

# 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 \(October 2013\)](#)

### Analysts

Stephen Walsh  
+1 415 732-7573  
[stephen.walsh@fitchratings.com](mailto:stephen.walsh@fitchratings.com)

Amy Laskey  
+1 212 908-0568  
[amy.laskey@fitchratings.com](mailto:amy.laskey@fitchratings.com)

### 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

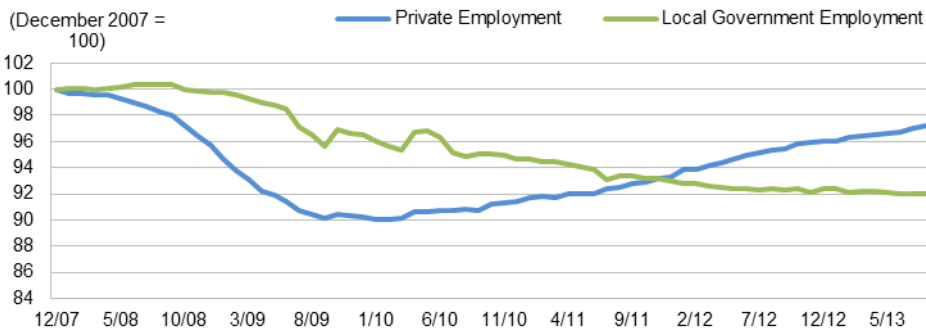
Outside of the immediate Bay Area, contentious public employee labor negotiations have also resulted in recent strike votes and job actions in Los Angeles County, San Joaquin County, San Benito County, Mendocino County and the University of California.

### 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.

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.

#### Related Criteria

[U.S. Local Government Tax-Supported Rating Criteria \(August 2012\)](#)

[Tax-Supported Rating Criteria \(August 2012\)](#)

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.

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTP://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](http://fitchratings.com/understandingcreditratings). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT [WWW.FITCHRATINGS.COM](http://WWW.FITCHRATINGS.COM). PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2013 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. One State Street Plaza, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings, Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings can be affected by future events or conditions that were not anticipated at the time a rating was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion is based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at anytime for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.