Case Study II

Fiscal Sustainability and Political Culture in Long Beach, California

BY MICHAEL MCGRATH

In August 2011, when the mayor of Long Beach, California, submitted his fiscal year 2012 budget proposal to the city council, there was a snag. A three-member faction of the council proposed what it called a "Public Safety and Quality of Life Protection Plan" to restore nearly half the cuts proposed by the mayor and city manager in an ongoing effort to reduce the city's structural deficit. The idea was to use a onetime windfall in the city's uplands oil fund—Long Beach has its own oil wells—to, among other things, maintain existing staffing levels within the police and fire departments. Ordinarily, protecting the public safety budget is the mantra of local governments, a political reality that reflects both citizen support for police and fire services and the clout of public employee unions, but this time a majority of the council stood with the manager and mayor, suggesting the possibility, at least, that Long Beach may have a new mantra: "fiscal sustainability."

Long Beach public managers and elected officials have been using the language of "sustainability" since 2003, when what some have described as a "perfect storm" of fiscal conditions shocked the city into undertaking a three-year strategic plan to address the city's "structural deficit," which could be defined as the difference between ongoing costs and ongoing sources of revenue. The process marked a change in the city's approach to budgeting. In the past, city officials had negotiated from a position of relative weakness with employee labor groups, spent windfalls on onetime budget solutions, and failed to build reserve funds for future needs. Since 2003, however, the city has pursued a far more prudent financial course, exacting major cuts in expenses and staff positions and reorganizing bureaus and divisions to reduce administrative costs and consolidate highly paid senior management positions. More recently, the city has made progress in addressing its most pressing fiscal challenge, unsustainable pension liabilities.

Background

Long Beach is the second largest city in the Los Angeles metropolitan region and the seventh largest in the state. Long Beach is one of the most racially, linguistically, and demographically diverse cities in the United States, with a median income below the state average and a higher-than-state-average unemployment rate. Gang activity continues to be a problem for local law enforcement agencies. With one of the busiest container ports in the country, it has an economy that is a mix of old and new—aerospace, oil production, shipping, business services, public sector jobs, and tourism. During the 1990s, with the end of the Cold War and thanks to the closing of U.S. Navy operations facilities and a downturn in the aerospace industry, the city's economy lost tens of thousands of jobs. City officials have tried to make up for the job losses with an aggressive redevelopment strategy, using tax increment financing to foster a more diversified economic base and revitalize the waterfront/downtown area and, more recently, some of the city's older neighborhoods.

Until 2002, Long Beach had been operating under what city officials have described as a "manageable" structural deficit, filling budgetary holes with onetime revenue sources to make it from fiscal year to fiscal year. Since the 1990s, losses in revenue to the state have included $15 million in property taxes to the Education Revenue Augmentation Fund, $900,000 in added property tax collection costs, and $300,000 from the cigarette tax. A local initiative to reduce the annual utility users' tax resulted in the loss of more millions in revenues. In the meantime, state mandates added costs to the city of about $3 million per year. Local sales taxes and hotel taxes were flat. The lowered revenues and increased costs had created a gap of about $46 million. In 2002, the Long Beach city manager developed a budget with more than $37 million "one-times," that is, nonrecurring revenue sources, to balance the budget.

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Three-Year Strategic Plan

When a new interim city manager was appointed, he was tasked with addressing the structural deficit challenge by developing a three-year financial strategic plan. It was an unusual opportunity to do something ambitious and politically risky, noted one public manager. Jerry Miller, the interim city manager, was not interested in a permanent appointment and didn't have to worry as much about the political fallout. An internal management team of department heads was assembled to generate budget scenarios. A ten-person budget advisory committee (BAC) was appointed by then-mayor Beverly O'Neill. During the months of November and December 2002, a "Voice Your Choice Community Survey on City Services" gave residents the opportunity to rate fifty-one city programs in nine service areas in terms of their importance: "essential," "important," "nice to have," and "not important." English-, Spanish-, and Khmer-language versions of the survey were distributed at city buildings. The survey, which was posted on the city Web site and published in the *Long Beach Press-Telegram* and the *Long Beach Business Journal*, received about 15,000 responses. In the survey results, citizens rated the most essential services as things such as health code enforcement (52 percent), gang prevention (56 percent), and fixing potholes (61.9 percent) and sidewalks (55.8 percent). Among the most common cutback suggestions from the public were comments such as "cut managers and management salaries," "stop the use of expensive consultants," "optimize services by consolidating services performed by two or more departments," "eliminate feather-bedding in the Fire Department," and "reorganize police department."

