

STATE OF THE CITY ADDRESS 2013

Mayor Patrick J. Morris

Good evening! Thank you attending what will be my final State of the City Address. This is not a happy time for our city. Indeed, since I last spoke with you 18 months ago we have been living through a financial nightmare from which we have not awakened.

This evening I am going to ask you, as I did a year and a half ago, to join me in understanding just how we went from dreams of a bright and prosperous future for our city to the nightmare of financial insolvency and formal admission into Federal bankruptcy court one month ago.

After tracing the history and impact of our insolvency I want you to understand just where we are today. Finally I will lay out IN DETAILED NUMBERS what I believe must be done to lift us out of the fiscal and service death spiral we are in.

This is a presentation not only of words. I will be sharing numbers. As you recall from your school days---math requires homework. So I have made copies of my presentation, available at the door. Please take a copy home. As concerned citizens it is vitally important that you understand the numbers, and by understanding the numbers-----ask the hard questions of that group of leaders who are seeking your votes next month to lead us out of our insolvency.

HOW WE GOT HERE

“If you want to understand today, you have to search yesterday” Pearl Buck

“Those who fail to learn from history are doomed to repeat it.” Sir Winston Churchill

You are all keenly aware of the economic impact of our Great Recession. In 2008 it struck with a tsunami-like force here in the Inland Empire that left many of us unemployed (almost 19 percent of our

residents), put us in foreclosure on our home mortgages (more than 5000 in our city) and put dozens of individual and businesses into bankruptcy (we lost 7 of our 12 auto dealerships).

Clearly that earth shaking four-year-long recession, from which we have not yet recovered, was a contributing factor in hastening our city's insolvency. But as one editorial writer astutely observed, "When the tide goes out you can see who's been swimming naked." The Great Recession and the resulting meltdown of our economy exposed the fact that our city has, for years, been lavishly endowing employee salaries, benefits and pensions at an unsustainable level and draining the general fund of money needed for vital services. Let me explain.

There are multiple layers of a municipal bankruptcy---that is a city becomes financially sick to the point of insolvency when:

1. It is unable to deliver and acceptable level and quality of essential public services to the community with existing revenues. That is called SERVICE INSOLVENCY.
2. It does not have the money to adequately maintain the public infrastructure, and these facilities begin to deteriorate to a level that requires massive capital infusion. That is called INFRASTRUCTURE INSOLVENCY.
3. Its budget is upside down---expenses exceed income. That is called BUDGET INSOLVENCY, and
4. It does not have sufficient cash on hand to pay the bills. That is called CASH INSOLVENCY.

SERVICE INSOLVENCY

For all municipal governments, the lion share of the costs is labor. Cities deliver services. It takes people to deliver services. In San Bernardino, 74 percent of our General Fund budget is spent on labor.

Eighty-one percent of that cost goes to police and fire salaries, health benefits, pensions and retiree health benefits. (Please see pie chart on page 9 of Mike Busch's council presentation).

This is a unique problem for San Bernardino for we are saddled with salaries over which the City Council has no control. Public safety salaries are on auto-pilot, set annually by a Charter provision known as section 186. Years ago police and fire unions walked our city and convinced the voters to lock in a permanent escalator for their salaries. Those salaries are set at the median of 10 like-sized cities in California. This year those cities included Huntington Beach, Irvine, Daly City, Pasadena and Orange, where family incomes are more than double those in our city and property values are triple to quadruple those in San Bernardino.

The sad fiscal result is that San Bernardino, the city with lowest per capita income in Southern California, pays the highest wages for police and fire services in the Inland Empire. Our working class families, where the average family of four lives on less than \$40,000, are being served by unionized public employees who are paid wages, double, triple and quadruple of the local residents. For example, the average annual salary with overtime for our city firemen is \$147,000. Because our public safety employees are so highly compensated we starve other services to our city residents. Because public safety is our highest priority, their salary (and other benefits I will discuss momentarily) crowd out almost all other services---in short we currently cannot afford both public safety and other services.

