

San Bernardino Executive Summary



On August 1, 2012, the City of San Bernardino, California filed a petition for protection from its creditors under Chapter 9 of the federal bankruptcy code. Attorney Dale Galipo's move to collect \$1.4 million the city had agreed to pay to the families of three men killed by police prompted an early bankruptcy filing to avoid paying the settlements. By first declaring a fiscal emergency and an inability to meet with its more than 10,000 creditors, the city sidestepped a requirement that would have meant more time between the recognition of looming insolvency and the filing itself. But the city's time in federal bankruptcy court might also be longer because of the emergency filing, experts said. The bankruptcy filing came less than a month after the City Council authorized it, in a move that surprised many members of the public despite warnings of insolvency since at least 2010. The city faced a \$45 million deficit in its \$128 million budget in 2012-13. All of its fiscal reserves were exhausted. There was serious concern as to whether the city would have sufficient cash flow to make payroll in mid-August.

The city is currently operating under a short-term financial (pendency) plan—under the general supervision of the presiding judge. On August 28th bankruptcy Judge Meredith Jury formally granted the city eligibility to pursue federal bankruptcy protection. While this is an important step towards recovery and ultimate fiscal solvency, critical challenges remain for the community and city leaders in the months and years to come.

After interviews with a wide range of individuals familiar with the situation in San Bernardino, below are key observations and lessons learned from the experience of San Bernardino:

- **Charters matter.** Although they are often taken for granted, the basic framework for public decision-making at the local level—city charters—are critically important. Charters determine not only who will make decisions, but also how they will be made. The charter for the City of San Bernardino fragments decision-making among numerous elected and appointed officials. Additional boards further diffuse authority and fragment decision-making. Provisions that put categories of spending on “automatic pilot”—in the case of San Bernardino, the compensation for public safety employees—take decision-making out of the hands of the elected and appointed officials. Especially during times of rapid economic change, there needs to be substantial flexibility afforded elected and appointed officials to revise spending and revenue decisions to meet the changing economic conditions. The charter does not provide for this flexibility—or a clear decision-making path for navigating these fiscal challenges.
- **Political culture matters.** This is the most difficult factor to nail down or describe. But it contributes significantly to San Bernardino's fiscal situation. This factor was noted in a report from three decades ago¹ and thus predates the current roster of elected and appointed officials—but it has managed to survive and, in the opinion of most, worsen in recent years. By most accounts, it suffuses the politics, operations and decision-making of the city. The political culture amplifies the impact of the deficiencies in the charter. Yet the same political culture also makes it all the more difficult to make substantive amendments to the charter. This negative, reinforcing cycle between the charter and the political culture increases the challenge for San Bernardino to put itself on a path for long-term fiscal sustainability.

- State government matters.** State aid constitutes a very small percentage of revenue for cities in California—two percent in the case of San Bernardino. This meager amount does little to even out disparities in fiscal capacity and need for cities like San Bernardino. State actions in recent years—including changes in the motor vehicle license taxes and redevelopment agencies—have served to only exacerbate rather than ameliorate San Bernardino’s fiscal problems. State law has no provision for the appointment of an emergency manager, so it will remain up to the elected officials—operating under the same city charter and in the same political culture—to find a way out of its bankruptcy situation (with only broad oversight by the U.S. Bankruptcy Court). Referenda affecting the ability to raise taxes and other revenue continue to be a challenge for local governments in the Golden State. Yet, the vast majority of California cities have managed to cope with the changes. So, while the charter and political culture play a larger role in the plight of San Bernardino, state actions also have had a deleterious impact on the city.

“A Perfect Storm” in San Bernardino

Introduction

San Bernardino is no small city. With a population of about 210,000 residents, it would be the largest city in 17 of the 50 states. Yet it has found itself on the doorstep of bankruptcy.

After much debate by the City Council in July of 2012, the City of San Bernardino formally filed a petition for protection from its creditors under Chapter 9 of the federal bankruptcy code on August 1, 2012 in U.S. Bankruptcy Court in Riverside. Much legal wrangling has occurred between and among various parties over the following 12 months. Based on her previous comments, U.S. Bankruptcy Judge Meredith Jury ruled in favor of the city’s petition. This has cleared the way for municipal bankruptcy. The issue now, of course, is for all of the impacted interests, individuals, and institutions to reconcile their differences and move forward. Sacrifices will have to be made, but it is not yet clear what form they will take.

Individuals interviewed for this report cite a wide variety of factors contributing to San Bernardino’s² current fiscal situation. Many of these individuals focused particular attention on one or two proximate economic factors. However, the larger picture strongly suggests that the current challenges in San Bernardino were decades in the making. Several individuals independently used the phrase “a perfect storm” in describing the economic, demographic, institutional and political factors contributing to the city’s recent bankruptcy petition. Although there are certain factors that may have influenced the particular timing of the bankruptcy petition, the Great Recession was the tipping point where stress devolved into crisis.

Caught Between Scylla and Charybdis³

Before the complicated and interconnected factors contributing to San Bernardino’s bankruptcy are detailed in the body of this case study, what were the immediate events precipitating the financial emergency and the filing of the bankruptcy petition?

Although warnings of potential bankruptcy were aired as early as the spring of 2010, the city's decades-long odyssey with economic and fiscal challenges finally came to a head in the late spring and early summer of 2012. On Monday, July 16, 2012, the City Council had before it a resolution to declare a financial emergency—a resolution that would set the stage for the formal filing of a Chapter 9 bankruptcy petition. The city was truly caught between a rock and a hard place—between the stigma of bankruptcy and the inability to meet its financial and service obligations.

The city faced a \$45 million deficit in its \$128 million budget for 2012-13.⁴ All of its reserves were exhausted. Serious questions were raised at a council meeting in mid-July 2012 about the city's cash flow—particularly relating to the ability to meet its payroll on August 15. The city's credit cards had been cancelled and vendors were requiring payments in cash only for expenses like fuel for police cars and fire trucks. Sensing the increasing fiscal peril, 25 employees of the city's 1,200 employees rushed for the exits during the first two weeks of July—putting additional pressure on the budget as these employees collected their pay for accumulated vacation time.

