Dan Walters: Detroit bankruptcy ruling puts public employee pensions on the table in California

dwalters@sacbee.com

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A legal showdown over pension obligations in municipal bankruptcies was averted in both Vallejo and Stockton, largely because officials in both chose not to make that fight.

No small factor was a rather heavy-handed threat by the California Public Employees' Retirement System to wage high-octane legal war should either city seek to "impair" pension obligations.

The bankruptcy judge in Stockton's case implied that he was receptive to including pension obligations as a debt to be reduced under federal bankruptcy law despite their seemingly impregnable standing in the state constitution. And insurers of the city's bonds took a stab at including them.

However, the issue was sidestepped when most of the bondholders and their insurers cut a deal with the city that excluded pensions.

San Bernardino is a different story. It stopped making payments to CalPERS for a while, still owes $15 million in past-due payments, and indicated in its bankruptcy filing that it wants pension debts on the table. And the huge retirement fund did what it threatened to do in Stockton and Vallejo – wage legal war.

CalPERS tried, unsuccessfully, to persuade the judge hearing San Bernardino's petition to block bankruptcy, but whether the case eventually hinges on pension obligations remains to be seen.

Meanwhile, a bankruptcy judge in Detroit ruled Tuesday that the city's truly massive bankruptcy can include a pension reduction, saying, "it has long been understood that bankruptcy law entails the impairment of contracts."

That's almost word-for-word what the Stockton bankruptcy judge, Christopher Klein, had said during one proceeding.

The uncanny similarity of the Detroit case to those in California extends to the almost identical provisions in the California and Michigan state constitutions that prohibit "impairment of contracts."

Michigan pension officials, and the state's public employee unions, are just as adamantly opposed to having pension obligations on the table as those in California, and if Detroit's bankruptcy culminates in a reduction of pensions, either retroactively or prospectively, the subsequent legal battle is destined for the U.S. Supreme Court.

The potential fallout is immense. If pensions can be reduced in bankruptcy, California cities, struggling with ever-increasing demands for pension fund payments, will use it as leverage to demand concessions from their unions.

Moreover, the unsettled situation could affect the outcome of a proposed 2014 or 2016 ballot measure, sponsored by San Jose Mayor Chuck Reed, that would allow local officials to modify future pension benefits. If Reed gets his measure on the ballot, he could – and would – contend that doing something about mounting pension payments through that process would be better than leaving it to the complexities of bankruptcy.

Some sober words for school boards amid predictions of plenty

Ed Source

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By John Fensterwald

For the first time since the Great Recession, school districts are getting more money this year from the state; some – big beneficiaries of the new Local Control Funding Formula – are getting a lot. And that increase is expected to be larger next year, in one-time and ongoing money, if the Legislative Analyst's predictions for a rebounding economy are on target.

School finance experts John Gray and Joel Montero, however, injected a cautionary note during a presentation Friday at the California School Boards Association's annual convention in San Diego.

"We are still in a volatile situation. Be conservative. Be careful," Montero advised several dozen school board members at his talk.

Montero is the unofficial fiscal worrywart of K-12 education. As the executive director of the state Fiscal Crisis and Management Assistance Team, or FCMAT, his job is to see that districts don't run out of money and end up in bankruptcy. FCMAT's oversight and dire warnings have worked; only a handful of the state's 1,000 districts are in receivership despite devastating cuts over the past five years.

Gray is president of School Services of California, a Sacramento consulting firm that provides services to and represents school districts, including in negotiations with employees unions. It's his role to advise districts to be chary with a dollar.

The Legislative Analyst's Office is projecting that there may be as much as $12 billion in new Proposition 98 money for the fiscal year starting July 1. In the state budget he will release next month, Gov. Jerry Brown will likely dedicate a big portion as one-time money – for paying off late payments or deferrals to schools and implementing Common Core, perhaps – but the increase for districts' operating budgets will likely be sizable nonetheless.

So why were Montero and Gray acting like Saturday Night Live's Debbie Downer? A combination, they said, of the hangover from the recession and the new complexities of the Local Control Funding Formula prompt them to urge caution to districts when creating a spending plan for next year and negotiating staff raises this year.

Rebounding from deficit spending

About 60 percent of the state's school districts deficit-spent last year, and many have done so for two or three years, Montero said. They got by through eating into their reserves. So a district's first priority should be to eliminate its operating deficit. For those districts with structural deficits, “You can (receive) more money this year but have no money to spend,” he said, particularly if a district has a declining enrollment, with fewer students generating state dollars.

