



Steven S. Choi, Ph.D., Mayor

[cityofirvine.org](http://cityofirvine.org)

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August 28, 2014

The Honorable Glenda Sanders  
Presiding Judge  
Orange County Superior Court  
700 Civic Center Drive West  
Santa Ana, CA 92701

RE: City of Irvine Response to Orange County Grand Jury Report  
"Orange County City Pension Liabilities; Budget Transparency Critically Needed"

Dear Honorable Judge Sanders:

The City of Irvine has reviewed the Orange County Grand Jury Report, "Orange County City Pension Liabilities; Budget Transparency Critically Needed," released on June 25, 2014. The City of Irvine appreciates the role of the volunteer members of the Grand Jury and thanks them for their time and effort analyzing this important topic. As requested by the Grand Jury, and in accordance with California Penal Code Section 933, this letter constitutes the City of Irvine's response to the findings and recommendations contained in the report.

The City of Irvine agrees with the importance of addressing long-term pension liabilities and the City is proud to be a state leader tackling this issue. In June 2013, the Irvine City Council adopted a plan to aggressively pay down its unfunded pension liability. Since the adoption of the plan, the City has made \$13 million in accelerated pension payments to the California Public Employees' Retirement System (CalPERS) with a goal of attaining 98% funding in 10 years. To make the additional pension payments the City utilized reserve funding and surplus year-end funds. Reserve funds will be repaid from savings realized by lower pension rates and from year-end surplus funds.

The City disagrees with the overly broad report finding, "Orange County cities made painful cuts in services to their residents..." The City of Irvine carefully managed its operations throughout the Great Recession without a material reduction in its core services. The City is proud of the condition of its infrastructure, its unprecedented and increasing level of financial support for local public schools and for the high quality of its services, including public safety, where Irvine has been recognized as the Safest City in the Nation for the ninth consecutive year among jurisdictions with populations over 100,000. The City Council's plan to accelerate payment of its unfunded pension liability will save millions of dollars.

Irvine is strongly positioned to address its unfunded pension liability. Irvine proactively adopted a second tier of retirement benefits for non-sworn employees hired after April 14, 2012. Subsequently, the State of California's Public Employees' Pension Reform Act of 2013 implemented reduced retirement benefits for all new public employees hired after January 1, 2013. The City's pension costs per employee are expected to decrease relatively quickly as a result of these actions. Newly hired public employees receive a less costly level of retirement benefits consistent with new retirement benefit tiers.

The City is anticipating the CalPERS changes noted within the Grand Jury report and will closely monitor the effect of those changes. Through prudent fiscal management and its plan for advancing payment of its unfunded pension obligations, the City of Irvine is well positioned to adjust to future impacts.

## **FINDINGS**

***F.1.** OC cities have large unfunded pension liabilities both in terms of absolute dollar value and on a per capita basis and as a percentage of city General Fund revenues.*

The City of Irvine agrees with the finding that Orange County cities have large unfunded pensions. This is why, in June 2013, the Irvine City Council implemented an aggressive and innovative plan to reduce its unfunded pension liability.

***F.2.** OC cities' unfunded pension liabilities have been increasing on a year over year basis over the past several years as a result of the 2007-2009 Great Recession and as key actuarial assumptions have been changed by CalPERS and OCERS.*

The City of Irvine agrees with the finding. Due to increasing pension liabilities in early 2012, the City implemented a lower tier of retirement benefits for new non-sworn members. In 2013, the State Legislature also adopted changes to the retirement system. Public Employees' Pension Reform Act of 2013 (PEPRA) was issued to further lower retirement formulas for new members. The City has adopted its own plan to aggressively pay-down its unfunded pension liability and has accelerated \$13 million in payments since the 2012 valuation report.

***F.3.** There are risks to OC cities of changes to key actuarial assumptions including revisions downward of expected returns on investment and the likely move by pension funds to using more realistic mortality assumptions, which would increase unfunded liabilities.*

The City of Irvine agrees with the finding. Assumption changes reflect actual experience and are necessary to ensure the viability of the retirement system. CalPERS is legally required to utilize experience studies to determine long-term investment returns, retirement experiences, and mortality assumptions, and make adjustments to the forecast accordingly.

***F.4.** Locating city budget information on a city web site is not always straightforward and prior year budgets are sometimes not posted by a city.*

The City of Irvine wholly disagrees with this finding as it pertains to itself. The City has 10 years of budgets posted on its website. This information is easily accessible by typing "budget" in the search engine or on the "City Budget" tab on "Popular Links," both on the front page of the website.