After hearing numerous and emotional pleas from concerned residents, the council delayed a vote on the resolution that day. But just two days later—July 18—the council would vote 5-2 to declare a financial emergency that would set the stage for the subsequent filing of a bankruptcy protection two weeks later.

Among the key facts available to the council in mid-July 2012 and additional facts that would emerge (and events that would transpire) in the ensuing months:

- In July 2012, city staff projected that—without further action—expenditures would exceed revenues by \$45 million in fiscal year 2012-13 on a general fund expenditure of \$128 million.⁵
- There were no reserves in the general fund.
- There was an estimated cash balance of a negative \$18 million in the general fund at the close of fiscal year 2011-12. The negative cash balance was estimated to grow to a negative \$59 million by the close of fiscal year 2012-13.
- The cash balance of all funds (not just the general fund) was \$6.6 million on June 30, 2012. It is because of the cash balances in these other funds that the city's checks didn't "bounce" during 2012-13.
- On August 1, 2012, the city officially filed a Chapter 9 bankruptcy petition with the U.S. District Court in nearby Riverside.
- On November 26, 2012, the council approved the Pendency Plan that was required by the U.S. District Court to serve as a roadmap for recovery as well as serve as the Plan of Adjustment that would ultimately need to be approved by the Court.
- Included among the spending reductions in the Pendency Plan was suspension of pension payments including those to CalPERS,⁶ pension obligation bonds and all legal claims. The Pendency Plan also included a reduction in salary and compensation to employees and deferral of payments of accumulated vacation time upon separation of service. Total expenditure reductions in salary and compensation summed to \$26 million and deferrals summed to \$35 million for a total reduction in spending of \$61 million in FY 2012-13.
- In late January and early February, the council accepted agreements with four labor groups for changes in employee benefits. The council imposed similar reductions in benefits on three additional labor groups.

- Between July 1, 2012 and February 14, 2013, 262 employees separated from service. On February 14, 2013, the total number of employees remaining was 938—a decrease of 22% over a seven-month period.
- Between July 2012 and February 2013, the cash balance of all funds (not just the general fund) fell from \$6.6 million to \$4.2 million. The mid-February estimate was that at June 30, 2013, the cash balance would deteriorate further to \$3.1 million. It is also worth noting that revenue flows more slowly into the city during the first few months of the fiscal year—as property taxes are due in December and April of each fiscal year—further weakening the city’s cash balance in the first half of fiscal year 2013-14.
- On April 22, 2013, the City Council approved a 14-month budget by at 6-0 vote that would serve the city through June 30, 2014.
- The 14-month budget assumes the 9% reduction in benefits to employees negotiated with four labor groups and imposed on three others in late winter would remain in place. However, the unions representing fire, police and mid-management opposed the imposition of these benefit reductions and filed an objection with U.S. District Court in early spring.

Prologue: Background and Context

The City of San Bernardino is nestled just across a ridge of mountains about 50 miles west of Los Angeles. Looking from the top floor of city Hall to the north, one sees the natural beauty that surrounds the city.

San Bernardino is an old city—at least by western standards. In the first decade of the 1800s, Spanish missionaries were among the first wave of individuals of European descent to settle in what would later become known as San Bernardino. Trailblazers Kit Carson and Jedediah Smith spent a good deal of time in the San Bernardino Valley in the 1820s. By the early 1850s, Mormon settlers purchased substantial holdings and flowed into the area. In 1854, the City of San Bernardino was officially incorporated.⁷

San Bernardino offered the natural passageway through the mountains to the Pacific Ocean. Intense competition between the Union Pacific, Southern Pacific and the Santa Fe Railroads caused the economy and population to rapidly increase in the 1880s. When the Santa Fe Railroad completed the first transcontinental link, thousands of Easterners descended upon San Bernardino. The Santa Fe Railroad would have a tremendous impact on the city for the next century. A little more than a generation later, the famous Route 66—running from Chicago to Los Angeles—would pass through San Bernardino and further reinforce its position as a transportation hub for individuals and products. These key transportation routes provided a strong economic foundation for San Bernardino for much of the 20th Century.

Economic Foundation

For much of the 20th Century, San Bernardino was home to a large number of blue-collar, middle-class families. These families were supported by decent-paying jobs in places such as Kaiser Steel, the Santa Fe Rail Yard and Norton Air Force Base. These jobs, in turn, spun off tens of thousands of related jobs in retail and services.

In addition to the strong economic base provided by the industries cited above, San Bernardino offered a plentiful array of moderately priced homes—especially when compared to Los Angeles and surrounding cities. As the cost of housing continued to rise rather dramatically near the coast, San Bernardino offered a plethora of lower-cost housing options.

San Bernardino continues to have a number of significant economic building blocks. The city is the county seat for San Bernardino County—the largest county geographically in the lower 48 states. The county runs from Los Angeles County on the west to the Arizona and Nevada borders. It is larger than nine of the 50 states. The county has a population of 2.1 million—the vast majority living in the western end of the county around the city. The courts and administrative offices serve as one economic anchor for the city.

With an enrollment of over 18,000 students, California State University San Bernardino serves as another anchor for the city. Similarly, San Bernardino Community College has an enrollment of 12,000 and provides a third anchor.

These three institutions were mentioned by several individuals to indicate that the city has had—and will continue to have—substantial economic assets that will exist for decades to come and provide an economic and cultural base for future revival of the city. Yet, while all of these large institutions are centers of employment in San Bernardino and serve as economic foundations, they also are tax-exempt institutions that require services from the city but do not provide property tax revenue.

Economic Shocks to San Bernardino

The first salvo in a series of shocks that would undermine San Bernardino's economy would occur in 1980. For more than two decades, I-15 connected Las Vegas to Los Angeles and San Diego and ran through the very heart of the City of San Bernardino. The routing of this Interstate highway here spurred economic development as it coursed its way through the city—from individuals, families and truckers making their way from Las Vegas to the coast and looking for restaurants and lodging, to residents of nearby communities who now had easy access to San Bernardino for shopping and entertainment as well. For example, the city had two thriving shopping malls along I-15 as well as other economically important retail establishments.

