



# City of Mission Viejo

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September 19, 2014

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

Re: Orange County City Pension Liabilities

Dear Judge Glenda Sanders:

The letter is in response to the Orange County Grand Jury Report, *"Orange County City Pension Liabilities – Budget Transparency Critically Needed"*. The City of Mission Viejo ("City") has provided responses below at the request of the Orange County Grand Jury and in the format prescribed in the Report. However, the City believes it is important to stress that while the Grand Jury believes that additional information on unfunded liabilities should be provided in budget documents, this information has been available to the public in a number of ways for many years. City Comprehensive Annual Financial Reports ("CAFR") require information on pension plan descriptions, funding policy, annual pension costs, actuarial assumptions, five-year trend information and five-years of funding progress. The CAFR's for the County of Orange and the Orange County Fire Authority also include this information. The Orange County Employees Retirement System ("OCERS") also issues an annual CAFR and publishes another user friendly document *"OCERS by the Numbers"* on an annual basis with a great deal of information on their entire pension system. In addition, all public agency CalPERS annual valuation reports for the last three years are available online on the CalPERS website. Transparency of public agency pensions and unfunded liabilities have not been an issue for agencies in Orange County for many years and the Grand Jury's Report should not be construed by the public that transparency is lacking in this area.

**Finding 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 partially disagrees with the finding. The City agrees that many Orange County cities have large unfunded pension liabilities in terms of absolute dollar value. A reason for the Grand Jury's investigation into city pension liabilities includes the ability of Orange County cities to recover from their unfunded liabilities. To assist in making this determination, the Grand Jury applied two assessments: Per Capita Assessment and



Assessment as a Percent of General Fund Revenues. Of those 10 cities analyzed, for the Per Capita Assessment the Grand Jury's own report states "No city on the list stands apart as having an overwhelming liability when measured using this metric." For the Assessment as a Percent of General Fund Revenues, the Grand Jury's own report states "...there is not any city in the list that stands apart as having an overwhelming liability when measured using this metric." The ranges, as reported by the Grand Jury, for these two assessments are:

Table 1: Results of Grand Jury Assessments

Assessment	Low	High
Per Capita	\$1,214.79	\$3,153.79
Percent of General Fund Revenue	107.5%	237.0%

Based on this data and the Grand Jury's own conclusions, as long as a city is within or below the ranges for these assessments, then those cities would not have an overwhelming liability when measured using these metrics and are in a reasonable position to manage their unfunded liabilities and successfully pay them down either through Annual Required Contributions ("ARC") or other additional payments as determined by each individual agency. The Grand Jury's report states that their assessments were done on only 10 cities "because unfunded pension liabilities for those cities which outsource fire and/or police services to OCFA and OCSD are not available". This City would argue that contracting agencies are not directly responsible for any portion of the Orange County Sheriff's Department ("OCSD") and Orange County Fire Authority ("OCFA") unfunded liabilities. If the City were to elect to contract with another agency for police services, this City argues that the County of Orange would not send the City an invoice for some prorated share of the OCSD unfunded liability. There is no statutory law or common law that exists at this time that obligates a contracting agency to assume the unfunded liabilities of another agency. An OCSD contact agency's responsibility is limited to paying the "full cost" of the ARC for staff resources utilized by the agency for each contract year. Thus, while a contract agency has an annual cost of service, a portion of which is utilized by OCSD to pay their ARC, contract agencies do not have ownership of any part of the unfunded liability of OCSD. While the relationship with OCFA is different, the argument is the same; the unfunded liabilities of OCFA are not the direct responsibility of the member agencies and it would be inappropriate to assign a portion of that liability to member agencies. If members of the public are interested in pension and unfunded liability information for the County of Orange or OCFA, that information is publicly available through those agencies as well as OCERS.

Since it is the City's position that a contract agencies unfunded liabilities are only those related to their own employees, by applying the same Grand Jury Assessments to the remaining cities, the results are as follows:

Table 2: Assessment Results for Contract Cities

City	Total UAL	City Population (1/1/13)	Per Capita UAL	Total General Fund Assumed Revenues for Current Adopted Budget(2013-14)	UAL as a Percent of General Fund Revenues
Aliso Viejo	\$ 586,580	49,533	\$ 12	\$ 14,834,715	3.95%
Buena Park	80,560,951	82,035	982	54,297,950	148.37%
Cypress	32,145,105	48,602	661	27,701,827	116.04%
Dana Point	3,333,724	33,902	98	28,680,025	11.62%
Irvine	141,532,791	231,363	612	144,349,304	98.05%
Laguna Hills	2,721,662	30,737	89	18,814,973	14.47%
Laguna Niguel	5,016,471	64,138	78	36,092,814	13.90%
Laguna Woods	410,802	16,519	25	4,378,276	9.38%
Lake Forest	3,853,959	78,723	49	35,882,100	10.74%
La Palma	14,817,978	15,836	936	8,351,900	177.42%
Los Alamitos	13,106,234	11,639	1,126	11,641,602	112.58%
Mission Viejo	17,364,881	94,799	183	50,740,225	34.22%
Placentia	32,523,942	51,900	627	30,429,745	106.88%
RSM	1,205,233	48,606	25	15,842,952	7.61%
San Clemente	1,359,666	64,615	21	50,383,370	2.70%
Seal Beach	23,117,356	24,514	943	28,071,000	82.35%
Stanton	4,192,825	38,808	108	14,013,231	29.92%
Tustin	48,308,273	78,071	619	47,764,400	101.14%
Villa Park	1,080,127	5,907	183	2,599,400	41.55%
Westminster	83,743,371	91,272	918	42,187,351	198.50%
Yorba Linda	16,886,032	66,512	254	29,438,943	57.36%

NOTES: Excludes La Habra and San Juan Capistrano since UAL information is not complete; Budget information for Laguna Wood is for FY 2012-13.

Total UAL as reported in Table 4 of the Grand Jury Report

City population as reported by the State of California Department of Finance on May 1, 2014

Revenue information obtained from each agency's adopted budget

Comparing these results with the results of the Grand Jury in Table 1, the following is noted:

- All 21 contract cities fall below the Grand Jury range for per capita UAL, with eight of those cities falling below \$100 per capita.
- 15 of the 21 contract cities fall below the Grand Jury range for UAL as a percent of General Fund revenue, with the remaining six falling within the range.

**Finding 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 agrees with the finding.

**Finding 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 agrees with the finding. However, in order to ensure the viability of the retirement system, assumption changes are necessary from time to time to accurately reflect the actual experience of the retirement system.

**Finding 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 agrees with the finding as it pertains to itself.

**Finding 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 disagrees with the finding as it pertains to itself. While the City did not review other agencies budgets after reading the Grand Jury report, the City of Mission Viejo does report multi-year information in the Master Financial Plan section of the City's budget. The information includes actual historical information for 6 years, current year amended budget, two years of proposed budget information and five years of projected future year information. A summary in table format begins on page 251 of the City's 2013-15 Budget and Master Financial Plan document, located on the city's website using the following link.  
<http://cityofmissionviejo.org/DepartmentPage.aspx?id=98>

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

The City disagrees with the finding as it pertains to itself. While the City did not review other agencies budgets after reading the Grand Jury report, the City of Mission Viejo does provide text on assumptions, changes in budgeted amounts and other items of note for both revenues and expenditures under the revenue section starting on page 28, expenditure section starting on page 37 and again in the Master Financial Plan section starting on page 231 of the 2013-15 Budget and Master Financial Plan document.

**Finding 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 disagrees with the finding as it pertains to itself. While the City did not review other agencies budgets after reading the Grand Jury report, the City of Mission Viejo does provide information of its discretionary reserves on pages 12, 16 and 18 of the 2013-15 Budget and Master Financial Plan document. This information

reflects the projected changes to reserves during the two year budget cycle and seven year trend data. The reserves policy is also located in the Appendices starting on page 282.

**Finding 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 partially disagrees with the finding. The City agrees that increases to the ARC are imposed externally by CalPERS and due to the most recent smoothing policy changes by the CalPERS Board, rates used to calculate the ARC will “ramp up” up to five years when there are changes to smoothing policies, assumptions or investment losses; however, the City does not necessarily agree that these changes are unpredictable. CalPERS notifies agencies when policy changes or assumption changes are planned to be proposed and what kind of effect agencies should anticipate from these changes. As an example, the new mortality assumptions that were approved earlier this year were communicated to agencies about a year before they were brought to the Board for discussion and the actual changes to rates will not occur for another two years. As for the smoothing changes, these were also communicated almost a year in advance and the Chief Actuary put on several presentations on the topic leading up to the CalPERS Board meetings and sought feedback from agencies on the various alternatives. Unpredictable is unforeseen and sudden. The process of changing mortality assumptions and smoothing policies was not sudden. It is also well known that CalPERS reviews actuarial assumptions every few years and agencies are aware of this when forecasting their budgets.

**Finding 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 agrees with the finding as it pertains to itself.

**Finding 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 agrees with the finding.

**Finding 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 disagrees with the finding. Public agency CalPERS Annual Valuation Reports are available to the public on-line on the CalPERS website at the following link <http://www.calpers.ca.gov/index.jsp?bc=/about/forms-pubs/calpers-reports/actuarial-reports/home.xml>.

**Finding 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 agrees with the finding; however, as previously discussed, the City argues that the unfunded pension liabilities of OCFA and OCSD are not the direct responsibility of contract cities and should not be reported by contract cities.