***F.5. City budgets posted online project revenues and expenditures for at most one or two years into the future and sometimes do not show prior year data.***

The City of Irvine wholly disagrees with this finding as it pertains to itself. The City of Irvine Budget contains a Strategic Business Plan (SBP) that projects revenues and expenditures five-years into the future. The SBP establishes the foundation and framework for guiding policy and financial management decisions. This long-term perspective integrates strategic planning and budgeting to forecast and actively communicate challenges and opportunities to the City before they arise. Furthermore, Irvine's Budget provides detailed revenue and expenditure information for the prior two fiscal years. 10-year historical data is also provided for major revenue sources.

The City of Irvine's Budget has been recognized repeatedly by the Government Finance Officers Association for the "Distinguished Budget Presentation Award." To receive this award, a governmental unit must publish a budget document that meets specific criteria for effectiveness as a policy document, operations guide, financial plan and communications device.

***F.6. City budgets often lack footnotes explaining key assumptions, risks, and unusual changes in budgeted amounts or revenues and expenditures.***

The City of Irvine wholly disagrees with this finding as it pertains to itself. The City of Irvine offers detailed information on risk and key assumptions throughout its fiscal year 2014-15 Budget. The City Manager's Budget Message discusses the economic environment, changes in service levels and key challenges facing the City. The Revenue Estimates section provides a detailed analysis of the key assumptions underlying the revenue estimates and a discussion of how the estimates were developed. 10-year trend information is also provided in accompanying charts.

***F.7. City budgets sometimes do not provide trend data on the accumulation/drawdown of reserves and lack details on the city's plan for the size of its reserves or their intended uses.***

The City of Irvine wholly disagrees with this finding as it pertains to itself. The City features a three-year summary of its two major reserve funds within its fiscal year 2014-15 Budget Summary section: its Asset Management Plan and Contingency Reserve funds. A detailed analysis of both funds is provided within footnotes to the schedules on each page. In addition, the City's Financial Policies section contains information on the City's adopted policies related to each fund including the intended uses of each. Information on the City Council's plan for the size of its contingency reserve fund and its progress in meeting this goal is also provided in the Budget Summary and Financial Policy sections of the document.

**F.8.** *Cities can control most future expenditures by increasing or decreasing budgets for those expenditures as funds are available. However, increases to annual required contributions to their pension systems are imposed externally, change unpredictably, and when they occur, are ramped up over two to five years.*

The City of Irvine agrees with this finding. Variability and fluctuations are expected and anticipated. CalPERS utilizes studies to make future projections. In addition, employee economic and demographic information change regularly and differ by city. The City anticipates fluctuations and plans for those in the five-year forecast. Through prudent fiscal management and the plan implemented by the Irvine City Council to accelerate payment of its pension obligations, Irvine is prepared to adjust to future uncertainties.

**F.9.** *City budgets posted online do not explicitly show the link between planned city pension expenditures and pension system actuarial reports and those reports' annual required contributions. Risks associated with predictions of future annual required pension contributions based on risk assessment data provided by their pension systems and/or based on their own analysis are not discussed.*

The City of Irvine partially disagrees with this finding as it pertains to itself. The City's five-year financial forecast contained within its Budget document incorporates long-term rate projections provided by CalPERS and applies this information to projected growth in staffing expenditures based on anticipated hiring and salary increases defined within the City's Memorandum of Understanding (MOU) agreements.

Beyond the actuarial reports, the City's Comprehensive Annual Financial Report (CAFR) provides extensive information about all aspects of the City's financial condition, including the City's pension plans. Furthermore, CalPERS Annual Valuation reports, which include an analysis of the risks associated with its predictions of future annual required pension contributions, are publicly available. Three years of these reports are available from the CalPERS website.

**F.10.** *Pension costs for New (Post-PEPRA) employees will be substantially lower than for Legacy employees, but only a small percentage of current employees, typically only a few percent of total employees, are new. Substantially reduced pension costs for cities as a result of pension reform will not be realized for one or more decades.*

The City of Irvine partially disagrees with this finding as it pertains to itself. While it is true that the lower costs provided by recent pension reforms will take time to manifest, Irvine anticipates it will experience more rapid benefits from these changes since it is benefiting from dynamic growth, in accordance with its Master Plan, unlike many older, built-out communities. Irvine is therefore hiring both new employees and replacement employees to address ongoing natural attrition. As a result, the impact of the City's adopted second tier of retirement benefits and also the State's recent PEPRA changes are expected to reduce pension costs at Irvine relatively quickly.