Then, in 1980, a new I-15 was rerouted about 15 miles to the west of San Bernardino. The new portion of I-15 began just a couple of miles north of the city and basically cauterized the flow of traffic to the city and diverted it to the west. The old portion of I-15 running directly through San Bernardino was renamed I-215, but the economic impact on San Bernardino would be felt in ensuing years in the gradual loss of retail and related jobs and economic activity. Thousands of jobs in the city were lost as a consequence.

The second shock would come just a couple years later. Kaiser Steel closed its doors in 1982. With Kaiser's closure, 8,800 good-paying jobs were wiped out. And with the loss of those jobs, another 2-3 times that number of jobs would be lost due to the secondary economic impact.⁸

A third shock would be the closure of the Santa Fe Rail Yard in 1986. A bedrock foundation of San Bernardino for a century, the closure of the Santa Fe resulted in the loss of 4,500 jobs—and the additional 2-3 times that when the economic multiplier is taken into account.

As big as these economic shocks were, the biggest of them all was yet to come. Norton Air Force Base closed in 1995 as a part of the initial round of the Base Closure and Realignment Commission. A total of 12,000 jobs were lost directly as a result.

All told, 30,000 or more jobs were lost as a direct result of these closures and probably another 60,000-90,000 jobs were lost when the economic multiplier impact is factored in.

Although these economic shocks were felt across the region, there was a disproportionate impact on San Bernardino in that the city was home to so many of the middle-class families who were supported by those jobs. These home-owning, middle class workers gradually moved out. At the same time, the tide of immigration was growing in San Bernardino. Over a period of a decade or more, an increasing portion of these middle class homes became rental properties—as owners moved and converted their homes to rentals, and others purchased the properties as income-producing investments. As several individuals noted, more than one family at a time would reside in these homes. Consequently, the percentage of stable, middle-income families fell from what it had been for much of the last half of the 20th Century. In fact, one person commented that nearly 50% of the students are new to their schools each year—but one reflection of this transience.

The real estate frenzy that took over much of the country in the early- to mid-2000s was particularly frothy in the Inland Empire. San Bernardino experienced a bit of a respite from the aforementioned economic shocks as easy credit and relatively plentiful property—“cheap dirt” as one person called it—propped up San Bernardino’s economy. But, with the weak underpinnings from the 1980s and 1990s still extant, the impact of the Great Recession throughout the Inland Empire was enormous. In San Bernardino, it was devastating. To wit:

- 46% of the 210,000 residents of San Bernardino are on some form of public assistance⁹
- 29% are living at or below the official poverty level
- For those that have not given up looking for work, the unemployment rate is 15%
- 56% of homes are underwater on their mortgage
- Retail sales are down by 30% from their peak
- Property tax receipts are down by 15% from their peak
- 48% of homes are renter-occupied¹⁰

Demographics of San Bernardino

The table below contains data from the 2010 Census. Several statistics simply jump off the page:

- The per capita income in San Bernardino (\$15,762) is just about half the average of California and 45% below the U.S. average.
- The percentage of the population below the federal poverty level (29%) is more than twice that of California and the U.S.
- The percentage of the population over age 25 that are college graduates (13%) is less than half that in California and the U.S. as a whole.
- The percentage of the population living in households where English is not the primary language spoken in the home (47%) is nearly 2.5 times greater than the U.S. average.

	2010 Census ¹¹			1980 Census ¹²		
	SB	CA	US	SB	CA	US
Population	209,952	37.3m	308.7m	118,794	23.7m	226.5m
Per Capita Income	\$15,762	\$29,634	\$27,915	\$6,411	\$8,285	\$9,494
% below Poverty	29%	14%	14%	16%	11%	13%
College grad>age 25	13%	30%	28%	12%	20%	17%
HS grad>age 25	68%	81%	85%	65%	74%	69%
Hispanic origin	60%	38%	17%	25%	19%	6%
Black	15%	6%	13%	15%	7%	12%
White	19%	40%	63%	67%	76%	80%

Not reflected in the table above is the crime rate information:

- The rate for Part 1 (violent) crime the City of San Bernardino in 2012 was 96 per 10,000 residents.¹³
- The highest rate of violent crime in California for cities with populations 10,000 or greater was Oakland at 199, followed by Stockton 155.¹⁴
- The average for all cities in California with populations 100,000 or greater was 42 and the median was 36.
- The U.S. average and median was 57 and 49, respectively.¹⁵

A few observations about the change in demographics between 1980 (prior to the economic shocks) and 2010:

- Although the differences in per capita income between San Bernardino and the averages for the U.S. and California are roughly the same between 1980 and 2010, what is substantially different is the percentage of the population below the poverty line. While the poverty rate for the city was only a bit below that of the U.S. and California in 1980, it more than doubled by 2010.
- Over the 30-year period, the percentage of the population with college degrees increased 50% in California and 65% for the U.S. as a whole. For San Bernardino, there was essentially no change.
- The non-Hispanic white population dropped precipitously during the period, falling from 67% to 19%. The percentage of African-Americans remained unchanged. The Hispanic population jumped dramatically—from 25% to 60%.

Shocks from Washington and Sacramento

As detailed previously, the single largest shock to San Bernardino came from the Federal Government—the closure of Norton Air Force Base in 1995. Although decreases in intergovernmental assistance, additional mandates and other federal policies undoubtedly affected the city, few are unique to San Bernardino.

Much is the case with state aid and policies—few if any of the changes in state policies in recent decades (or even the past year) are unique to San Bernardino. But a few in the recent past have had (or will have) a differential impact on the city.

Intergovernmental revenue as a percentage of the general fund budget in San Bernardino is quite small—\$7.7 million out of a general fund budget of \$128.4 million (6.0%). The city's most recent CAFR distinguishes \$2.0 million of this as either state grants or state payments in lieu of tax. The balance of intergovernmental revenue is listed as "other" and totals \$5.7 million.¹⁶ In California, moreover, the effect of the state on municipal finances cannot stop at a description of the amount of "intergovernmental revenue." The state retracted most direct intergovernmental grants and aid that it could during the 1980's immediately following Proposition 13. Since then, the most severe financial impacts of the state of California on cities have been various end-arounds to redirect local, rather than state revenues. This has come not only in the form of program shifts, but in the redirection of non-state revenues such as local property taxes and vehicle license fees to schools or public safety programs, relieving the state of its previous financial support. The latest example of this was just two years ago, in 2011, when the state redirected all vehicle license fees going to city general funds to pay for state administered law enforcement grants previously paid for by the state general fund. This maneuver cost the City of San Bernardino \$1 million and may cause California's four newest cities to become insolvent and disincorporate.