Three years ago, with bankruptcy looming, we tried to negotiate a modest downward wage adjustment with the fire union. They refused, the city council imposed the cut, the union sued, and based upon charter provision 186 the judge granted the union a \$1.4 million judgment against the city for back wages. Just three months ago, as we struggled to pay our bills in bankruptcy, that same charter provision required that we increase the pay of our police and fire personnel by \$1.3 million dollars. For the lieutenants in our police department it amounted to a thousand dollar a month salary increase at a time when the city is holding hundreds of positions vacant in all departments and we can't pay our creditors some \$25 million dollars we have owed them for over a year.

Twice in recent years I have joined reformers trying to modernize the city's charter, removing these special interest protections, but they have been defeated by political campaigns led by the city attorney heavily financed by the public safety unions. I have preached this word many times---the road to financial health for this city starts with charter reform.

But the giant whale in the general fund deficit that eats the city's services and destroys the city's financial viability, is public employee pensions and related benefits paid into the California Public Employee Retirement System (CALPERS).

The growth of this monster goes back many years as the public unions acquired control of this city's political process with their Political Action Committees. The hundreds of thousands of dollars that the unions have contributed to the campaigns of selected council members and other elected officials have captured the loyalty of the electeds, corrupted labor negotiations and put the city in an almost impossible fiscal bind.

The ramp-up of the pension assault on the general fund budget began in 2001 at a time when the city's CALPERS pension accounts were super-funded---that is we had more money in the accounts than pension obligations so our annual employer contribution to CALPERS was a modest \$1.5 million.

That year the city council, at the urging of the unions, voted to increase city-funded police and fire retirement contributions from 2% to 3%, all paid by the city---with employees eligible to retire at 55 years old. The council also reduced the retirement age for all other employees from 60 years old to 55. These actions cost the general fund some \$9 million a year, erased the super-funded accounts and added \$60 million to the city's unfunded liability to CALPERS.

In 2005 the city council entered into a risky and failed arbitrage attempt to benefit the public safety retirement plan. They voted to obligate the city to a massive debt---issuing \$50.4 million in Pension Obligation Bonds. The bond proceeds were given to CALPERS to pay down a portion of the mounting unfunded liability to CALPERS for police and fire retirement benefits. Subsequently, CALPERS market losses more than wiped out the value of the bond issue and the city is on the hook for 24 years to pay the

bondholders \$114 million from the general fund. That obligation escalates annually; currently draining \$3.4 million from the general fund and will by 2033 cost the city \$4.5 million annually.

In 2007 the city council once again increased the retirement benefits for all of the city's non-safety employees from 2% a year to 2.7% a year, all funded by the general fund, none by the employees. That politically generous giveaway cost the general fund \$2.4 million dollars a year and added an unfunded \$20 million liability to the city's CALPERS retirement account.

Then in 2008, just as the Great Recession was melting down our local economy, the city council once again, at the urging of the public safety unions, reduced the retirement age for police and firemen from 55 to 50. This remarkable gift of pension benefits allows a police officer or fireman with 30 years of service to retire at 50 years old with 90% of their final pay with an annual escalator of up to 2% a year for the rest of their life---all paid for by the city. When these enlarged benefits packages are granted they automatically grandfather in all employees. Because many current employees did not pay over the years for these more generous retirement benefits the city is burdened with an unfunded liability to CALPERS that amounts to tens of millions of dollars.

Think about it! It makes no sense; we are living longer and retiring city employees earlier, many at mid-life, with outlandishly generous and unsustainable benefits. An insurance executive on the CALPERS board recently raised the mortality issue. He said the average female worker under 30 is expected to live to be 100. So the average young female public safety officer could retire after 30 years of service, at age 50---and for half a century, and collect a pension, paid for by the city, equal to 90 percent of final pay with an annual adjustment for inflation.

As I understand it, heretofore CALPERS has not had mortality projections included in its actuarial assumptions, but is now working on such a study. When completed next spring it will undoubtedly substantially raise our city's backbreaking CALPERS contribution rates even higher.