**F.11.** *CalPERS Annual Valuation Reports for Miscellaneous and Safety City employees are available to the public online for a very small number of cities.*

The City of Irvine wholly disagrees with this finding. CalPERS publishes three years of the City of Irvine's Safety and Miscellaneous Actuarial Valuations online. Reports are public documents and the City's reports are available at <http://www.calpers.ca.gov/index.jsp?bc=/about/forms-pubs/calpers-reports/actuarial-reports/browse-results.xml&strCatId=2&q=irvine-city>.

**F.12.** *OCERS provides pension plans for OCFA and OCSD employees, but there is no way to trace through publically available sources OCERS unfunded pension liabilities to the city budgets which outsource to OCFA and OCSD for fire and police services.*

The City of Irvine wholly disagrees with this finding as it pertains to itself. The City of Irvine is a Structural Fire Fund (SFF) member of the Orange County Fire Authority (OCFA) which means the City's "contribution" to the OCFA is made directly through property taxes paid to the Orange County Treasurer-Tax Collector; therefore, monies are not allocated by the City of Irvine. Furthermore, the liabilities and debt of the Fire Authority are that of the Fire Authority and not of the City of Irvine. In June 2014, the OCFA Board of Directors requested a legal opinion from the Agency's legal counsel regarding the liability of member agencies for OCFA pension obligations. The written opinion concluded that under law and the Joint Powers Agreement, member agencies do not have liability for OCFA's pension obligations. The OCFA Joint Powers Agreement notes in Article VI, Section 3 (Liabilities): "Except as otherwise provided herein, the debts, liabilities and obligations of the Authority shall be the debts, liabilities and obligations of the Authority alone and not the parties of this Agreement."

## **RECOMMENDATIONS**

**R.1.** *Each city should post its current and at least three most recent prior year budgets on the city's website, and these budgets should be easily located. Each city's web site should have a search engine and a single search on the word "budget" should immediately link to the current budget. (F.1) (F.4)*

The recommendation has been implemented and has been the City's practice for years. At this time, the City has 10-years of budgets posted on its website. This information is easily accessible either on an easy to view tab on the front page or via the search engine. **(F.4)**

**R.2.** *Each city's budget information should contain not only this year/next year budget projections, but should show at least five years of projected revenues and expenditures. Projections should be at the same level of detail and use the same line item structure as information for the current budget. (F.1) (F.2) (F.3) (F.5) (F.8) (F.10)*

The Strategic Business Plan, which is included in the City of Irvine's Budget, provides five years of projected General Fund revenue and expenditure data in substantially the same level of detail as the current budget. The expenditure forecast is detailed between salaries and benefits, contracts and supplies, and significant transfers-out to other

funds. As a result, the City of Irvine's budget presentation already addresses the Grand Jury's concerns with respect to this recommendation.

The City of Irvine is proud of its Budget document and has worked hard to improve its quality over time to make it the highly effective planning and communication tool it is today. The City of Irvine's Budget has repeatedly been recognized with the "Distinguished Budget Presentation" award from the Government Finance Officers Association (GFOA). To receive this award, a governmental agency must publish a budget document that meets specific criteria for effectiveness as a policy document, operations guide, financial plan and communications device. These criteria, which can be found on [www.gfoa.org](http://www.gfoa.org), reflect the guidelines established by the National Advisory Council on State and Local Budgeting and the GFOA's best practices on budgeting.

***R.3. Each city's budget should show separate line items for predicted employee and predicted employer contributions for the city pension systems. (F.8) (F.9)***

Over the last several years the City negotiated with its employees to assume their share of CalPERS pension costs. As a result, these costs are now paid by employees, not the City, and therefore are not budgeted. Employer pension costs, however, are a component of salaries and benefits and are not broken-out separately in the summary level budget. The 2015-16 Budget will include additional information within the Strategic Business Plan Section specifying predicted employer contributions for the City's retirement plans as a distinct component of overall salary and benefit costs.