With the notable exception of the short-term federal aid provided by the American Recovery and Reinvestment Act (commonly known as the "Stimulus Act"), federal aid to localities has been on the decline for several decades.

Three actions by state lawmakers in the past 24 months have had (and will continue to have) a disproportionate impact on San Bernardino. The first was the shifting of responsibility for supervision of state prisoners placed on parole from the state to counties whose last offense was not a violent crime or sex offense. In addition, newly-convicted offenders who were deemed to be non-violent, non-serious, and non-sex offenders were placed on probation or in local jails in lieu of state prison.¹⁷ As part of the 2011-12 budget plan, the California legislature enacted a major shift—or "realignment"—of state program responsibilities and revenues to local governments. In total, the realignment plan provides \$6.3 billion to local governments (primarily counties) to fund various criminal justice, mental health, and social services programs in 2011-12, and ongoing funds for these programs annually thereafter.¹⁸

In October 2011 the governor proposed the realignment of public safety tasks from state prisons to local government¹⁹ as a way to address certain judicial orders dealing with state prison overcrowding and to reduce state expenditures. This program shifts the prisoner burden from state prisons to local counties and cities. Some of the approximately 11,000 of these individuals have already been returned to community supervision reside in San Bernardino and other cities in that county, and additional individuals will arrive over the next year. This has the potential to increase the need for additional police services, social services and other concomitant services—putting still more stress on an already fiscally stressed community.

A budget-related law (Chapter 43, Statutes of 2011) excluded the redirected 1.0625 cent sales tax revenues from the Proposition 98²⁰ calculation, reducing the minimum guarantee by roughly \$2 billion. Chapter 43 excluded these revenues, however, contingent on the approval of a ballot measure by November 2012 that (1) reauthorizes the exclusion of the 1.0625 cent sales tax revenues from the Proposition 98 calculation and (2) provides funding for school districts and community colleges by an

amount equal to the reduction in the minimum guarantee due to the exclusion. Absent a ballot measure with these specific provisions, Chapter 43 would increase the Proposition 98 minimum guarantee back to its original level.

Such has also been case with direct state aid to cities in California for the last several decades—only more so. The state withdrew most direct intergovernmental grants to cities in the years immediately following the passage of Proposition 13. Since then, the state also has redirected certain taxes and other sources of city revenue to replace categorical grants previously funded by the state (e.g., public safety programs, schools). This has resulted in fewer financial resources for cities and less flexibility for cities to target resources to their highest-priority needs. A recent example of this occurred just two years ago when the state redirected all vehicle license fees going to city general funds to pay for state administered law enforcement grants previously paid for by the state general fund. This maneuver cost the City of San Bernardino \$1 million.

Another example of this occurred over one year ago. Based on legislation approved in 2011, the state dissolved local redevelopment agencies (RDAs) on February 1, 2012, and the process for winding them down began. These redevelopment agencies were an important development tool for many cities with significant degrees of blighted buildings and distressed properties. They provided a means for cities to not only rehabilitate properties, but also to put them back on the property tax rolls and receive additional revenue as a consequence. Many cities like San Bernardino provided direct staff support to their local RDAs, and the overnight dissolution caused deep reductions in general fund revenue from the RDA and corresponding layoffs in staff.

Although the dissolution of the RDAs will not change the amount of property tax revenues raised, it will change how this additional revenue is used and redistributed. Additional property tax revenue derived from the dissolved RDAs will be redistributed to local school districts and other types of local governments, with a corresponding reduction and savings in state general fund support for schools. Counties, cities and special districts have received increased allocations of general property taxes that previously were used to pay the expenses of the RDAs. Although there is some disagreement as to whether cities were consistently using the revenues from these redevelopment agencies as intended, the dissolution of the redevelopment agencies has had (and will have) a significant negative impact on San Bernardino.²¹

The City Charter in San Bernardino

Everyone interviewed for this report made direct or indirect reference to the city charter one way or the other. And almost everyone indicated that the charter was a major factor contributing to the city's fiscal situation. One commentator noted: "I have never seen a more dysfunctional design for a city government than the provisions contained in the city charter. It is an understatement to say it is designed to diffuse power and prevent sound management, accountability and transparency. It actually seems worse than the old commission form of government with all its fiefdoms. At least there you could hold a commissioner accountable. That being said, the people of the city have operated with that system for so long and they know so little about other options, that they cannot possibly understand it could be any other way. It is going to take some reformers to come along who can convince them to bring their system into the 21st (or even 20th) century. Then the political culture can start to change."

Two provisions in particular were invariably mentioned: Section 186 and various provisions relating to the overall structure of local government.

Section 186 in Context

This section of the city charter provides formula for setting the compensation of fire and police employees. The provisions of Section 186 are quite detailed. The calculation of salaries in Section 186 begins with identifying the salaries of public safety employees for all California cities with populations between 100,000 and 250,000. Management and labor alternate in deleting cities from the list until it is reduced to 10 cities. At that point, salaries are set at the arithmetical average of the 10 cities that remain. Salary provisions for specific ranks, grades and length of service are also detailed in Section 186.

Below are the 10 cities used in the calculation of the salaries of public safety employees in 2012 (along with the median household income):²²

**Per Capita Income of the 10 Cities
Used as Comparables for Setting Salaries of
Public Safety Employees in San Bernardino in 2012**

	Per Capita Income
San Bernardino:	\$35,111
Lancaster:	47,198
Palmdale:	\$50,394
Norwalk:	\$54,411
Oceanside:	\$55,620
Oxnard:	\$58,090
Concord:	\$60,391
Fontana:	\$64,202
Fullerton:	\$64,648
Santa Clarita:	\$78,738
Irvine:	\$87,484
Average:	\$62,118

The figures above hint at the city's financial struggles. A third of the city's residents fall below the national poverty line, making San Bernardino the poorest city of its size in the state. To exacerbate matters, as John Husing pointed out in his presentation in March 2013 at the University of California Riverside, the median household income of the cities used to establish public safety salaries in the city were between 34% and 149% greater than that of San Bernardino.²³ The practical consequence of Section 186 is that San Bernardino's reference to population, rather than average income, places a disproportionate burden on already strained local finances. As an unfortunate consequence of politics and historical trends, the city found itself committed to salaries and pensions that were neither proportionate nor sustainable.