On November 23, 2002, a community meeting on city services was held at the convention center. Community members were invited to hear about budget challenges, view the preliminary results of the survey, and discuss services with city staff members and to offer suggestions on savings and possible new sources of revenues. More than 800 people attended this first forum. During the forum, council members and BAC members met with members of the public to share ideas. Small-group meetings were held, and priorities were listed by the public participants. The information from the forum and survey was taken back to the management team, which divided up into various groups—quality of life, nuts and bolts, public works, city infrastructure, and technology—based on expertise. For three months, the teams met three times a week to go through the various scenarios. In January 2003, the three-year financial strategic plan was submitted to the city council. Quoting from the final strategic planning document:

> Reductions in management and administrative staffing throughout the organization make up a significant portion of overall cost reductions in the proposed Plan. These reductions equal approximately 13.2 percent of the overall plan solutions, totaling $11.3 million in reduced expenditures. Management staffing would be reduced by close to 25 percent or approximately 48 positions in General and related fund programs over the next three years, with an estimated $5.3 million in savings. (See http://www.longbeach.gov/civica/filebank/blobdload.asp?BlobID=3307)

During the next eight years, the city would cut more than $144 million from its general fund budgets, eliminate more than six hundred employee positions (about 19 percent of the general fund workforce), and increase revenue sources by about $40 million, consolidating bureaus and divisions to streamline the organization and removing hundreds of vehicles from the city fleet. Staff members were asked to do more with less, and citizens were asked to tolerate longer wait times for certain city services or to use their own resources to address service needs. For example, the city now has a longer wait time for sidewalk repairs and tree trimming, but members of the public can agree to pay their share of the costs to get the job done sooner or to hire their own private contractors.

Pension Reform

The financial crisis of 2008 marked a new stage of Long Beach's quest for fiscal sustainability, a move away from the public engagement/collaborative problem-solving strategy of the period from 2002 to 2003 to a more traditional top-down approach of negotiations, maneuverings, and structural changes led by elected and appointed public officials. There was an emphasis on holding the line against "one-time" budget fixes and in renegotiating labor contracts to make city benefits packages more "sustainable." Between 2008 and 2010, the California Public Employees' Retirement System (CalPERS) lost an estimated $70.2 billion, or about 30 percent of its assets. These market losses meant higher contributions from the cities. Long Beach wasn't a merely passive victim of the pension crisis. Since the 1990s, the city has been paying both the employer and the employee shares of PERS fees in lieu of actual salary increases, which the city could ill afford. Ordinarily, an employee is supposed to pay a percentage of his or her salary for the PERS contribution, with the employer contributing a certain percentage. After 1999, as part of a statewide trend, the city agreed to increase the formula for calculating annual retirement benefits, an arrangement that was made during a buoyant national economy when PERS was said to be "super-funded," meaning that no annual contribution from the city was needed thanks to a surplus in the PERS investment fund. If unchecked, the growth of employee costs—salaries and benefits—threatened to devour the city's budget.

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The current mayor, Bob Foster, a former chief executive of Southern California Edison, has been a strong advocate of changing the city's pension policies to make them sustainable. It was a central theme in his 2012 budget message, in which he argued that hindsight "would have urged us to build a reserve or make a payment in case circumstances changed. We did neither. Not only did the city increase pension benefits going forward but [it] also made the increases retroactive to be inclusive of all the years employees had worked. The spending of the 'windfall' is the single largest cause of our present difficulties." In 2010, Foster proposed using contracted raises to pay for the employee share of pension costs. Under this proposal, the employee's contribution would increase until his or her full share was reached. Additionally, he proposed that new employees would have different pension provisions. For public safety employees, the new retirement age would be fifty-five rather than fifty and the formula would change from 3 percent per year of service to 2 percent. For all other employees, the retirement age would move from fifty-five to sixty and the formula from 2.5 percent to 2 percent.