Add to these pension benefits the retiree health care benefits the city council has gifted to retirees which annually cost the general fund over \$600,000 and adding tens of millions of unfunded liability.

In total, these pension and retiree health care benefits are consuming greater and greater portions of the general fund and costing the city tens of millions of dollars that could have been used to provide vital services and maintain public infrastructure. During the last 13 years the actions of the city council, in response to union pressure, have exploded the city's annual obligation to the CALPERS pension fund from \$1.5 million to \$14 million and over the next 10 years it is expected to go nuclear--- up to\$33 million--- over 25% of the city's budget. To add insult to injury---we have added over \$161 million in unfunded liability owed to the CALPERS pension fund.

INFRASTRUCTURE INSOLVENCY

Years ago, to pay the escalating costs of labor we began underfunding and finally defunding critical infrastructure---streets, sidewalks, medians, parks and public buildings. We became the irresponsible absentee landlord who fails to invest in the property year-after-year, but just lowers the rent, until eventually he's milked the entire value out the property and walks away. Only as a city government, we can't walk away.

For years we have gone through the ritual of adopting an annual Capital Improvement Program Budget totaling millions of dollars, but then spend almost nothing because there was no money to spend.---it was being used to cover basic operating costs for salaries, benefits and pensions.

We also began to transfer responsibility for infrastructure construction and maintenance from the General Fund to the city's Redevelopment Agency—more and more every year until the city's General Fund was investing almost nothing in infrastructure. Blight eradication, the purpose of redevelopment, essentially became eradicating the blight created by the city through its failure to maintain its streets, parks and public buildings.

Just before the Governor and Legislature abolished Redevelopment in 2011, our Redevelopment Agency was providing more than \$6.5 million in direct subsidies to backfill the General Fund---using tax increment to fix basic city infrastructure. With the state's elimination of Redevelopment we currently have almost no infrastructure investment.

BUDGET AND CASH INSOLVENCY

The city has been warned for years of the impending fiscal crises facing San Bernardino. In 2006, soon after my election I brought in Management Partners, a highly respected city management consulting firm, to assess the city's financial condition and recommend ways to rebuild our financial foundation. They spent nine months evaluating every aspect of the city's operation, identifying opportunities for modernizing and improving city services and reducing costs.

In their executive letter to the city council they concluded that the city service and fiscal health was, in a word, "very fragile" and unless the city council moved quickly to adopt their recommendations San Bernardino could be facing insolvency. Of the 187 recommendations made in their extensive report the council picked off the low hanging fruit, adopting some 40 recommendations, but left the major reform recommendations untouched.

As I have explained, it was the Great Recession that totally exposed the weakness of our city's organizational structure and its financial condition and hastened our insolvency. Every year at budget time the council chose to cover the exploding labor costs and the loss of sales and property tax revenue by floating bonds, borrowing from reserve funds, selling properties, and transferring obligations to the Redevelopment Agency --- one-off budget solutions that were bound to and did run out. A council member even recommended the "city pull out the credit card" and borrow from the water and refuse funds, totally illegal acts that I called "fiscal insanity."

Judgment day came in the 2011-12 fiscal year with nothing left to borrow and very penny of cash in every fund gone; the city had run up a \$16 million dollar deficit to its restricted funds and was projected to

have a \$45 million budget deficit by year end. On August 1, 2012 the city declared bankruptcy because it was insolvent at every level---service, infrastructure, budget and cash flow---we had no other option.

WHERE WE ARE TODAY

After the city filed for bankruptcy protection in Federal Court our biggest creditor, CALPERS, objected. After a series of court hearings lasting 13 months bankruptcy judge Meredith Jury overruled CALPERS objections. On August 28, the court found the city eligible for bankruptcy protection. She has ordered us into mediation with a bankruptcy judge in Reno. The judge has given the city until next week, October 15th, to prepare what is called a “term sheet” that lays out the city’s proposals for settling with our creditors. Eventually the city is expected to lay out for the judge a long term adjustment plan which hopefully she will approve, and the City will emerge from bankruptcy.

