



City of Huntington Beach

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CITY MANAGER'S OFFICE

September 22, 2014

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

RE: Response of the City of Huntington Beach to Orange County Grand Jury 2013-2014 Report, titled "Orange County City Pension Liabilities – Budget Transparency Critically Needed"

Dear Judge Sanders:

This letter constitutes, in accordance with Section 933.05 of the California Penal Code, the response of the City of Huntington Beach (City) to the Orange County Grand Jury 2013-2014 Report, dated June 25, 2014, titled "Orange County City Pension Liabilities – Budget Transparency Critically Needed" (Grand Jury Report). The enumerated items in this response correspond to the numbering of the Findings and Recommendations contained in the Grand Jury Report.

General Comments

The City appreciates the Grand Jury's review of city pension liabilities. Of all local government expenditures, the liabilities created by public pensions represent an ever increasing cost center even in light of many cities achieving full employee pick up of the employee retirement share. The City of Huntington Beach is serious about addressing future unfunded liabilities and has taken aggressive, innovative, and proactive measures to address this issue. For example, the City Council adopted a unique "One Equals Five Plan" for reducing the City's unfunded liability for its CalPERS pension plans. Based on an analysis conducted by the City's independent actuary, each additional \$1 million contributed to the City's pension plans will benefit the City five times over resulting in \$5 million in taxpayer savings over a 25 year period. As part of the FY 2013/14 Adopted Budget, staff proposed a revision to the City Council's Financial Policies to allow for a certain amount of additional General Fund revenue received above budgeted expectations to be deposited directly into a "One Equals Five" fund for direct payment to CalPERS at the end of each year. This action is a proactive approach in reducing the City's unfunded CalPERS liabilities and will yield an estimated \$54 million in savings to taxpayers and improve the funded status of the plans. These contributions are in addition to the already required CalPERS contribution rates that are deposited into the plans on a bi-weekly basis, thereby promoting the financial sustainability of the plans themselves.

With regard to creating greater transparency in the annual budget process, the City is in agreement that more can be accomplished using public budget documents and the internet.

Grand Jury Findings and Recommendations

The City of Huntington Beach is providing the following response to each of the findings and recommendations, in accordance with California Penal Code Sections 933 and 933.05 (a) and (b).

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 agrees with the 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.

The City agrees with the finding. In order to develop a proactive plan to reduce the impact of the Great Recession and the actuarial assumptions on the City's General Fund, the City hired Bartel Associated to conduct an independent review and provide recommendations for reducing such impacts. As a result of this review and the recommendations contained therein, the City started negotiating full employee pickups of the employee share of CalPERS pension costs, saving the City over \$3.2 million annually.

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 agrees with the finding. CalPERS offered employers two options for absorbing the financial impact of the reduction of the estimated rate of return from 7.75% to 7.50%. For employers that could not immediately afford the impact of the reduced rate of return, there was an opportunity to opt-in to a "Phase-In" of the change in the discount rate over a two-year period. While this option to "Phase-In" the discount rate change seems reasonable, it would result in higher pension costs in the long run. As such, the City of Huntington Beach decided against the "Phase-In" of the impact of the discount rate change, and budgeted the full impact of the change in the first year. This simple yet proactive decision resulted in \$1.0 million in savings to Huntington Beach taxpayers.

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 disagrees wholly or partially with the finding. The City provides one click access to its budget and financial report information in addition to providing access to the last eight prior year's budgets.

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 disagrees wholly or partially with the finding.

The City's budget includes a Long-Term Financial Plan as a separate tabbed section. The Long-Term Financial Plan includes five-year revenue and expenditure projections, an unfunded liabilities review to include actions taken to lessen the City's liabilities, as well as a discussion on General Fund Reserves and a look at potential future risk factors. This information is posted online.

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

The City disagrees wholly or partially with the finding.