**Recommendation 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 a single search on the word “budget” should immediately link to the current budget.**

The recommendation has been implemented. The City adopts two year budgets. The current budget document along with the prior adopted budget provide for four years of budget information available through the website.

**Recommendation 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.**

The recommendation has already been implemented. The budgets of the City of Mission Viejo have included five years of projected revenue and expenditures for a number of years. For the most recent FY 2013-15 budget this information is located in the Master Financial Plan section of the budget starting on page 231. The City will not be implementing the recommendation that the projections should be at the same level of detail and line item structure as information for the current budget. The budget document is 300 pages. When presenting information, consideration needs to be given to the complexity of format and readability for the public. The City believes that the detail information included in this document is presented in the most appropriate format for users.

**Recommendation 3 – Each city’s budget should show separate line items for predicted employee and predicted employer contributions for the city pension systems.**

The recommendation has already been implemented. The financial data in the Master Financial Plan section of the budget already includes separate line items for both employer contributions and employer paid employee contributions. For the most recent FY 2013-15 budget, this information is located at the bottom of page 251.

**Recommendation 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.**

The recommendation has already been implemented. The budgets of the City of Mission Viejo have included reserve information for a number of years. For the most recent FY 2013-15 budget, information on discretionary reserves is located on pages 12, 16 and 18. This information reflects the projected changes to reserves during the two year budget cycle and seven year trend data. The reserves policy is also located in the Appendices starting on page 282. In addition, discussion of the pension unfunded liability was addressed on page vi of the Budget Message.

**Recommendation 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.**

The recommendation has not been implemented and will be included in the FY 15-17 budget. The City would like to note that information from the CalPERS Annual Valuation Report and ARC information has been made available to the public in the City's CAFR for many years in accordance with governmental accounting standards. The information for the most recent report for the period ending June 30, 2013 is located in footnote 18, beginning on page 79 of that document, with additional required supplementary information located on page 84. The following is a link to the last five CAFR documents on the City's website.  
<http://cityofmissionviejo.org/DepartmentPage.aspx?id=102>.

**Recommendation 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.**

This recommendation will only be partially implemented. As pertaining to OCSD, this recommendation has been implemented. The OCSD has provided projections of future costs of service five years out. This information will be incorporated into the FY 15-17 budget. Additionally these projections include pension costs projected to be allocated to our agency over a five year period based upon current level of service, including those costs directly related to the amortization of the unfunded liability. As previously stated, the actual unfunded liabilities of OCSD are not the direct responsibility of this agency; therefore discussion and financial information related to OCSD's total unfunded liabilities will not be disclosed or discussed as part of the City's budget document. However, the City will disclose how to obtain OCSD unfunded liability information from the County of Orange and OCERS.

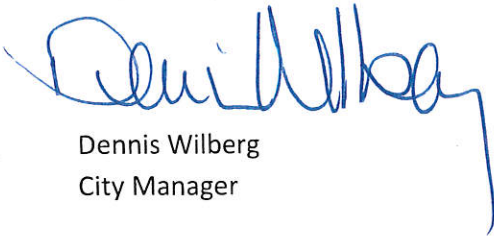
As pertaining to OCFA, the recommendation will not be implemented because it is not warranted or is not reasonable. At the time of incorporation in 1989, the City of Mission Viejo was required to allocate a defined percentage of its 1% Basic Levy property tax revenues to the Orange County Structural Fire Fund, which is

exclusively utilized for the provision of fire protection services. The City does not outsource to or contract with OCFA for these services, so consequently, the City does not include the cost of fire protection services in its budget. Furthermore, the liabilities and debt of the OCFA are solely the obligations of the OCFA and not the City. In June 2014, the OCFA Board of Directors requested a legal opinion from OCFA 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 states in Article VI, Section 3: "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." Also, as is the case with OCSD, since the unfunded liabilities of the OCFA are the direct responsibility of OCFA, information on OCFA unfunded liabilities will not be disclosed in City budget documents.

**Recommendation 7 – Each city that has CalPERS as a provider for pensions should include a provision in their agreements with CalPERS and CalPERS will post their Annual Valuation Reports online.**

This recommendation is not warranted since all agency valuations for the last three years are located at the following CalPERS website link. <http://www.calpers.ca.gov/index.jsp?bc=/about/forms-pubs/calpers-reports/actuarial-reports/home.xml>. The City of Mission Viejo has also made the annual valuations for the three most recent fiscal years available on the City's website at <http://cityofmissionviejo.org/DepartmentPage.aspx?id=102>.

Respectfully,



Dennis Wilberg  
City Manager



Cheryl Dyas  
Director of Administrative Services

cc: Orange County Grand Jury  
Mission Viejo City Council