Rising Labor Demands Challenge Local Governments in San Francisco Bay Area

Comment

Labor Disputes on the Rise: Public employee unions in the San Francisco Bay Area (the Bay Area) have become increasingly vocal in the aftermath of the recession, challenging local governments with job actions and strikes in an effort to achieve compensation increases.

Demands Follow Concessions: The rise in labor demands and in some cases disruptions follows multiple years of labor force and compensation reductions during the recent downturn.

Impacts Concentrated Regionally: Increased labor activity has been especially prominent in the Bay Area, where a strong recovery in private employment and soaring housing prices contribute to heightened labor expectations.

Rising Costs Strain Local Finances: Recent labor demands pose a risk to local government financial flexibility, where revenues continue their slow recovery and benefit costs continue to rise.

Potential for Credit Impacts: Credit impacts will hinge on management's ability to maintain financial flexibility in the face of rising labor costs. Local governments that lower reserves below adequate levels or incur operating deficits to meet rising compensation levels will likely face downward rating pressure.

Related Research

Fitch Fundamentals — U.S. Index Trend Analysis — 3Q13 (October 2013)

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Labor Disputes on the Rise

Public employee unions in the nine-county Bay Area have become increasingly vocal in the aftermath of the recession, challenging local governments with job actions and strikes in an effort to achieve compensation increases. The recently settled strike by San Francisco Bay Area Rapid Transit District (SF BART) workers received the greatest media attention to date, but local governments throughout the region and beyond have begun to face similar challenges in negotiating new labor agreements.

Recent Bay Area Labor Actions

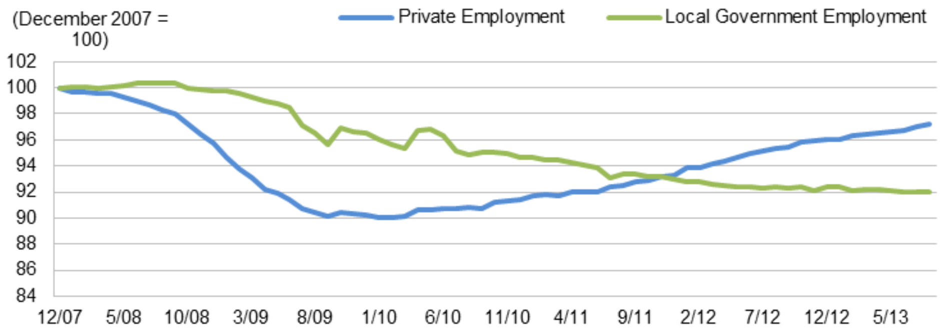
Jurisdiction	Labor Action	Status as of October 2013
San Francisco Bay Area Rapid Transit District	Four-Day Strike, October 2013	Settled
City of Hayward	Three-Day Strike, August 2013	Settled
City of Oakland	One-Day Strike, July 2013	Settled
Alameda-Contra Costa Transit District	Strike Authorized, October 2013	Cooling-Off Period
Santa Clara County	Strike Authorized, August 2013	Settled
Contra Costa County	Strike Authorized, May 2013	Open

Outside of the immediate Bay Area, contentious public employee labor negotiations have also resulted in recent strike votes and job actions in Los Angeles County, San Joaquin County, San Benito County, Mendocino County and the University of California.

Demands Follow Concessions

The rise in labor demands and disturbances follows multiple years of workforce reductions and concessions from public employees during the recent downturn. Local government employment levels dropped sharply during this period and have yet to recover. Many public workers took pay and benefit cuts, and renewed efforts by employers to control pension and healthcare costs have pushed labor relations in some jurisdictions to a breaking point.

Employment Losses Continue for Local Governments
(Seasonally Adjusted, California Only)



Source: U.S. Bureau of Labor Statistics.

Related Criteria

U.S. Local Government Tax-Supported Rating Criteria (August 2012)

Tax-Supported Rating Criteria (August 2012)

The battle by SF BART unions to restore pay increases foregone during the recent downturn is typical of recent labor disputes, although many public workers have fared worse. BART workers went four years without raises and agreed to annual net pay increases of 2% over the next four years, combining both wage gains and graduated increases in employee pension and healthcare contributions.

BART concessions during the downturn were generally smaller than experienced in other jurisdictions, some of which saw temporary wage cuts as large as 10%. The contract gains for BART workers are generally in line with recent increases in other Bay Area jurisdictions. BART's labor disputes stand out for their contentiousness, but are consistent with broader labor efforts to halt concession bargaining and return to pre-recession patterns of annual compensation increases.

Impacts Concentrated Regionally

Increased labor activity has been especially prominent in the Bay Area, where a booming economy has contributed to heightened labor expectations. The San Francisco-Hayward-Oakland Metropolitan Statistical Area led the nation in gross domestic product gains in 2012, with real growth of 7.4%, more than double the average for the nation's 10 largest metropolitan areas. Home price increases and employment growth have similarly exceeded national rates.

Fitch anticipates that labor demands will rise along with local economic improvement more generally. Whether public employee labor disputes begin to increase in other regions experiencing economic recovery remains to be seen. California's statutory labor protections and the Bay Area's strong labor tradition are likely key factors in the recent increase in labor disputes, but the broader trend of public workers seeking to restore lost pay is likely to be replayed elsewhere.

Rising Costs Strain Local Finances

Recent labor demands pose a risk to local governments where post-recession revenues still lag overall economic gains and benefit costs continue to rise. Local sales tax revenues for Bay Area cities and counties in fiscal year 2011–2012 remained on average 2% below fiscal year 2006–2007 levels, reflecting the slow nature of revenue recovery following the downturn. Taxable assessed values, a leading indicator of property tax revenue growth, increased at a 3% annual rate between fiscal years 2007 and 2012, a sharp drop from 9% annual growth rates in the preceding five years.

Health insurance premiums in California continued to rise throughout the recent downturn, with average annual increases of 7%–8%. The growth rate for premiums dropped to 6.4% in 2012, but remained well above the state's 1.7% overall inflation rate. Pension costs have risen as well, in large part due to investment losses during the financial crisis. A recently approved proposal by the California Public Employees' Retirement System (CalPERS) will add to many public employers' cost burdens over the next several years. CalPERS is the nation's largest public pension plan and projects a 50% increase in contribution rates over a five-year period.

Reserve levels for Bay Area governments have been fairly steady, on an aggregate basis, since the downturn. Total fund balances for the region's nine counties and 10 largest cities fell only one percentage point, to 29% of general fund spending, between fiscal years 2007 and 2012, with substantial variation across jurisdictions. SF BART's unrestricted net assets (a related measure of financial flexibility for enterprise operations) fell by 33% over the same period. SF BART's labor unions publicly criticized the district's reserve levels and demanded a greater share for workers despite this decline. Similar demands to reduce reserves have been made in other labor disputes as well. Fitch considers reserves to provide a key source of financial flexibility for local governments and views pressure to reduce them as a potential credit risk.

Potential for Credit Impact

The credit impact of increasing labor disputes must be analyzed on a case-by-case basis and will hinge on management's ability to maintain financial flexibility in the face of rising labor costs. Labor costs typically account for upward of two-thirds of local government expenditures and have been a key factor in recent municipal bankruptcies in Detroit, Stockton and San Bernardino. Fitch does not anticipate any new municipal bankruptcy filings among entities it rates in the Bay Area, but local governments that lower reserves below adequate levels or incur operating deficits to meet rising compensation levels will likely face downward rating pressure.