The City's budget, while voluminous, contains information meant to be understood by those familiar with budgets as well as those reading one for the first time. The Transmittal Letter is an executive summary of the proposed budget with corresponding graphs and charts designed to assist readers in understanding the entire budget book. Within each Department section, accomplishments for the prior year and goals for the forthcoming Fiscal Year are documented. Finally, within the budget detail and highlighted within the division detail, is a "Significant Change" narrative. This narrative gives a comprehensive understanding of changes within that division to help the reader better understand those percent changes from prior years that are significant. The City of Huntington Beach's Adopted Budget is an award winning document, which has received the prestigious "Distinguished Budget Presentation Award" from the Government Finance Officers Association's (GFOA) of the United States and Canada for the past 27 years.

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 disagrees wholly or partially with the finding.

The City discusses its General Fund reserves within the Transmittal Letter, to include a chart of fund balances, the tabbed Long-Term Financial Plan section, and within the tabbed Financial Policies & Procedures section. This discussion includes sizing and use of reserves.

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 agrees with this 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.

The City disagrees wholly or partially with the finding. The City can only represent its presentation of budget and pension information on the City's website.

Through the posted budget, Long-Term Financial Plan, and Strategic Planning documents, the City attempts to relate pension expenditures with sound financial practices; however, improvement can be made in online information as it relates to future annual pension contributions and risk assessment data.

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 agrees with this 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.

The City disagrees wholly or partially with the finding. The City posts the most recently available Valuation Reports under the "Employee Salary and Benefits" section of its website. The City understands that CalPERS maintains a searchable database of valuation reports on its website for all member 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.

The City disagrees wholly or partially with the finding. The City of Huntington Beach does not utilize OCERS and therefore is unable to respond to, agree, or disagree with this finding.

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 a single search on the word "budget" should immediately link to the current budget. **(F.1) (F.4)**

The recommendation has been implemented. The City's website allows a single search on the word "budget" to link to a list of results which includes the most recent budget as well as the "Budget Information" page that lists current and prior year budgets. This page includes the previous eight Fiscal Year budgets. An additional link is available from the main page drop down menu with a one click link to the "Budget Information" page.

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 recommendation has been partially implemented. As described for Finding 5 (F.5), the City's budget includes a Long-Term Financial Plan as a separate tabbed section. The Long-Term Financial Plan includes five-year revenue and expenditure projections, an unfunded liabilities review to include actions taken to lessen the City's liabilities, as well as a discussion on General Fund Reserves and a look at potential future risk factors.

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)**

The recommendation has been implemented. The City operates on an October 1 to September 30 Fiscal Year and shows the predicted employer contributions as a separate, discrete line item within its tabbed Budget Summaries section. As the City does not budget for the employee share (as those amounts are paid by the employees to CalPERS directly through Payroll), those amounts should not be budgeted in the General Fund as they are not City/employer 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 been implemented, and the City will continue to make improvements based on the Grand Jury recommendation. As stated in response to Finding 7 (F.7), the City discusses its General Fund reserves within the Transmittal Letter, to include a chart of fund balances, the tabbed Long-Term Financial Plan section, and within the tabbed Financial Policies & Procedures section. This discussion includes sizing and use of reserves. Additionally, the City addressed the accelerated amortization of unfunded liabilities through innovative programs (i.e., "One Equals Five" plan) identified in the budget and other financial documents. Based on the Grand Jury recommendation, the City will enhance the presentation of this information in its Fiscal Year 14/15 Budget.

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)**

The recommendation has not yet been implemented, but will be implemented in the future. The City will commit to including this information within its Fiscal Year 14/15 Budget.

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 because it is not warranted. The City does not outsource police or fire services and thus the recommendation does not apply.

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 because it is not warranted. The City will post its valuation reports on its website and CalPERS already posts the most recent Public Agency Actuarial Valuations, in a searchable manner, at the following website: <http://www.calpers.ca.gov/index.jsp?bc=/about/forms-pubs/calpers-reports/actuarial-reports/home.xml>. This information is readily searchable within the CalPERS website.

On behalf of the City of Huntington Beach, I want to thank you for the opportunity to provide this response to the Orange County Grand Jury.

Sincerely,



Fred A. Wilson
City Manager

C: City Council
City Attorney
Assistant City Manager
Director of Finance