By not paying our creditors and deferring some \$25 million in debts, the city is now cash solvent---that is, we are paying our current bills as they come due, but we remain insolvent in all other ways

THE TALE OF TWO OTHER CITIES

Two weeks ago, I was invited to speak at the League of California Cities annual conference in Sacramento, about municipal bankruptcy, together with the Mayor Pro Tems of Vallejo and Stockton. Each of us spoke about our city’s bankruptcy and the lessons learned. The similarities between our three cities and the economic and political conditions we were experiencing as we approached bankruptcy is quite striking---old charter cities, filled with blue collar families of modest income reeling from the impact of the Great Recession and, most importantly, city councils elected with large contributions from police and fire unions and politically beholden to those special interests.

The warning given by the leaders of both Vallejo and Stockton was, “No matter how hard the battle, for the sake of your city’s survival, wrestle back control of city labor contracts and pension benefits.” The Mayor Pro Tem of Vallejo confessed that her city council did not do that, bailing out of bankruptcy without

addressing these issues. Just two years after leaving bankruptcy her city is again awash in red ink---the general fund budget in deficit millions of dollars because of labor costs, particularly pension benefits owed to CALPERS.

So what must be done? Let me set the stage with a recap. The City of San Bernardino is bankrupt because it is insolvent at all levels of municipal governance. This translates into a deficit of approximately \$360 million in the next ten years that must be solved by radical and immediate action today:

- We are “service insolvent” from at least a decade-and-a-half of failing to control the biggest cost of delivering municipal services ... labor. In fact, instead of controlling costs by telling labor groups “no,” by changing our charter, or by changing the way we deliver municipal services, we have done the unthinkable ... we have systematically year-after-year **increased** our labor costs by giving more generous pensions and benefits, floating high-risk bonds to pay for it, and ignoring every warning sign that screamed this was fiscal insanity.
- The result of this leadership failure? We have cut hundreds of employees from our city workforce to pay for these unsustainable salaries, benefits, and pensions, thereby diminishing year-after-year the quality and level of basic municipal services to our residents and businesses. In essence, the city leadership has hoodwinked the public into paying more and more for less and less service.
- More frightening, despite all these cuts and layoffs, we can’t sustain our current labor costs. Charter section 186 will continue escalating salaries year-after-year for public safety employees, and already announced adjustments by CALPERS show our pension costs will more than double in the next ten years.
- So even if we continue the vacancies, don’t restore the cuts, keep the current labor concessions, and still delivering unacceptably poor level of municipal services, our city will still run up an additional \$115 million operating deficit over the next 10 years. That’s right,

keeping our current labor costs and methods of delivering municipal services means we end up \$115 million farther in the hole.

- We are also “infrastructure insolvent” from several decades of reducing our infrastructure spending to zero, and only temporarily patching some of that gap by directing millions of economic development funds to pay for maintenance, repair and replacement on failing streets, parks, public buildings, and other public facilities. And when redevelopment agencies were dissolved two years ago ... the jig was up.
 - The result of this unacceptable negligence? A \$201 million infrastructure and fleet deficit that looms over our future. That’s right, we need roughly \$201 million invested into our infrastructure and city fleet just to keep delivering basic services and bring our streets, sidewalks, parks, public buildings, and other facilities back to basic level of acceptable condition. This number doesn’t include the many and much needed upgrades and improvements to these facilities nor the extensive work needed on our failing sewer system.
- And finally, our present budget and cash flow solvency is really a fiction. We achieved this solvency by annually borrowing from reserves and other funds until they were depleted, and then entering bankruptcy and running up another \$25 million in debt. This solvency is also only temporary. If we don’t make drastic changes now, in less than twelve months we will be budget and cash flow insolvent again, unable to pay employees, unable to pay bills, unable to keep the doors of city hall open. The cost of permanently fixing our budget and cash flow insolvency is \$44 million. Think City of Vallejo ... only the second tidal wave of insolvency will come faster in San Bernardino if we don’t act to make the necessary and drastic changes now.