As cited in the opening pages of this case study²⁴, public safety salaries constitute \$93 million (72%) of the city's \$128 million general fund budget. With a shortfall of approximately \$45 million, the city would still have a deficit even if all other spending besides public safety were eliminated. This is the primary

reason that almost everyone cited Section 186 as one key policy that had to change in order for the city to get back on track. However, an equally significant aspect of Section 186 is its limitation on the city's flexibility to respond to fiscal crisis. If this limitation were not there, there might have been a much more speedy and effective management response as things began to turn sour. This charter flexibility issue was a similar critical factor in Vallejo and Stockton. Yet one individual offered a spirited defense of public safety by stating that if the city does keep the community safe, the city would never attract sufficient capital and therefore could not prosper. He stated his belief that San Bernardino is already one of the most dangerous cities in America²⁵ and that the city must be able to attract and retain high-quality public safety officers to get the city back on track; for him, lower salaries would simply mean that San Bernardino would only "get the rejects" from other departments.

The issue of public safety salaries—probably more than any other single issue—now defines the parameters of the public debate within the City of San Bernardino. The fact that the setting of these salaries is accomplished via the "automatic pilot" provision established in Section 186 means that elected and top appointed officials are not afforded the flexibility to modify the salaries of public safety personnel to reflect significant changes in fiscal circumstances. This lack of flexibility is further compounded because of the fact that public safety expenditures represent 72% of the city's budget.

The Structure of Government in San Bernardino

Direct election of city attorney. The second aspect of the city charter mentioned by the majority of individuals interviewed for this case study is the structure of city government. Specifically mentioned by a majority of individuals was the provision in the charter that requires the direct election of the city attorney—rather than the appointment of that position by the mayor or city manager. However, several knowledgeable individuals pointed out that the election of the city attorney is not all that unusual throughout the country. One person in particular noted that he has seen elected city attorneys work fairly well in some of the places where such a provision is in place. So, while this person still suggested that—in his opinion—a charter that calls for the appointment of a city attorney rather than an elected one is his preference, he averred that it alone is not the Achilles Heel of the charter.²⁶

Direct election of the mayor and the hybrid role of the city manager. Absent a city charter, the general law provisions of the California state statutes require the council-manager form of government. In a nutshell, under the provisions of the general law, the City Council hires a professional manager to direct the day-to-day management of the city. The manager serves at the pleasure of the council and can be removed at any time by a majority vote of the council. The city manager, in turn, has direct supervisory responsibility and hire-and-fire authority over all department heads, except the city attorney that is also hired by the council. Most of the over 100 cities in California with their own charters also operate within the basic structure of the council-manager form of government. In some cities, the mayor is elected at-large by the voters. In others, the mayor is selected by a majority vote of the council.

The City of San Bernardino the mayor is elected at-large. But this is not what makes San Bernardino significantly different from other California cities. What is substantially different is that the lines of authority between and among the City Council, mayor and manager (and also the elected city attorney) as outlined in the charter make decision-making difficult and complex. One person described it as "almost ungovernable."

Under the charter, the mayor nominates individuals to serve as city manager—as well as the fire chief and police chief. A majority vote of the council is required to approve these nominations. These individuals can only be removed from their positions if the mayor submits to the council a petition for their removal—and the council approves the petition by a majority vote of the council. Thus, once nominated by the mayor and confirmed by the council, the majority of the council determine whether these individuals remain in their positions—even though they all formally report to the mayor (or they report to the city manager who, in turn, reports to the mayor)—even if the mayor wishes to remove them and select others for those positions. This has the net effect of diffusing executive authority and decision-making. It is quite unusual to require council approval to remove a department head. As one fiscal expert noted: “It is a recipe for intransigence and disaster.”

As chief administrative officer for the city, the city manager has supervisory responsibility over most other department heads. These department heads, like the police and fire chiefs, cannot be removed from their positions without a majority vote of the council—and with the same net effect. And lower-level employees—categorized in the charter as “classified” employees—cannot be suspended or removed except after appeals are reviewed and acted upon by the Civil Service Board as outlined in Sections 246-261 of the charter. Thus, key decisions involving personnel involve actions not only of the city manager or other supervisor, but also either the City Council or the Civil Service Board.

Another fiscal expert described this situation this way: “I had never before seen such an attitude of local lordship fiefdoms.” The charter provision, in effect, undercuts the manager’s authority: department heads understand that they needed more to “count to 4” - keep a majority, or four of the seven council members happy and in their defense, rather than to serve on a team under the manager. This charter enhanced breakdown can have an adverse impact in budget development, as one can imagine - or one can simply look back at the documented history of this city.

The net consequence of San Bernardino’s structure of government is that no one person or body has full authority to execute decisions. The city governance is a complex web of largely independent and often contradictory interests. This has negative impacts on both management and policy. As chief executive officer or chief administrative officer for the city, the mayor or city manager can make only initial management decisions. There is always the possibility that these initial decisions—particularly when they have a strong set of defenders on the council—can be slowed down or stymied by the protections of these positions afforded by the charter. Conversely—and unlike the typical council-manager form of government—the council doesn’t have the institutional power alone to remove the manager since he/she serves at the pleasure of the mayor. At the best, this complex arrangement makes efficient governance difficult. At worst, the competing interests means the status quo—even when detrimental to the city as a whole—is very difficult to shift.

There have been four attempts in the past decade to make major revisions to the charter in the past decade. They all involve significant revisions to (or elimination of) Section 186 of the charter and/or the change of the office of the city attorney from an elected to an appointed position. All have failed to get council approval in order to be placed on the ballot and go before the voters.