With these changes, the mayor suggested, the city's structural deficit could be cut in half during the next three years, allowing the city to preserve levels of service and avoid layoffs. The city manager, chairman of the city council budget oversight committee, and council majority supported this strategy as the basis of future labor negotiations. A breakthrough was reach in August 2011 when the two largest unions, the police and firefighters' associations, agreed to renegotiate their contracts. Those public safety agreements alone are projected to save the city nearly $100 million during a period of ten years.

Proportionate Share

Today police and fire services account for about 70 percent of the annual budget, up from about 58 percent of the budget only ten years ago. Until recently, public pressure to preserve police and fire at all costs has meant that the other departments had to shoulder the lion's share of these severe budget reductions. Two years ago, with support from the city council majority and mayor, the city manager adopted a new policy known as proportionate share, ensuring that the proportion of the municipal budget taken up by public safety would go no higher than 70 percent, so that future cuts in the budget would be shouldered by each department proportionally. The strategy is to look at departments that have experienced growth and to require those departments to make appropriate reductions to keep their growth under control. The policy means making painful cuts in police and fire services, as reflected in the 2012 budget, but without this policy, the city would have to exact draconian cuts in libraries, sidewalks, code enforcement, animal control, and parks to maintain its goal of structural balance.

Without proportionate share, city officials have estimated that 100 percent of the Long Beach general budget would go toward public safety by the year 2030. The proportionate approach has been adopted by the city staff and supported by the

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mayor, the chairman of the budget oversight committee, a majority of the council, and, seemingly, the community. "We need to have the ability and political support to say we can't just have a police and a fire department at the expense of everything else," said one public manager interviewed for this study. "Our community accepts that now. Eight or nine years ago, if you would have cut one police officer, it would have been a huge thing." Proportionate share has had the added effect of creating incentives for employee unions to renegotiate pension benefits to avoid more draconian departmental reductions.

Structural Reform

Long Beach has a city manager/city council form of government, but over the years has departed from the "pure" model, which featured at-large council districts, mayors elected from the council, and no separation of powers between elected officials. In Long Beach, a nine-member city council is elected by district with no at-large seats. The mayor is elected citywide by popular vote instead being elected from the council or serving on a rotating basis. In 2007, the charter was further amended to give the mayor enhanced powers over the budget. Though the office has no vote on the council, the mayor presides over council meetings and reviews and presents the annual budgets developed by a professional city manager. The mayor also has veto power over city council actions, including the ability to veto line items in the budget. The council can override the mayoral veto with a two-thirds majority. The change in mayoral powers was proposed by the current mayor, Bob Foster, who advocated the change precisely to give his office a stronger leadership role in the budget process. The mayor has from July until August to review the budget drafted by the city manager and present it to the council with a mayor's budget message, which allows him to articulate a clear message on budget priorities.

In his last two budget messages, Foster has focused on the need for pension reform, building the city's reserve, matching ongoing costs with ongoing revenues, and protecting the city's oil fund by making conservative projections of the cost of oil. Last year, for example, the projected price was $55 a barrel, much lower than the actual price of about $95 a barrel, which gave the city a windfall of about $10 million. Citizens and interest groups, however, have successfully resisted structural change in some cases. A proposal by the mayor to merge the city's appointed civil service commission with a modern human resources department failed at the ballot box. Another charter revision initiated by the public discourages contracting out city services, a strategy that some cities have pursued. Outsourcing requires a finding that "the work or services to be contracted for can be performed by a private contractor as efficiently, effectively and at an estimated lower cost to the City than if said work or services were performed by employees of the City." The city is currently doing an analysis on contracting out street sweeping, vehicle towing, and other services, but some council members have resisted.

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Innovation

As one elected official interviewed for this study noted, innovation isn't all that easy with the pension growth sword of Damocles hanging over your head, but the city has continued to innovate and find new ways of addressing issues, such as homelessness in the downtown area and air pollution from trucking activities to and from the port. Long Beach recently entered a local-state-private partnership to build a $490 million courthouse. Through its redevelopment agency, it was able to purchase land for the new courthouse and do a swap with the state for the existing courthouse, which is considered obsolete. The project features a design/build/operate agreement with Long Beach Judicial Partners, a private company. The group made an agreement with the city to build the courthouse on land owned by the redevelopment agency, which will receive title to the valuable oceanfront (Ocean Boulevard) property where the old courthouse stands.