So there you have it. The failure of city leadership to control labor costs or change the way we deliver municipal services, has put us in a position where we have less than 12 months to put together and begin

implementing a plan that solves a \$360 million deficit in ten years. Frightening isn't it? You bet it is! The whale has become a Tyrannosaurs Rex that could kill our city.

And if this all feels like déjà vu ... it should. We gathered in this very theater over 18 months ago in March 2012, before our city's bankruptcy, for another State of the City address. And for those of you that attended, this is what you heard:

[2012 State of the City speech clip]

TEN YEAR RECOVERY PLAN FOR SAN BERNARDINO

And so here we are 18 months later, in bankruptcy, with a community justifiably angry about our city's condition and the failure of leadership to address the fiscal crises. I am once again pleading with you, the government, civic, and business leaders of San Bernardino. You must demand, and the elected leaders must immediately act, on the two fundamental reforms that are absolutely essential to address our city's multiple levels of insolvency: (1) reduce our labor costs, and (2) radically change to how we deliver municipal services.

As you heard in the video clip, when I addressed these two fundamental reforms 18 months ago, I took them separately as if they were separate issues. After extensive work over the past year with our Finance Department and expert consultants, we have come to realize that these issues are really two sides of the same coin. They represent two paths to the same objective of restoring our city to solvency at all levels (service, infrastructure, budget, and cash flow), and most likely, both paths must be pursued simultaneously because neither exclusively solves our problem. So instead of talking about them separately, I am going to weave them into 5 specific actions for a ten-year plan to solve our \$360 million problem. So let's get down to talking specifics.

Our \$360 million General Fund deficit over the next ten years is made up of multiple components. The following amounts are taken primarily from data published by our Finance Department and outside consultants that was presented at the September 23, 2013 council meeting :

- \$183 million is the estimated accrued infrastructure deficit;
 - Streets, Sidewalks & Transportation Systems - \$88.5 million
 - Parks, Libraries, & Other Buildings/Facilities - \$91 million
 - Miscellaneous - \$3.5 million
- \$115 million is the cumulative operating deficit over the next 10 years according to the most recent 10-year expense and revenue projections;
- \$18 million is the funding needed for replacement of our very old and almost fully depreciated fleet of city vehicles;
- \$25 million is our present debt due and owing to creditors that has accrued prior to and during the bankruptcy; and
- \$19 million is the minimum reserves needed to cover economic uncertainty, leave obligations, workers' compensation and general liability (approximately 13% to 15% of the city's annual budget).

Let's start with a common-sense approach to addressing the \$183 million infrastructure deficit. To actually get this work done requires a massive amount of upfront capital to design, engineer, and construct the improvements. We simply cannot deploy a pay-as-you-go strategy and get this work accomplished in ten years. Upfront capital is required to complete this infrastructure, with payment over a longer period of time. It's no different than undertaking an extreme makeover of your house. This front-loaded funding requirement will necessitate access to the capital markets, which means we must deal fairly and appropriately with our bond creditors in bankruptcy.

While there may be some reduction that is negotiated on the city's current bond debt, if we want the capacity to address our city's infrastructure deficit, we must retain an ability to access the capital markets at reasonable rates. Assuming we are smart and can successfully negotiate with creditors and access the capital markets, we can pay for a 10-year elimination of the infrastructure deficit over 30 years, thereby reducing the 10-year funding requirement for the infrastructure deficit from \$183 million to \$110 million (30 year municipal bonds, "A" rated at current rate of 5% yields annual debt service of approximately \$11 million).

This makes our total 10-year deficit \$287 million, which translates into a need for roughly \$29 million in annual savings and additional revenue.

So let's start adding up how we fill this \$29 million annual gap:

The first action involves significantly reducing the cost to deliver our city services. As you now know, 80% of the cost of delivering services is due to labor, comprised of salaries, benefits and pensions. The first action therefore deals almost exclusively with lowering labor costs.