None of the institutional provisions of the charter by themselves solely (or in combination with) explain the bankruptcy petition of the city. But the perceived vulnerability in these institutional provisions is exposed when combined with the political culture in San Bernardino.

Political Culture in San Bernardino

“There is an almost tangible absence of consensus among the residents of San Bernardino about the sense of identity and unity of purpose—the spirit of the community-at-large and furthermore, a surprising apathy toward efforts to address this issue...

There is an almost schizophrenic feeling [that] most residents seem to share about their city. When asked (or even when not prompted by a question), most will confess that San Bernardino has an extremely negative public image not only among its own citizens, but throughout the Inland Empire and Southern California, yet most are also convinced that growth is imminent and the future holds economic prosperity...

More specifically, in terms of development, the city government presents an appallingly poor image to the development community—the kind that makes them their own worst public relations enemy. Additionally, the city government is not well organized to take best advantage of the development prospects [that] do arrive and, consequently, recent building projects have not been optimally located nor designed from the standpoint of the public interest.”²⁷

What is most remarkable about the quotes above is the date: 1981. In October of 1981, an urban assistance team from the American Institute of Architects had a four-day immersion in San Bernardino. The quotes above from that study summarize the independent impressions of the issues with which the city must cope. It is only a snapshot in one point in time more than 30 years ago and should be treated as such. However, it does offer a brief glimpse into San Bernardino that suggests that problems of political efficacy, political culture and governance that pre-dates all of economic shocks of the last two decades as well as pre-dates all of the current actors on the political stage in 2013.

“Toxic.” Several individuals independently used this word to describe the political environment in San Bernardino. Whether fair or not, much of the public’s focus has been on the fundamental and profound disagreement between the mayor and city attorney regarding the issue of compensation for police and fire employees.

The city attorney, James Penman, was elected to that position in 1987 and has held that office since then. A native of San Bernardino for all but the first few months of his life, Mr. Penman worked his way through college serving as a firefighter until graduating from Cal State San Bernardino in 1969. He served as a resident counselor and executive director of Neighborly Home, a social service arm of the Presbyterian Church in San Bernardino while working his way through Western State University School of Law. He also served as chair of the San Bernardino Police Commission during that same period. He was a lawyer in private practice for seven years prior to being elected to his first term as city attorney in 1987.²⁸

Patrick Morris was appointed to the Superior Court Bench in San Bernardino in 1976 and served the Superior Court until he was recruited to run as mayor and was subsequently elected in 2006. Mr. Morris graduated from nearby University of Redlands and received his law degree from Stanford. He has been recognized for an alternative treatment program for non-violent drug addicts and established one of the first Mental Health Courts for those offenders who are seriously mentally ill that get caught up in the court system.

These two individuals, committed to their community but expressing it in different ways, often serve as the flash point for Section 186 debates over salaries for police and fire employees—and the concomitant policy and budget debates regarding the direction of the city and the politics as to how divergent priorities are played out on the public stage. The council votes often hang in the balance as these two individuals attempt to guide the city from the conflicting powers afforded to each of them by the city charter—as well as the power leveraged by their political acumen.

Several individuals interviewed for this case study indicated the politics of San Bernardino are strident and some indicated that recent mayors—both the current mayor and the one preceding him—were not prepared for the fierce political battles that ensued.

According to many who were interviewed, the unions representing fire and police are very skilled in their use of political power. From the police union sponsoring a billboard labeled “Worst Managed City in America” with photos of the mayor and four council members voting against its positions to door-to-door campaigning for (or against) candidates, they are very clear in making their positions known. These factors, combined with the relatively low voter turnout in San Bernardino, enable the unions representing police and fire to exert considerable influence in these elections.

In deference to fire and police unions, they are simply representing their members’ like any other special interest—and seem to be very effective in doing so. It is the provisions within the charter that prevent sound fiscal management controls and cause deep dysfunction, political culture, lack of broad citizen engagement and relative absence of competing interests that contribute to the effectiveness of these unions in representing their members.



Source: *San Bernardino Sun*, 4/30/13

Petition to recall all elected officials. In May of 2013, a group called San Bernardino Residents for Responsible Government began a petition to recall all elected officials of the city in the November election. But, like so many things involving San Bernardino, this recall has placed the city in a “murky

swamp”²⁹ in that the city clerk has the responsibility under the charter for supervising elections. However, because the city clerk is an elected official and is among those included in the recall, she chose to recuse herself. The city attorney, who would normally advise the city clerk on such matters, also recused himself and his office because he, too, is a target of the recall. The council then deputized the city manager to step in as the elections official. But the problem with that was that the city charter specifically designates the city clerk as the chief elections official.

In early June, after consulting with experts, the city clerk agreed to serve as the chief elections official. The city manager will handle only papers and issues related to the recall of the city clerk.

In late August, 2013, the county registrar of voters announced that recall petitions for two council members and the city attorney have qualified for the November 5, 2013 ballot. The mayor has indicated he will not seek re-election and three other council seats are up for election on the same date.³⁰

Bankruptcy: What's Next?

Against the backdrop of all of the various economic, political and institutional factors described above, on August 28th Judge Meredith Jury formally granted San Bernardino the right to pursue bankruptcy protection. While this is a critical step in the long road to solvency, the city is still left with a host of challenges in the months and years to come.

Because the State of California has no law regarding the appointment of an emergency manager, the Court will oversee the bankruptcy. But the Court will not serve as an emergency manager. The Court will not impose cuts or make other budgetary/management decisions. This means that all budget decisions—from additional cuts that will need to be made, to services potentially contracted out, to payments to vendors, claimant, bondholders and CalPERS—go back to the city for further negotiations between and among all of the elected officials. The Court will rule only on the financial viability and implementation of these plans. The role of the federal courts under Chapter 9 of the federal bankruptcy code is rather limited in order to respect state sovereignty and democratic governance under the 10th Amendment to the U.S. Constitution.

