September 15, 2014

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

Subject: Response to Grand Jury Report- "Orange County City
             Pension Liabilities- Budget Transparency Critically Needed"

Dear Judge Sanders:

In accordance with the California Penal Code, Section 933 and 933.05, the City of Cypress is submitting this response to the Grand Jury Report "Orange County City Pension Liabilities- Budget Transparency Critically Needed" As stipulated in the statute, the responses are provided for each finding and recommendation with statements of agreement or disagreement either wholly or partially and the corresponding reasons for each.

Per the requirements and instructions, the City of Cypress is responding to Findings (F.1 through F.12) and Recommendations (R.1 through R.7).

Responses to Grand Jury 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 General Fund revenues.

Response: The City of Cypress agrees with this finding. However it should be noted that the cities pay their Annual Required Contribution (ARC) as billed from CalPERS and are not delinquent. The unfunded pension liabilities are a result of CalPERS changes in assumptions/ investment returns not underpayments by the Cities.

Leroy Mills, Mayor

Rob Johnson, Mayor Pro Tem   **Doug Bailey**, Council Member
Prakash Narain, M.D., Council Member   **Mariellen Yarc**, Council Member

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.

Response: The City of Cypress agrees with this finding. However the major dollar impact on unfunded liabilities was the enhanced benefits negotiated with employee groups in the early 2000's.

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

Response: The City of Cypress agrees partially with this finding. It should also be noted that there are number of factors, including investment earnings and employee tenure that could offset the unfunded liability associated with the revised mortality assumptions.

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

Response: The City of Cypress agrees partially with this finding. We are not familiar the websites of other cities. However, the City of Cypress' web site has budget information under the Finance Section and has included prior budgets.

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

Response: The City of Cypress agrees partially with this finding. We are unaware of what other cities post. The City of Cypress' budget shows one year into the future and does show prior year data.

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

Response: The City of Cypress agrees partially with this finding. We are unaware of what other cities report.

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

Response: The City of Cypress agrees partially with this finding. We are unaware of what other cities report.

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.

Response: The City of Cypress disagrees partially with this finding. The City budget is based on projected revenues for the period, and then projected expenditures and changes in reserves are determined. The first level of expenditures budgeted include fixed and required costs (which would include personnel costs to provide basic services including the ARC requirement by CalPERS), then variable costs are budgeted along with one-time costs, and finally any changes in reserves are factored in.

F.9   City budgets posted online do not explicitly show 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.

Response: The City of Cypress agrees partially with this finding. It should be noted that the required ARC is budgeted and paid annually.

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.

Response: The City of Cypress agrees partially with this finding. It should be noted that negotiated concessions with Legacy employees can help reduce current city pension costs.

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.

Response: The City of Cypress disagrees with this finding. CalPERS provides this information on-line for all of its contracting agencies.

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.

Response: The City of Cypress agrees partially with this finding. We are unaware of what other Cities report.

Responses to Grand Jury Recommendations:

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

Response: This recommendation has been previously implemented by the City of Cypress in regards to having past budgets available on-line. The City of Cypress will not implement the single search recommendation. The current Search on "budget" goes to the site in which the Annual Budget can be accessed easily at the top of page. Since not all searches under "budget" want the current budget, the search that directs the user

to a page with multi-referenced "budget" items is more appropriate and user friendly.

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 in the current budget. (F.1) (F.2) (F.3) (F.5) (F.8) (F.10)

Response: This recommendation will not be implemented. Multi-year budgets/projections beyond two years are notoriously inaccurate and of little value. Most costs are associated with Memorandums of Understanding (MOU) or contract costs which both are limited to a defined time period usually of three years or less. Also, the CalPERS actuarial rates are only given for one year in advance so those costs cannot be accurately determined and incorporated into long-term projections. In addition, revenues fluctuate based on the economy and building development which again cannot be accurately determined multi-years in advance. To put in five years or more of estimates would not represent a true projection and may, in fact, be a disservice to those believing that these estimates represent a credible financial analysis when it's based on "guesstimates".

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)

Response: This recommendation will not be implemented. The City of Cypress accounts for its employee benefits in an Internal Service Fund whereby employee costs are determined for individual employees and benefits are allocated based on an internal calculation. The City's budget reflects these costs in a line-item (Fringe Applied) allocated to operational programs. It should be noted that the City of Cypress does currently include a 5% unfunded pension liability cost in the fringe applied calculation, the purpose of which is to smooth out any future large fluctuations in CalPERS ARC that may impact short-term operations.

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 discussions of reserves should address possible use of reserves to accelerate amortization of unfunded pension liabilities (F.7)

Response: This recommendation has been implemented by the City of Cypress. The City discusses any changes in its reserves.

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 be also be provided by the city. (F.1) (F.2) (F.8) (F.9)

Response: The recommendation will not be implemented because the City will continue to pay its required ARC. By budgeting the CalPERS required ARC, the City is assured of the availability of resources to make its required payments.

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 be provided by the agencies and incorporated in the city's budgets. (F.6) (F.12)

Response: The recommendation will not be implemented because the City of Cypress is part of the Structural Fire Fund whereby the OCFA receives property tax directly from the residents and the City does not make payments to the OCFA and therefore does not record any liability or expenditures for Fire services. In addition, the City has its own Police Department.
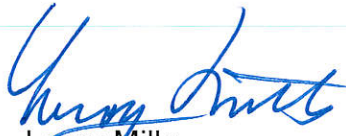
R.7 Each city that has CalPERS as a provider for pensions should include a provision in their agreements with CalPERS that CalPERS will post their Annual Valuation Reports online (F.11)

Response: The recommendation will not be implemented because this information is already available from the CalPERS website.

If you have any questions regarding the responses provided in this letter, please contact Mr. Richard Storey, Director of Finance and Administrative Services, at (714) 229-6709 or via e-mail at rstorey@ci.cypress.ca.us.

Sincerely,

Leroy Mills
Mayor
City of Cypress

cc: City Council
Peter Grant, City Manager
Dave Baker, Foreman, Orange County Grand Jury, 700 Civic Center Drive West, Santa Ana, CA 92701