And let me be clear, when I say "lowering labor costs," I DO NOT mean further reductions in our workforce, I DO NOT mean further cuts to staffing. With one exception, our fire department, we have done this for years, cut and cut the number of employees delivering city services to the very bone. And that's how we became service insolvent. We simply cannot reduce our workforce any more. We must find other ways to deliver better services for less cost. Hundreds of other cities in California do it, and so must we.

Think of Highland to our east: a city of 55,000 residents that was once told it could not survive because it was a bedroom community without a sufficient commercial and industrial tax base. It is, in fact, a remarkably healthy city financially. It contracts out all of its services---police (with the Sheriff), fire (with Cal Fire), refuse, public works, community development and parks all with private providers. A modest city staff of 34 manages those contracts with such skill that it boasts a healthy reserve of \$85 million.

There are two essential ways to go about the task of lowering labor costs. The first is to examine what the cost would be if some else delivered the services. This is commonly referred to as "contracting out" the service. For public safety (police and fire), that typically means asking another public agency to propose a cost for delivering the same or a better level of service. And while there may be some novel options that involve the private sector performing support activities related to public safety, the provision of sworn police officers and firefighters is exclusively the province of public agencies. And with this exclusivity comes the reality that other public agencies will also pay public pension and benefit costs.

For non-safety city services (public works, parks & rec., community development), we can look to the private sector as an alternative provider and potentially receive proposals that have significantly different cost structures. Finally, one additional benefit of looking at alternative service providers for both safety and non-safety services is realizing additional savings from economies of scale. San Bernardino is a mid-size city, and there are public and private agencies providing municipal services on a far larger scale, that may be able to bring significant savings to the table through their economies of scale.

If significant savings, however, cannot be achieved by contracting out the service, then we must achieve those savings the old fashion way ... through continuous and tough negotiations with public employee unions to reduce employee salaries, benefits, and pension costs. This may sound harsh, but it's our reality. If labor currently represents 80% of our city's annual expenses, and we need to generate approximately \$30 million in annual savings, there is no way around this Grand Canyon. Unfortunately, our city's track record in this area is dismal. We haven't taken the necessary aggressive stances in negotiations with public employee unions in the past several decades. In fact, as I discussed with you earlier, we've done the opposite ... we've given away the farm. But going forward, if contracting out won't produce the savings, then a new kind of leadership will be needed in this city to develop those savings through the tough, ethical, and vigorous collective bargaining process with public employee unions.

So how do we establish a target for what we need in savings from either contracting out or negotiated concessions? My suggestion is that we estimate the savings if we contracted out the service, and then if that savings can't be realized after receiving proposals from potential contractors, we must achieve that savings through reductions to city employee salaries, benefits and pension costs. In the following savings estimates, we used several methodologies to estimate the savings, including the elimination of maintenance and operation costs and administrative overhead (internal service charges) after the service was contracted out; and we also used benchmarking to compare our cost of service delivery with similar cities.

For example, our City Manager recently completed a benchmarking that compared San Bernardino's cost per resident for Police and Fire services to the demographically and geographically similar Moreno Valley.

Moreno Valley contracts for police services with Riverside Sheriff and for fire services with Cal Fire. San Bernardino provides these services with its own employees. The total annual cost for police and fire services was \$28 million less in Moreno Valley. However, Moreno Valley has 5 fewer fire stations. After backing out \$1.75 million cost for each fire station, the total annual savings is approximately \$19.25 million.

Finally, to ensure decent numbers, we had to subtract from the projected savings, the “pension legacy costs” associated with the employees in these departments. In other words, if we take an entire group of employees out of the city CALPERS account because we’ve contracted out that service, CAL PERS requires that the city continue paying all the unfunded liability associated with the pension benefits already granted to these employees. So while we can control our pension costs going forward by contracting out, we cannot escape the significant yoke of the \$160 million unfunded pension liability created over the past decades due to overgenerous pension benefits being granted year-after-year. The “pension legacy cost” for public safety today is \$9.5 million annually for the next 30 years, and it will only grow larger.