The fact then remains that decisions necessary to put the city on a sustainable financial path rest with the same elected officials, the same institutional structures and the same political culture that made decision-making so difficult in the recent past. The council passed and the mayor approved a Pendency Plan last November as required by the Court. The Pendency Plan provided a budget through June 30, 2014. But that Plan—while providing for a resumption of payments to CalPERS beginning in July 2013—also continued deferral of payments on the pension obligation bonds and deferral of other obligations. The Plan also included assumptions about the continued 9% contribution of employees toward the cost of benefits. It is not clear whether this contribution—which is being contested by three of seven unions—will be upheld in bankruptcy court. Increases for fire and police employees are still required under Section 186 of the city charter. It is not yet known whether Judge Jury has the authority to set aside the provisions of Section 186 even if the council includes such a provision in future revisions to the Pendency Plan.

In short, the City of San Bernardino and the U.S. Bankruptcy Court both find themselves in *terra incognita*. Add in the complications from the recall election—which could remove elected officials

immediately in November 2013, combined with new elections, which might put yet another mix of elected officials in place in March 2014—so much is simply unknown. And unknowable.

It is likely to take several years for the city to work through the bankruptcy—given the complicated fiscal and legal issues that will need to be resolved.

Thinking the Unthinkable

Part 1. Discussions have occurred regarding disincorporation. This is not just idle, coffee-shop chatter. And it is far more complex than simply locking the doors of City Hall and turning the keys over to the County of San Bernardino.

These discussions have involved the Local Agency Formation Commission of San Bernardino County. LAFCoS are authorized under California state statutes and operate in all counties in California. Their primary function is to facilitate the incorporation of new cities and other local government entities as well as address issues of annexation. But they do have authority to facilitate the disincorporation of local government entities. LAFCoS have been involved in only one disincorporation since they were created in state law in 1972: a tiny city of less than 400 residents. Under state statutes, LAFCoS cannot impair or discharge any liabilities and must ensure payments to bondholders. An orderly transfer of buildings and other assets to the County (or another entity) would need to occur.

Because of Proposition 13's tax limitation, neither the County, nor even the voters, would have the authority to impose an ad valorem tax within the previous city limits in order to pay off bonds or other obligations. Instead, an assessment would be imposed *on each individual property owner* that reflected that owner's share of the outstanding debt and other financial obligations. And a majority of voters in the city would need to approve a disincorporation—along with the state legislature and governor. Although the unthinkable has at least been thought, it seems highly unlikely that disincorporation would occur given the requirement for a vote of current residents.

Part 2. One question that arose during these interviews is this: what happens if another economic or legal shock were to hit this city in the near future? The Pendency Plan and the subsequent 14-month budget passed in April that is intended to carry the city through June 30, 2014 is in balance—but precariously so. Rulings regarding Section 186, employee contributions to benefits and other decisions could very easily knock it out of balance. And the Pendency Plan still does not yet address the issue of deferred payments to CalPERS, the pension obligation bonds and other financial obligations that have been deferred.

This is not just about balancing expenditures with revenues over a fiscal year. It potentially is far more immediate than that. What happens if the city simply does not have enough cash on hand to meet payroll? This is not a theoretical question. In July 2012, the city was facing that very prospect for its payrolls in August and September 2012. Who gets paid? Who doesn't? What provisions are in place for a pro-rata payment? What lawsuits might ensue for violation of existing contracts? What happens for the payroll due two weeks later? Can the city shut down for a few days except for certain public safety employees? Would this be mathematically achievable, given that over 70% of the budget is already dedicated to public safety?

Conclusion

By most accounts, a “perfect storm” of factors has contributed to San Bernardino’s fiscal situation. The four key factors are: the charter, political culture, state actions (or inactions) and economic shocks. The last two factors have caused many cities across the U.S. to stumble in recent years or even in recent decades, but the vast majority of them have been able to regain their footing. But a weak charter that diffuses political and managerial accountability combined with a negative political culture made overcoming the economic shocks and state actions too steep a hill for San Bernardino to climb.

While the U.S. Bankruptcy Court has ruled San Bernardino is eligible for bankruptcy protection, the extent to which the city is able to develop a long-term plan for financial and service-level sustainability remains to be seen. It remains to be seen whether the Court will adjudge such a plan viable—and then oversee that plan to make ensure it is implemented. In sum, this case study described the confluence of many factors that led the City Council to seek bankruptcy protection on August 1, 2012. What unfolds in the future months (and years) remains to be determined. *Terra incognita* indeed.

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A Token of Appreciation

This project was made possible with the generous support of the John D. and Catherine T. MacArthur Foundation.

We would like to thank the following individuals who provided background information and insight to this case study of the City of San Bernardino:

- **A.J. Wilson**, Executive Director, San Bernardino Airport Authority
- **Cassie MacDuff**, Reporter, *Press-Enterprise*, Riverside, California
- **Michael Coleman**, Fiscal Policy Advisor, CaliforniaCityFinance.com, League of California Cities, California Society of Municipal Finance Officers.
- **James Penman**, City Attorney, City of San Bernardino
- **Nancy Cisneros**, Regional Public Affairs Manager, League of California Cities
- **Ken Sawa**, CEO, Catholic Charities of San Bernardino and Riverside Counties, California
- **Beverly Earl**, Director of Family and Community Services, Catholic Charities San Bernardino
- **Tobin Brinker**, History Teacher, Frisbee Middle School; former member of the San Bernardino City Council, December 2006-March 2012
- **Robert Blough**, General Manager, San Bernardino Public Employees Association
- **Charles McNeely**, former city manager, City of San Bernardino
- **Kathleen Rollings-McDonald**, Executive Officer, Local Agency Formation Commission, San Bernardino County
- **Gregory Deveraux**, Chief Executive Officer, County of San Bernardino
- Larry Sharp, former CEO of Arrowhead Credit Union (retired); Member, Inland Action
- **Dr. Ron Loveridge**, Professor of Political Science, University of California Riverside; former Mayor, Riverside
- **Patrick Morris**, Mayor, City of San Bernardino
- Jim Morris, Chief of Staff, City of San Bernardino (son of mayor; serving as an unpaid volunteer)
- **Sam Racadio**, Councilmember, City of Highland, California, 2010-present; former city manager of Highland, 1988-2006
- **Dr. Joshua Beckley**, Senior Pastor, Ecclesia Christian Fellowship, San Bernardino

¹ San Bernardino R/UDAT: Regional Urban Assistance Team, American Institute of Architects, October 8-12, 1981.