***R.4. Each city's budget should provide trend data on the accumulation/drawdown of reserves and provide details on the city's policy for the size of its reserves and on the intended uses of such reserves. In particular any discussion of reserves should address possible use of reserves to accelerate amortization of unfunded pension liabilities. (F.7)***

The recommendation has already been implemented. As previously noted, the Irvine City Council, in 2013, established a plan to accelerate payment of its unfunded pension liability utilizing reserve funding. A policy outlining the parameters of the new plan was included in the fiscal year 2014-15 Budget, supplementing policies already in place addressing the City's Contingency Reserve Fund and Asset Management Plan Fund. These policies include a discussion of the intended use of such reserves and the City's policy for the target size of the City's Contingency Reserve Fund. The City also provides three-year trend information on the accumulation/drawdown of these reserve funds within the Budget Summary section of its Budget document by providing the actual fund balances for last year, estimated fund balances for the current year and projected fund balances at the end of next year. Revenue and expenditure detail is also provided for each fund.

***R.5. Each city using CalPERS for one or more of its pension plans should identify the names and dates of the CalPERS Annual Valuation Report(s) which call out Annual Required Contributions (ARCs) for these plans and should provide a separate expenditure line item for predicted city catch-up contributions for the city pension***

*systems based on these ARCs. A discussion of the risks associated with these CalPERS projections should also be provided by the city. (F.1) (F.2) (F.8) (F.9)*

Communicating information on the status of its pension plans is important to the City. First, the City of Irvine has already been working to develop a pension scorecard that will be presented annually to the public to communicate the City's progress in reducing its unfunded pension liability. This scorecard will provide an elevated level of attention to the important topic of pension funding. The presentation is expected to occur this winter and will show the savings and other ongoing impacts of the City's plan to accelerate payment of its unfunded pension liability.

Second, the City's Comprehensive Annual Financial Report includes extensive information on the City's pension plans, as required by governmental accounting standards.

Lastly, the City will implement the Grand Jury's specific suggestions on this topic in its fiscal year 2015-16 Budget. This will be accomplished by inserting a brief discussion within the Strategic Business Plan chapter of its annual Budget document to address these issues.

***R.6. Each city which outsources fire or police services to OCFA and/or OCSD should require them to provide projections of future costs of service out at least five years into the future and require that these projected costs explicitly show the relationship of projected pension costs including amortization of unfunded liabilities. This level of pension cost information should be provided in budgeted expenditures for outsourced services. A discussion of the risks associated with these projections should also be provided by the agencies and incorporated in the city's budgets. (F.6) (F.12)***

The recommendation will not be implemented as it is not applicable to the City of Irvine and is therefore not warranted. First, while the City outsources fire services to OCFA, it is not a contract city but a Structural Fire Fund City. Therefore the City does not directly budget the actual cost of these services as is discussed within the recommendation and in fact, the City of Irvine is a fiscal donor agency. The cost of Irvine fire services is instead a component of the property tax payments of its residents and business owners.

Second, liabilities and debt of the Fire Authority are that of the Fire Authority and not of the City of Irvine. In June 2014, the OCFA Board of Directors requested a legal opinion from the Agency's legal counsel regarding the liability of member agencies for OCFA pension obligations. The written opinion concluded that under law and the Joint Powers Agreement, member agencies do not have liability for OCFA's pension obligations. The OCFA Joint Powers Agreement notes in Article VI, Section 3 (Liabilities): "Except as otherwise provided herein, the debts, liabilities and obligations of the Authority shall be the debts, liabilities and obligations of the Authority alone and not the parties of this Agreement."

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*R.7. Each city that has CalPERS as a provider for pensions should include a provision in their agreements with CalPERS that CalPERS will post their Annual Valuation Reports online. (F.11)*

The recommendation will not be implemented as it is not warranted. CalPERS posts three years of the City of Irvine's Safety and Miscellaneous Actuarial Valuations on its website. Reports are available on the CalPERS website as they are public documents. Please see most recent reports posted at <http://www.calpers.ca.gov/index.jsp?bc=/about/forms-pubs/calpers-reports/actuarial-reports/browse-results.xml&strCatId=2&q=irvine-city>.

Please contact me or City Manager Sean Joyce at (949)724-6249 if you have questions or if we can provide additional information.

Sincerely,

A handwritten signature in cursive script, appearing to read "Steven S. Choi".

Steven S. Choi, Ph.D.  
Mayor

cc: Irvine City Council  
Sean Joyce, City Manager  
Ken Brown, Director of Administrative Services  
Dave Baker, Foreman, 2013-14 Orange County Grand Jury