1. Let’s look then at the savings to the general fund from our first action ... controlling labor costs.

- **Reduced labor costs that should be generated by contracting out = \$10 million annually.**
 - \$8 million in net annual savings from Police and Fire; and
 - \$2 million net annual savings from the following non-safety services: public works, community development, and parks and recreation.
- If, however, the contracting out option cannot produce the expected savings of \$10 million, as discussed, city leaders will be required to negotiate vigorously and continuously over the next decade to achieve these savings from reduced salaries, benefits, and pension costs. And for public safety, that will necessitate that the voters repeal Charter Section 186 which provides for automatic yearly salary adjustments for police and fire, and which annually increases labor costs for public safety by at least a \$1 million or more.

2. The second action deals with restructuring to lower the cost of delivering fire services. Our fire department, aside from management, has largely been untouched throughout our years of our growing insolvency. Though we have held vacancies our constant manning agreement with the union means we

simply backfill those vacancies with overtime. Last year we paid our firemen almost \$7 million in overtime.

Firemen, the highest paid employees in the city and the most generous in campaign giving, have the most powerful grip on the electeds in city hall. If you watched last night's City Council meeting you saw a demonstration of that power. A majority of the council tabled a motion to instruct the City Manager to seek bids from the County and Cal Fire for fire services. They hid behind the advice of the City Attorney that "this was not the right time in our bankruptcy to seek such a bid." I argued unsuccessfully that it was precisely the right time.

- **Close Four Fire Stations = \$7 million annually**

- Close four stations that have the fewest calls for service (these stations average between 1.5 to 4.5 calls per day), and where there is an opportunity to cover their service areas from nearby stations or other agencies.
 - Identified stations: Verdemonst (#232), Highland/Orange (#228), Rialto Bench (#229), and Mill/Arrowhead (#230)
 - Identified coverage opportunities. There are existing fire stations within 1 to 2 miles of each of the closed stations: University Station #225 is about 2 miles from Verdemonst; San Manuel is about 1 mile from Highland/Orange; Rialto & Colton Fire Depts. have stations less than 1.5 miles from Rialto Bench; and Downtown Central Station #221 less than 1 mile from Mill/Arrowhead.
- Savings from closure of each station, removal of equipment from service, and reduction in staffing = approx. \$1.75 million per station.

3. The third action addresses additional savings that will come if the city is able to contract out most services. If we don't contract out services, the additional savings in these two areas will be proportionately reduced and, once again, additional reductions in overall labor costs for city employees will need to occur to make up for these savings.

- **Reduced Demand for Other Internal City Services & Fleet Replacement Due to Contracting Out = \$4 million annually**

- Reduced Demand for Attorney Services = \$2.3 million annually

- City attorney services are largely driven by our workforce and their activities. Reducing the workforce and eliminating most service departments should reduce services needed from the City Attorney by a roughly commensurate amount.
- Reduction in workforce and activity from the described actions is equivalent to reducing the workforce by about 80% of workforce and related activity.
- City Attorney budget currently at \$4 million. Even with a conservative estimate of reducing it by 60%, that's an annual savings of approximately \$2.3 million.
- Reduced Need for Fleet Replacement = \$1.7 million annually
 - Estimate that 85% to 90% of fleet services demand is generated by Public Safety, Public Works, Parks, and Community Development.
 - By contracting out for these services, avoid vast majority of the \$18 million needed to replace an almost fully depreciated city fleet.

4. The fourth action addresses the need for additional revenues.

- **New Revenue Opportunities = \$6 million annually**

- Extension of UUT to City Utilities = \$4 million
 - Extend UUT to city utilities (water, sewer, and refuse)
- Contract Out Refuse to Private Company = \$2 million
 - Additional revenue comes from Franchise Fee paid by the franchisee/contractor.

5. The fifth and final action addresses the annual savings we might expect to achieve for the next 10 years is through tough negotiations with our creditors in bankruptcy.

- **Restructure Debt with Creditors = \$3 million annually**

- City Council is currently working to finalize an initial term sheet to begin mediated negotiations with creditors on restructuring the City's debt to both secured and unsecured creditors. Savings would be achieved primarily through a reduction in

principal on various debts and/or re-amortization of debt payments over a new extended time period.

