



CITY of LAGUNA WOODS

Bert Hack
Mayor

September 23, 2014

Cynthia Conners
Mayor Pro Tem

The Honorable Glenda Sanders
Presiding Judge of the Superior Court

Noel Hatch
Councilmember

700 Civic Center Drive West
Santa Ana, CA 92701

Shari L. Horne
Councilmember

SUBJECT: Response to Orange County Grand Jury Report, "Orange County City Pension Liabilities – Budget Transparency Critically Needed"

Bob Ring
Councilmember

Dear Judge Sanders:

Christopher Macon
City Manager

Thank you for the opportunity to provide comments in response to the Orange County Grand Jury report titled "*Orange County City Pension Liabilities – Budget Transparency Critically Needed.*" The City of Laguna Woods ("City") has long advocated for increased transparency in local government and welcomes public discourse on the subject of pension liabilities.

RESPONSE TO 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 generally agrees with this finding, but notes the following:

1. The City is not responsible for the Orange County Sheriff's Department's or Orange County Fire Authority's unfunded liabilities. While the City's relationship with each agency is different, it remains true that no common law or statutory obligation exists for the City to assume the unfunded liabilities of independent agencies.
2. According to the City's most recent Actuarial Valuation Report from the California Public Employees Retirement System (CalPERS), City pensions were 77.2% funded with a total of 22.8% (or, \$410,802) unfunded using a market value of assets basis. That amount equates to approximately \$25.37 per capita using the same population figure included in the Orange County Grand Jury's Report. The City's per capita rate is substantially lower than the cities that are actually responsible for unfunded police and/or fire liabilities (e.g., according to the Orange County Grand Jury's Report, the City of Garden Grove's per capita rate was the lowest of the 10 cities evaluated at \$1,214.79 per capita and the City of Newport Beach's was the highest at \$3,153.79 per capita). While the City's liability of \$410,802 is technically "unfunded" from CalPERS' perspective, the City does have an unallocated fund balance of more than \$8 million from which staff is currently evaluating the merits of making a payment to clear the liability. Doing so has proven challenging due to CalPERS processes.

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.

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.

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 partially disagrees with this finding. The City's current year budget and two prior year budgets are available on its website under the "Local Government Transparency" tab (see "City Budgets"). The City recognizes that improvements could be made to its website and is currently in-process on a redesign project to provide greater electronic resources to residents, businesses, and contractors, as well as to address issues of transparency, usability, and accessibility. As a part of the website redesign project, the display of budget information will be evaluated and improved, as necessary.

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 partially agrees with this finding, in that its budgets have not generally included the projection of revenues and expenditures beyond the fiscal year for which it was prepared. As the City continues to enhance its budget and budget development process in the interests of increased transparency, public participation, and responsible financial stewardship, multi-year projections and increased retrospective information will be included.

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

The City disagrees with this finding. The City's budget includes a "City Budget Detail" chapter that provides summary information with respect to both revenues and expenditures, including significant trends and observations (see Chapter 6.0 beginning on page 45 of the City's Fiscal Year 2014-15 Budget). The City presents this information in narrative form, rather than footnotes, due to the complexity and interrelatedness of budget matters.

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 partially disagrees with this finding. While information regarding the accumulation/drawdown of reserves over time is available in other financial reports, only changes relative to the fiscal year for which it was prepared are included in the City's budget. Reserve policies are included both in the "City Budget Practices" chapter (see Chapter 5.0 beginning on page 41 of the City's Fiscal Year 2014-15 Budget) and appendices section.

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 agrees with this 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.

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 with this finding. CalPERS posts agency valuations on its website at www.calpers.ca.gov (About CalPERS > Forms & Publications Center > CalPERS Reports, Studies & Fact Sheets > Public Agency Actuarial Valuations).

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 agrees with the finding; however, as noted in our response to Finding 1:

1. The City is not responsible for the Orange County Sheriff's Department's or Orange County Fire Authority's unfunded liabilities. While the City's relationship with each agency is different, it remains true that no common law or statutory obligation exists for the City to assume the unfunded liabilities of independent agencies.

RESPONSE TO 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.

This recommendation will be implemented as a part of the City's upcoming website redesign project (see response to Finding 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.

The City is currently working toward implementing this recommendation and expects to be fully implemented within the next two fiscal year budget cycles.

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

The City will implement this recommendation beginning in Fiscal Year 2015-16; however, employee contributions will be shown as payroll deductions, not budgeted expenditures.

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.

The City's budget substantially addresses this recommendation (see response to Finding 7); however, City staff will explore further implementation beginning in Fiscal Year 2015-16.

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.

The City will implement this recommendation beginning in Fiscal Year 2015-16.

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.

Regarding the Orange County Sheriff's Department: The City's current year budget includes a five-year projection of future costs of services. It does not "explicitly show the relationship of projected pension costs;" however, the City will add that information beginning in Fiscal Year 2015-16. Please note that the City is not responsible for the Sheriff's Department's unfunded liability and any inclusion of related information will be limited accordingly.

Regarding the Orange County Fire Authority: This recommendation is not warranted and will not be implemented. The Fire Authority provides its services through the Orange County Structural Fire Fund, which directly allocates a portion of the City's basic levy property tax as a means of funding. That allocation is made before the City otherwise receives property tax revenue, resulting in no direct or budgeted expenditures. For clarity, the City will include a discussion of how local fire services are funded beginning in Fiscal Year 2015-16.

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.

This recommendation is not warranted and will not be implemented. CalPERS posts agency valuations on its website at www.calpers.ca.gov (About CalPERS > Forms & Publications Center > CalPERS Reports, Studies & Fact Sheets > Public Agency Actuarial Valuations).

If you have any questions or would like additional information, please do not hesitate to contact me at (949) 639-0525 or cmacon@lagunawoodscity.org.

Sincerely,



Christopher Macon
City Manager

CC: Orange County Grand Jury
Laguna Woods City Council