WWW.EDCHOICE.ORG

The Foundation for Educational Choice

POLICY BRIEF

OCTOBER 2010

Trouble Brewing in Los Angeles

BY STUART BUCK

The city of Los Angeles 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 Los Angeles faces a total $152.6 billion liability for pensions that are underfunded – including $49.1 billion for the city pension systems, $2.4 billion for retiree health benefits, and an estimated $101 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.

Los Angeles faces a total $152.6 billion liability for pensions that are underfunded.

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

BACKGROUND

The Los Angeles City Employees' Retirement System (also known as LACERS) covers over 30,000 current employees and some 15,000 retirees. Its investment portfolio was worth $9.3 billion as of September 30, 2009. The Los Angeles County Employees Retirement Association (LACERA) covers 157,000 members, including some 57,000 retirees. Its assets were about $30.5 billion in 2009. Los Angeles also operates two other pension plans: the Fire and Police Pension Plan and the Water and Power Employees' Retirement Plan. The former has nearly $11 billion in assets, and covers nearly 14,000 current employees and over 12,000 retirees.

As an example of member benefits, police and fire employees can retire at 55; if they have 30 years of service, most will retire with a pension equal to 70% of their final year's salary (some retirees in Tier 5 can get up to 90% of their final year's salary with 33 years of service). Other city employees can retire as early as 55 with 30 years of service, with a pension equal to 2.16% of their final year's salary times their years of service.

In April, the *Los Angeles Times* reported that "pension costs are expected to consume 19% of the general fund budget in the coming fiscal year."[1] Moreover, "the city projects that the taxpayers' share of city pension costs will grow from $653 million this year to nearly $1.3 billion in four years, accounting for one 1 of every 4 dollars spent on basic services."[2] By August, the *Los Angeles Times* was reporting that "by 2015, nearly 20% of the city's general fund budget is expected to go toward the retirement costs of police officers and firefighters, who now have an average retirement age of 51. The figure was 8% last year. Once civilian employees are factored in, nearly a third of the city's general fund could be consumed by retirement costs by 2015."[3]

FINDINGS

Unfortunately, Los Angeles' financial situation is even worse. The current estimates of pension liabilities have been made on the assumption that Los Angeles pensions will earn 7.75% or 8% on their investments in perpetuity. If we use a more conservative assumption that Los Angeles' investments will earn about 5.19%—which is the corporate bond rate that private pension plans currently use – LACERA actually has an unfunded liability of about $20.5 billion, while the police/fire pension has an unfunded liability of $7.7 billion, and LACERS has an unfunded liability of $7.9 billion.[4] In addition, the retiree health benefits for police/fire employees would be underfunded using this measure by some $2.4 billion.

Adding it all up, Los Angeles is facing a $49.1 billion liability for its two main pension systems, $2.4 billion for retired police/ fire health benefits, and $101 billion for its estimated share of California state pension and healthcare benefits. The total is $152.6 billion, which amounts to about $15,471 per person in Los Angeles, including children.

On top of that, if we look at the actual market value of pension 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 $29.7 billion (LACERA), $11 billion (police/fire), and $8.4 billion (LACERS). These figures may change from month to month as the value of pension investments changes, but it is undoubtedly much higher than anything that Los Angeles' pension systems currently admit.

We should also take into account Los Angeles' share of the unfunded pension and healthcare liabilities incurred by the California state government, as those unfunded liabilities will also affect Los Angeles taxpayers. In a separate report, I estimate that California's unfunded liabilities are around $378.4 billion. Los Angeles' population in July 2008 was 9,862,049, while California's population was 36,961,664 in July 2009, according to the U.S. Census Bureau. Los Angeles' pro rata share of the state's unfunded liabilities is therefore roughly $101 billion.

Adding it all up, Los Angeles is facing a $49.1 billion liability for its three main pension systems, $2.4 billion for retired police/fire health benefits, and $101 billion for its estimated share of California state pension and healthcare. The total is $152.6 billion, which amounts to about $15,471 per person in Los Angeles, including children.

As a subset of the above figures, Los Angeles teachers make up exactly 9.09% of the membership of the California teachers' pension plan, which is underfunded in the amount of $101.5 billion. Los Angeles teachers are therefore likely responsible for an estimated $9.23 billion in underfunding.