² Throughout this report, “San Bernardino” will refer to the City. The County of San Bernardino has a solid financial position and is a legally separate entity.

³ Two monsters in Greek mythology that threatened ships in Homer’s *Odyssey*.

⁴ Memo to the Mayor and City Council from the Interim City Manager dated February 19, 2013. Page 3 provided a brief summary of information provided to elected officials since July 2012—including the projection of a \$45 million deficit in 2012-13.

⁵ As of late June 2013, the most recent audited financial report (CAFR) available is for the fiscal year from two years ago—that is, June 30, 2011. For that fiscal year, general fund expenditures totaled \$128.4 million while revenue totaled \$115.9 million. The total fund balance in the general fund at the beginning of that fiscal year was a miniscule \$410,293—0.3% of expenditures. At the close of the fiscal year, it was a negative \$1.2 million. The delay has been attributable to a number of factors including the move to a new financial reporting system, the concern regarding the ability of the City to pay for the completion of that system, the retirement of the finance director in December 2012, the departure of the subsequent finance director and interim city manager in early 2013, the contracting out of the leadership of the finance office to a private firm and the demands of responding to the requests for information from the bankruptcy court and various creditors.

⁶ “CalPERS” is the California Public Employee Retirement System.

⁷ See the “History” section of the web site of the City of San Bernardino.

⁸ A number of individuals mentioned the economic impact of the closure of Kaiser Steel, the rerouting of I-15 and other factors mentioned in the following paragraphs. However, the most specific information was provided by John Husing of Economics and Politics, Inc. in his March 12, 2013 presentation at the Randall Lewis Seminar Series, Center for Sustainable Suburban Development, University of California Riverside. <http://cssd.ucr.edu/Seminars/2013Seminars.html>

⁹ Brochure from Mary’s Mercy Center, 2013.

¹⁰ See citation for John Husing above.

¹¹ U.S. Census Bureau, 2010 Census, <http://quickfacts.census.gov/qfd/states/06/0665000.html>

¹² U.S. Census Bureau, 1980s Census,

Population: <http://www.census.gov/population/www/censusdata/files/c1008090.txt>

Income: 1980a_ca, AB-03, 1980a_caCs1-01.

Poverty: <http://www.census.gov/hhes/www/poverty/data/historical/people.html>;

Education: <http://www.census.gov/hhes/socdemo/education/data/cps/1981/tab-12.pdf>;

Race: http://www.census.gov/us/chart_race.html.

¹³ Source: <http://www.sbcity.org/civica/filebank/blobload.asp?BlobID=15717> (Police Department, City of San Bernardino Web site).

¹⁴ FBI, Uniform Crime Reports, Table 4 for 2012: <http://www.fbi.gov/about-us/cjis/ucr/crime-in-the-u.s/2012/preliminary-annual-uniform-crime-report-january-december-2012>

¹⁵ See FBI citation above.

¹⁶ CAFR for Fiscal Year Ending June 30, 2011, page 118. November 2012.

¹⁷ Source: **CAL Realignment.org**; <http://www.calrealignment.org/realignment-overview.html>

¹⁸ Specifically, the state redirected 1.0625 cents of the state’s sales tax rate to counties. In addition, the realignment plan redirects an estimated \$453 million from the base 0.65 percent vehicle license fee (VLF) rate for local law enforcement programs. Under prior law, these VLF revenues were allocated to the Department of Motor Vehicles for administrative purposes and to cities and Orange County for general purposes. The budget also shifts \$763 million on a one-time basis in 2011-12 from the Mental Health Services Fund (established by Proposition 63 in November 2004) for support of the Early and Periodic Screening, Diagnosis, and Treatment Program and Mental Health Managed Care program.

¹⁹ See “Addressing Issues to Promote Its Long-Term Success,” California Legislative Analyst’s Office, August 19, 2011.

²⁰ California voters enacted Proposition 98 in 1988 as an amendment to the State Constitution. This measure, which was later amended by Proposition 111, establishes a minimum annual funding level for K-14 schools (K-12 schools and community colleges). Proposition 98 funding constitutes over 70 percent of total K-12 funding and about two-thirds of total community college funding.

²¹ State of California, Legislative Analyst’s Office, *2012-13 Budget: Unwinding Redevelopment*, February 2012, http://www.lao.ca.gov/analysis/2012/general_govt/unwinding-redevelopment-021712.pdf. See especially pages 1 and 26.

²² See citation for John Husing above.

²³ See citation for John Husing above. Although no one specifically mentioned the comparison of the rates of violent crime in these same set of 10 cities, they range from a low of 5 instance of violent crime per 10,000 residents to a high of 43. The average and median were 26 and 31, respectively. For comparison (and as cited previously), the rate of violent crime in San Bernardino in 2012 was 96 and the highest in California was 199 (Oakland).

²⁴ San Bernardino R/UDAT, op. cit.

²⁵ According to the preliminary statistics for 2012 posted by the FBI, the City of Flint, Michigan had the highest rate of violent crime (273 per 10,000 residents) for cities that reported data. That compares to 96 for San Bernardino.

²⁶ The elected offices of the City are the mayor, the seven members of the City Council, the city attorney, the city clerk and the city treasurer. Almost no one mentioned the city clerk or city treasurer as factors contributing to the problems of the City of San Bernardino. And, when they were mentioned, these positions were only mentioned in the context of the elective offices of the City.

²⁷ San Bernardino R/UDAT: Regional Urban Assistance Team, American Institute of Architects, October 8-12, 1981, p. 9.

²⁸ Office of the City Attorney, City of San Bernardino Web site.

²⁹ "San Bernardino: City Enters Legal Quagmire with Recalls," Cassie MacDuff, *Press-Enterprise*, May 24, 2013.

<http://www.pe.com/local-news/columns/cassie-macduff-headlines/20130524-san-bernardino-city-enters-legal-quagmire-with-recalls.ece>

³⁰ *Los Angeles Times*, August 30, 2013; <http://www.latimes.com/local/political/la-me-pc-san-bernardino-recall-20130830,0,7480384.story>