahead, but eventually everyone has to fund this liability," he said. "They are just at the beginning of that process."

There are some factors in play that could reduce the severity of the situation. The annual retiree medical obligation could be reduced next year, as the city negotiates contracts with an array of different local bargaining units. But unions would have to agree to cutting benefits for their members — which is far from a sure thing.

Whether or not that happens, the City Council wants to fully fund the trust within a decade. Policymakers want the trust to begin earning interest so deposits from the general fund could eventually be reduced.

But even if that happens, the city will still have to pay millions more into the trust than it is now.

"It's not going to be an overnight solution to fix a problem that has taken years to create," said City Councilman Eric Guerra. "I'm glad we are having the conversation to figure out what the solution is."

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