If you add up the numbers above, you get a rough estimate of \$30 million \$24 million in savings and \$6 million in new revenue. It's a massive restructuring of the way we deliver city services. It involves removing approximately 85 to 90% of our general fund workforce from the City's PERS account by contracting for city services with other public agencies and private contractors; or almost \$13 million in annual savings from further reductions to employee salaries, benefits and pensions costs. It also involves extending the Utility Users Tax to include city utilities. This is a tax extension the voters will have to approve, and if approved, will cause a modest increase to water, sewer, and refuse rates.

You can bet that the ideas and numbers I've put out this evening will get plenty of scrutiny and draw lots of criticism. They should. I'm confident there will be special revenues identified that will be reduced or eliminated by the above actions, but there will also be additional savings as the full impact of becoming a largely contract city becomes clear. The purpose of presenting these specific actions and these estimated numbers to you tonight, is to plant the flag and create a starting point for a very serious discussion, during a time-compressed window, to adopt a plan to save San Bernardino.

Additionally, I want to address three other actions and reforms I believe are critical to our city's 10-year recovery plan:

1. Sewer System: Transfer responsibility of sewer collection system to Water Department and adjust rates to pay for all repair, replacement and augmentation of sewer pipes that are falling apart or under capacity in city. Bond up based on rate adjustments and get sewer system work done simultaneously with \$183 million infrastructure deficit work.
2. Measure Z: In 2021, Measure Z sunsets. If we expect to stay on-track with the recovery plan for San Bernardino, we cannot afford to have Measure Z go away in 2021. Measure Z is a 1/4% increase in our local sales tax, a fiscal measure that many other cities have adopted. It is essential to a stable fiscal future. Measure Z currently brings in \$6.6 million to our General Fund and will bring in

approximately \$8.2 million when it's due to sunset in 2021. There is no amount of savings, economic growth or any other factor that could substitute for this critical revenue source. Voter approval to continue Measure Z beyond 2021 almost certainly wouldn't happen today. But if we exercise 8 years of successful fiscal discipline, radically restructure our city services to reduce costs by \$24 million annually, and use those savings to make major investment in repairing our city's infrastructure deficit, I strongly believe that public confidence in our city governance will be restored and I would fully expect healthy support for extending Measure Z.

3. And ultimately the voters of the State of California must also step forward and change the laws surrounding the CALPERS retirement stranglehold on our public budgets. The legislation signed by the Governor last year known as PEPR, intended to begin controlling public pensions, makes only modest adjustments to the voracious appetite of employee retirement and health benefits---because the law only applies to NEW employees, leaving current employees yet-to-be earned retirement benefits untouched.

So tomorrow I am joining with Chuck Reed, the Mayor of San Jose, and other advocates to bring forward a bold initiative, a state constitutional amendment that will define a government employee's "vested rights" as applying only to the pension and retiree healthcare benefits for service already earned. It would explicitly empower government employers and the voters to amend pension and retiree healthcare for an employee's future years of service. This is a standard similar to the one government applies to private employee pension plans. This would be a MAJOR public pension reform that will help save our cities and counties and the vital services we provide.

Finally, let me be clear. What I have presented tonight is not a 10-year plan to revitalize our city. That plan has many more required components and will likely take at least 20 to 30 years, including investing more in our parks, libraries and public spaces; investing more in our community policing services to address quality of life issues like homelessness, transiency and code enforcement; investing in economic development that builds upon the \$1.5 billion of new transportation infrastructure that's being laid down in our city; incentivizing new housing that begins to systematically address the aged, decrepit and unacceptable

condition of our city's housing stock, and many other innovative and strategic actions required for the revitalization San Bernardino. But we all know that none of these other actions can be successful, and they are not even meaningful, if we cannot address the \$360 million deficit over the next 10 years that could prevent us from staying solvent and delivering an even acceptable level of basic municipal services to the residents and businesses in San Bernardino.

Thank you.