A paradox is that many districts have built up record reserves – far beyond the 1 to 3 percent of a district’s operating budget that state law requires. They did so because of uncertainty: not knowing whether Proposition 30, creating temporary taxes, would pass a year ago and not knowing what the Local Control Funding Formula would look like.

Healthy reserves, of course, are good. What’s dicey, Montero and Gray said, is spending them down too quickly, based on the assumption that projected state revenue three years from now will cover spending commitments they can make today.

“The pressure (from calls to increase spending) is going to intensify on you,” Gray said. “You will likely live with what you do in year one (of LCFF) for a long time.”

Furthermore, Brown’s projection that the LCFF will be fully funded in eight years assumes uninterrupted economic growth. The last recession technically ended four years ago, even if growth in California has been puny. Twelve straight years of economic growth hasn’t happened, Gray said, so it’s prudent to expect a setback. The biggest beneficiaries of LCFF should have the largest reserves, Montero said, because they’d be most vulnerable if the revenues fall short of state predictions.

FORMULA TARGETS HIGH-NEEDS STUDENTS

Districts with high concentrations of high-needs students will get substantially more money.

District	Funds per Student Received in 2012-13	*Projected per Student Funds for 2020-21	Projected per Student Increase
Lafayette Elementary School District in Contra Costa County with 5 percent low-income and English learners	$5,769	$8,813	$3,044
Sierra Sands Elementary School District in Kern County with 51 percent low-income and English learners	$6,272	$9,996	$3,724
King City Union Elementary School District in Monterey County with 90 percent low-income and English learners	$6,226	$11,616	$5,392

Source: California Department of Finance

*Includes base, supplemental and concentration grants plus estimated annual cost-of-living adjustments.

Each district’s unique situation

Another point to keep in mind, they said, is that each district will get a different increase per student annually over the next eight years or so, making comparisons between districts problematic.

“Once fully implemented, LCFF will be the simplest formula around,” Gray said. “But in the transition period, the next eight years – or longer – the system will be more complicated than the one we left.” So educating stakeholders on how the formula works is critical, he added.

The range in per-student funding at full implementation will be between about $8,500 and $13,000. This year, each district will get about one-eighth of the difference between what they got in per-student funding in 2012-13, the last year of the old formula, and their target at full funding. The average increase this year is $308, but some districts will get less than $200 per student, while others will see more than $600 per student.

Whether a district gets a lot or a little will depend in part on how many low-income students, students learning English and foster youth it serves and in part on its starting point, the funding level it received in 2012-13. So, Gray noted, even two districts with the same percentage of students with high needs won’t get the same per-student funding increases in the transition.

Unlike the old system, where districts got the same increases to their “revenue limits,” or base grants, every district’s funding situation in the LCFF transition period will be distinct. So it will be difficult explaining to teachers in one district why there’s no money for the raise that teachers in an adjoining district have negotiated, Gray said.

“Stakeholders may not understand how you receive the money,” Gray told school board members. He cited one unnamed district with declining enrollment and a huge deficit problem that is seeking to roll back salaries, while another unnamed district has reached an impasse with its teachers union despite an offer of a 7.5 percent raise.

“How your neighbors behave will have a significant impact on you,” Gray said. “The pressure is going to intensify.” (To what extent it is permissible for districts to grant pay and benefit increases using some of the additional dollars intended to provide extra services for high-needs students – a major fear of low-income advocacy groups – is a separate and important issue that the State Board of Education is expected to weigh in on when it adopts LCFF regulations in January.)

Pent-up demand for spending

Finally, Montero and Gray cautioned, there will be huge pressure – more than districts can accommodate – to restore programs, start new ones and grant pay increases.

“You’re facing a pent-up demand,” Gray said. “Most districts haven’t given raises for five years. Expectations are high. You survived with fewer people, paying them less.”

Along with bargaining units' demands, parents and community members will be letting school boards know what they want. The LCFF requires incorporating parents' views in a three-year Local Control and Accountability Plan, which school boards must adopt by July 1.

Under the old system, with Sacramento-dictated spending rules for dozens of categorical programs, school boards had little control. Now the dynamic has changed, and the responsibility, Gray told school board members, is theirs.

"It a lot easier to say I can't do something. It's harder to say I won't do something," he said. "Stakeholders will have different ideas on how to spend money. You have to stay strong to say (maintaining) facilities or adult ed is important to our success. It's important to hang tough and determine your priorities."

"Your job has been terrible since 2008-09," Montero said. "Now the economy is improving and likely to continue to improve. Board members are hungry and anxious to do something. Be smart about that."