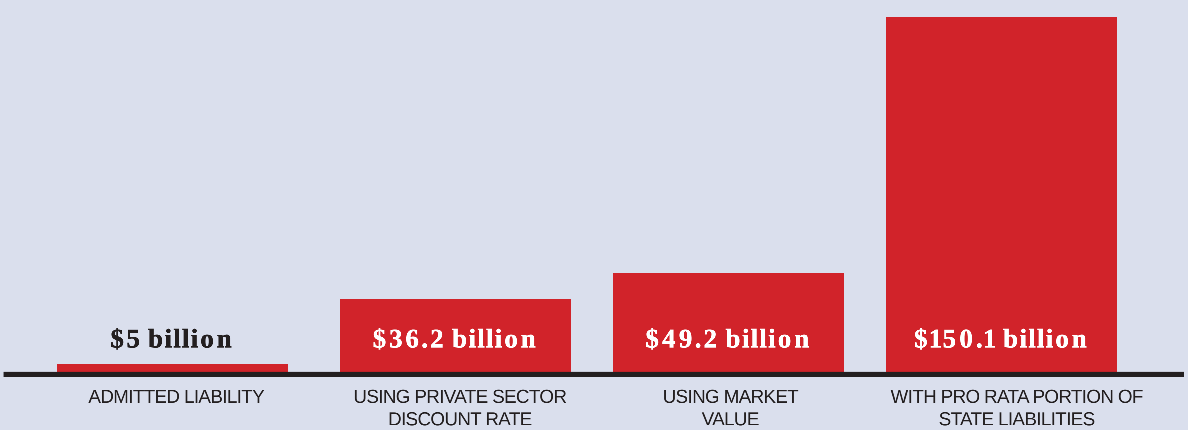
CONCLUSION

The prospects for reform are growing. In April, the *Los Angeles Times* reported that "In Los Angeles, which faces a $1-billion shortfall in three years, the mayor and top budget officials are working on a plan to cut pension costs by scaling back benefits for newly hired workers."[5] In August, city councilman Bill Rosendahl told the *Los Angeles Times* that "his constituents are demanding comprehensive changes to a system that threatens to eat away at core services. 'We can no longer sustain the pension and healthcare plan that presently exists.'"[6] Former mayor Richard Riordan has also gotten involved, calling for "a series of reforms, including ending pensions for new hires and raising the retirement age."[7]

Absent significant reform at both the city and state level, Los Angeles' staggering pension and retiree health benefit liabilities will constrain the city's ability to engage in any other public spending in the foreseeable future.

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

LOS ANGELES' UNFUNDED PUBLIC PENSION OBLIGATIONS



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."[8] On the other hand, a pension reform bill "intended to curb pension spiking has become so watered down that it would now do little to prevent California public employees from boosting their end-of-career paychecks, critics say, prompting reform advocates and bill sponsor state Controller John Chiang to withdraw support."[9]

Absent significant reform at both the city and state level, Los Angeles' 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."[10]

---

1 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-20100423/2.

2 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-20100423/3.

3 David Zahniser, "L.A. pensions may consume a third of city's general fund by 2015," *Los Angeles Times*, 3 Aug. 2010, available at http://articles.latimes.com/2010/aug/03/local/la-me-la-city-pensions-20100804.

4 I do not re-estimate the liabilities of the Water and Power Employees' Retirement Plan, which already uses an interest rate assumption of 5%, and whose unfunded liability is admitted to be about $90 million.

5 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-20100423/3.

6 David Zahniser, "L.A. pensions may consume a third of city's general fund by 2015," *Los Angeles Times*, 3 Aug. 2010, available at http://articles.latimes.com/2010/aug/03/local/la-me-la-city-pensions-20100804.

7 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.

8 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.

9 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.

10 Quoted in Steven Greenhut, "Progressives for Pension Reform?," *City Journal*, 9 Sept. 2010, available at http://www.city-journal.org/2010/eon0909sg.html.

ABOUT THE AUTHOR

Stuart Buck is currently a Distinguished Doctoral Fellow in the Department of Education Reform at the University of Arkansas. He attended Harvard Law School, graduating with honors in 2000, and serving as an editor of the Harvard Law Review. After law school, Buck clerked for Judge David A. Nelson of the United States Court of Appeals for the Sixth Circuit in 2000-01, and then for Judge Stephen F. Williams of the United States Court of Appeals for the D.C. Circuit in 2001-02.

ABOUT THE FOUNDATION FOR EDUCATIONAL CHOICE

The Foundation for Educational Choice The Foundation for Educational Choice is a 501(c)(3) nonprofit and nonpartisan organization, solely dedicated to advancing Milton and Rose Friedman's vision of school choice for all children. First established as the Milton and Rose D. Friedman Foundation in 1996, the foundation continues to promote school choice as the most effective and equitable way to improve the quality of K-12 education in America. The foundation is dedicated to research, education, and outreach on the vital issues and implications related to choice and competition in K-12 education.