



CITY of LAGUNA NIGUEL

30111 Crown Valley Parkway • Laguna Niguel, California 92677
Phone/949•362•4300 Fax/949•362•4340

CITY COUNCIL

Laurie Davies
Linda Lindholm
Jerry McCloskey
Robert Ming
Jerry Slusiewicz

September 17, 2014

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

Re: City of Laguna Niguel Response to 2013-2014 Grand Jury Report Entitled: "Orange County City Pension Liabilities – Budget Transparency Critically Needed"

Dear Judge Sanders:

On June 25, 2014, the 2013-2014 Orange County Grand Jury issued a report entitled: "**Orange County City Pension Liabilities – Budget Transparency Critically Needed**". The City of Laguna Niguel is required to respond to Findings F.1 through F.12 and Recommendations R.1 through R.7.

The Laguna Niguel City Council reviewed and discussed the Grand Jury Report on September 16, 2014. The responses from the City of Laguna Niguel are set forth below. In the interest of brevity, our response is limited to the Findings and Recommendations for Orange County Cities which are paraphrased below.

Finding 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.

City Response: Based on our understanding of the Grand Jury's methodology and calculations, the City agrees with the finding.

Finding 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.

City Response: Based on our understanding of the Grand Jury's methodology and calculations, the City agrees with the finding.

Finding 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.

City Response: Based on our understanding of the Grand Jury's methodology and calculations, the City agrees with the finding.

Finding 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.

City Response: Based on our reading of the Grand Jury Report and a cursory review of other Orange County city websites, the City disagrees with the finding that locating city budget information on a city website is not always straightforward. The City does agree with the finding that prior year budgets are sometimes not posted by a city.

Finding 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.

City Response: Based on our reading of the Grand Jury Report and a cursory review of other Orange County city websites, the City agrees with the finding.

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

City Response: Based on our reading of the Grand Jury Report, the City would like to point out that the Budget Message contained within the operating budget contains information on revenue, expenditure, and personnel highlights for material changes year-over-year.

Finding 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.

City Response: Based on our reading of the Grand Jury Report and a cursory review of other Orange County city websites that post budgetary information, the City agrees with the finding.

Finding 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.

City Response: Based on our understanding of the Grand Jury's methodology and calculations, the City agrees with the finding.

Finding 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.

City Response: Based on our understanding of the Grand Jury's methodology and calculations, the City agrees with the finding.

Finding 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.

City Response: Based on our understanding of the Grand Jury's methodology and calculations, the City agrees with the finding.

Finding 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.

City Response: Based on our reading of the Grand Jury Report and a cursory review of other Orange County city websites, the City agrees with the finding.

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

City Response: Based on our reading of the Grand Jury Report and a cursory review of other Orange County city websites, the City agrees with the finding.

Recommendation 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 website should have a search engine and a single search on the word "budget" should immediately link to the current budget.

City Response: The City's website includes a search engine that returns a direct link to the current budget when searching on the single word "budget". Historically, the City has only posted the current budget on its website. In the interest of increased transparency and clarity, the City will implement the Grand Jury's recommendation to post at least the preceding three years' worth of adopted budgets along with the current budget, as well as the preceding three years' and current year's Comprehensive Annual Financial Report (CAFR).

Recommendation 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.

City Response: This recommendation will not be implemented in our one-year adopted budget as noted below because the purpose of the adopted budget document itself is to link what we want to accomplish for the community in the current operating cycle with the currently available resources necessary to do so. Those resources have to be either known or reasonably estimable. Forecasting one year is reasonable based on current and historical economic and financial data. Forecasts exceeding one year never include known or reasonably estimable resources because assumptions are made before current economic data is collected and analyzed to provide some foundation for long-term estimates; however, these long range forecasts should be included in a separate long-term financial planning document and used as one of many sources when developing a conservative budget document. The City is currently in the process of developing a document entitled "Five-Year Revenue and Expenditure Forecast" that will include the same level of detail and line item structure found in the City's annual budget document.

Recommendation R.3: Each city's budget should show separate line items for predicted employee and predicted employer contributions for the city pension systems.

City Response: This recommendation will not be implemented because the employee contribution is not a City expense. As such, there is no logical or legitimate reason to include employee contributions as part of the City's operating budget. The City already includes the employer contribution as part of its operating budget.

Recommendation 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.

City Response: The recommendation to include trend data on the accumulation/drawdown of reserves will not be implemented because the budget document reflects planned operations for the upcoming fiscal year and not changes in balance sheet accounts, of which fund balance/reserves, or equity as it is known in the private sector, are balance sheet accounts. The use of any portion of fund balance should be described in the budget document to cover any shortfall in current resources. The City has a Council adopted Financial Reserves Policy posted on its website that is reviewed annually. Prior to the issuance of the Grand Jury Report, the City decided that it will include the Financial Reserves Policy in the FY 2015-2016 Adopted Budget document as part of the requirement to obtain the Government Finance Officers Association (GFOA) Distinguished Budget Presentation Award.

Recommendation 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 the ARCs. A discussion of the risks associated with these CalPERS projections should also be provided by the City.

City Response: Trend information for the CalPERS Annual Valuation Reports and risk information associated with projections provided by CalPERS will be implemented in the City's upcoming "Five-Year Revenue and Expenditure Forecast".

Recommendation 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.

City Response: This recommendation will not be implemented for two reasons. First, the City is a Structural Fire Fund city where the costs of fire services are netted against the City's property tax revenue before receipt of said revenue. As such, there is no fire service cost to reflect in the City's budget. Secondly, the City has repeatedly requested that the OCSD provide the City with a breakdown of pension costs. OCSD has advised the City that because cost allocation is Countywide and not departmental, projections of future pension costs related to the City are difficult, if not impossible, to calculate.

Recommendation 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.

City Response: This recommendation will not be implemented as it is not warranted. CalPERS posts three years of the City of Laguna Niguel's Miscellaneous Actuarial Valuations on its website. Please see most recent reports using the following URL <http://www.calpers.ca.gov/index.jsp?bc=/about/forms-pubs/calpers-reports/actuarial-reports/browse-results.xml&strCatId=2&q=laguna-niguel-city>

As noted in “**Table 4 - Unfunded Pension Liabilities by City and Plan Using Market Value of Assets**” of the Grand Jury Report, the City of Laguna Niguel has a “Funded Ratio” just shy of 80%, making the City one of the highest funded cities in the County of Orange, if not in the State of California. Thank you for the opportunity to respond to this Grand Jury Report.

Yours truly,



Rod Foster
City Manager

Cc: Orange County Grand Jury