The company agrees to maintain the property for a period of 30 years, at which point the state would be given ownership. This arrangement fits with Mayor Foster's belief that government is unreliable when it comes to spending on infrastructure and maintenance. Another innovation is the city's new Go Long Beach application. The smart phone app makes it easier for citizens to report potholes, graffiti, sidewalk damage, weed-strewn lots, downed streetlights, or missing street signs. The app forwards the report, a picture, a description, and the exact GPS coordinates to police or work crews, which are able to respond more rapidly to the problem. Long Beach is the largest city in Southern California to use mobile technology in this way. More recently, it has introduced mobile applications so people can easily find public art installations and another for downtown restaurants.

Conclusion

Fiscal sustainability is an ideal that cannot be discussed without considering the external pressures on local governments. For instance, recent attempts by state government to eliminate local redevelopment agencies could have a dramatic impact on Long Beach's budget and economic well-being. The city has staked a lot on the use of tax increment financing to diversify the local economy and revitalize older urban districts. Not surprisingly, local officials have strongly supported a lawsuit by the League of California Cities and the California Redevelopment Association to oppose the new policy. Cities across the country are facing severe financial challenges, but the challenge of fiscal stewardship is even greater in California, where economic volatility, political polarization, and efforts by the state to balance its budgets at the expense of localities makes fiscal sustainability a constantly moving target. Most, though not all, of the public managers and elected officials interviewed for this case investigation judged Long Beach to be a success story.

Long Beach's 2012 deficit of about $20 million is less than half the size of deficits in some other California cities of similar size. The city has no direct, outstanding general obligation debt and, consequently, no official credit rating, but according to the city treasurer's office, it has an "implied" credit rating of AA– (S&P); Aa2 (Moody's), and AA (Fitch). Long

Beach hasn't eliminated its structural deficit, but recent agreements with the police and fire unions to renegotiate pension costs bode well for future budgets. Fiscal sustainability is not just a matter of balancing budgets. Levels of service and citizen satisfaction have to be factored into the equation. In Long Beach, the unceasing campaign of cost cutting seems to have occurred without unacceptable reductions in services or anger on the part of citizens.

Interestingly, in a recent study by the Knight Foundation and the Gallup organization, Long Beach scored very highly in levels of "community attachment," second only to Boulder, Colorado. Citizens expressed particularly high ratings for their parks, playgrounds, and trails, and this score was higher in 2010 than in 2009. Crime statistics suggest cuts and changes in the police department have not damaged public safety. In fact, violent crime rates have declined steadily during the past six years.

Long Beach was clearly on an unsustainable financial course in 2002, when the city held a community-wide conversation on budgets and levels of service. Via surveys and public meetings, the public communicated its desire to begin with cuts in administrative costs and to preserve core services, such as police, fire, and parks. This was hardly a surprising outcome, but city staff and public officials built trust and credibility by honoring this mandate, no matter how vague or predictable, by starting its budget-cutting regime by addressing administrative costs and organizational changes that would consolidate or eliminate highly paid senior positions. As the budget crisis continued and more severe cuts in city services were deemed necessary, the political will on the part of elected and appointed officials had been established. Advocates of public engagement might find that it was not as deep or as participatory as it could have been. Most of the spadework was done internally, and the public engagement strategy did not grow or deepen as the budget crisis continued. Instead, the city has adopted a strategy that could better be described as "transparency" than "engagement," focusing on accessible public documents (for example, a very easy-to-understand "Citizen Budget Book"). Council meetings and budget oversight committee meetings are videotaped, archived, and available on the city's Web site, as are budget documents.

The financial future is uncertain, but efforts to address the question of structural balance dating back to 2003 put Long Beach in a better position than other cities of similar size to face the fiscal crisis that erupted in 2008. The city would have been in an even better position if it had never negotiated overly generous and unsupportable pension agreements with employee unions, had paid closer attention to the need to build reserve funds, and not spent onetime revenues on patchwork fixes of short-term deficits. Long Beach has made an important first step on the road to sustainability, which is to change the political and organizational culture, to build consensus for tough decisions, and to think in terms of structural balance, multiyear projections, prioritizing essential services, and adopting a more realistic negotiating posture with public employee unions. All of this has been accomplished without dramatic reductions in the quality of services or widespread public anger, dissatisfaction, or insurmountable opposition.

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