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September 23, 2014

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

RE: Orange County City Pension Liabilities – Budget Transparency Critically Needed

Dear Judge Sanders:

Upon reviewing the findings and recommendations of the Orange County Grand Jury report entitled “Orange County City Pension Liabilities – Budget Transparency Critically Needed,” the City of Lake Forest offers the following responses:

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.

Response: The City has not independently reviewed the unfunded pension liabilities of all 34 Orange County cities to verify this finding. Without such a foundation from which to offer an informed opinion, the City respectfully disagrees with this 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.

Response: The City has not independently reviewed the unfunded pension liabilities of all 34 Orange County cities to verify this finding. Without such a foundation from which to offer an informed opinion, the City respectfully disagrees with this 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.

Response: 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.

Response: The City has not independently reviewed the websites of all 34 Orange County cities to verify this finding. Without such a foundation from which to offer an informed opinion, the City respectfully disagrees with this finding. As for Lake Forest, the City's current budget and prior year budgets are available on the City's website. The budget information can be easily accessed via the search engine by typing in the key word "budget" or by navigating through the drop-down menus on the City's homepage.

- 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.

Response: The City has not independently reviewed the online budgets of all 34 Orange County cities to verify this finding. Without such a foundation from which to offer an informed opinion, the City respectfully disagrees with this finding. As for Lake Forest, the City posts multi-year information in the Five-Year Strategic Business Plan, located on the City's website at <http://www.lakeforestca.gov/civica/filebank/blobdload.asp?BlobID=8021>.

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

Response: The City has not independently reviewed the budgets of all 34 Orange County cities to verify this finding. Without such a foundation from which to offer an informed opinion, the City respectfully disagrees with this finding. As for Lake Forest, the City's budget does provide information regarding key assumptions, risks, and changes related to revenues and expenditures in the City Manager's Message as well as in the Operating Budget Analysis section.

- 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.

Response: The City has not independently reviewed the budgets of all 34 Orange County cities to verify this finding. Without such a foundation from which to offer an informed opinion, the City respectfully disagrees with this 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.

Response: The City agrees that most future expenditures can be controlled by increasing or decreasing budgets for those expenditures as funds are available. However, the City has not independently reviewed the pension systems of all 34 Orange County cities and their associated annual required contributions to verify whether increases are imposed externally, change unpredictably, or are ramped up over two to five years. Without such a foundation from which to offer an informed opinion, the City respectfully disagrees 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.

Response: The City has not independently reviewed the online budgets of all 34 Orange County cities to verify this finding. Without such a foundation from which to offer an informed opinion, the City respectfully disagrees 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.

Response: The City agrees that pension costs are lower for "new" employees in comparison to "legacy" employees. However, the City has not independently reviewed the personnel turnover trends and projections of all 34 Orange County cities. Without such a foundation from which to offer an informed opinion, the City respectfully disagrees with the finding

that substantially reduced pension costs for cities as a result of pension reform will not be realized for one or more decades.

- 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 has not independently reviewed the Annual Valuation Reports for all 34 Orange County cities to verify this finding. Without such a foundation from which to offer an informed opinion, the City respectfully disagrees with this finding. As for Lake Forest, CalPERS posts their Annual Valuation Report online at <http://www.calpers.ca.gov/index.jsp?bc=/about/forms-pubs/calpers-reports/actuarial-reports/browse-results.xml&strCatId=2&q=lake-forest-city>.

- 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 has not independently reviewed the budgets for all 34 Orange County cities to verify this finding. Without such a foundation from which to offer an informed opinion, the City respectfully disagrees 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.

Response: The City makes no recommendations as to what other cities should do. As for Lake Forest, the City's current budget and prior year budgets are available on the City's website at <http://www.lakeforestca.gov/depts/finance/budgets.asp>.

The City's website contains a search engine; however, due to the volume of content on the City's website, searching on the word "budget" currently returns 38 results, including a link to the current budget. Future search results will vary based upon the available content on the website at the time the search is conducted.

- 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.

Response: The City makes no recommendations as to what other cities should do. As for Lake Forest, the City prepares a Five Year Strategic Plan that is updated biennially. This plan provides summary-level information for projected revenues and expenditures for the time period recommended by the Grand Jury. Projections are produced at the summary level for ease of understanding for readers. In addition, producing summary level projections is a more practical, cost-effective strategy. The Five Year Strategic Plan can be found online at <http://www.lakeforestca.gov/depts/finance/statements.asp>.

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

Response: The City makes no recommendations as to what other cities should do. As for Lake Forest, the City prepares a Five Year Strategic Plan that is updated biennially. This plan includes the predicted employer contributions for the City's pension system. The plan's projected expenditures do not reflect predicted employee contributions as they are not a City expenditure. However, Footnote 13 of the City's Comprehensive Annual Financial Report documents the City's Contribution Policy, which discloses that the City does not make pension contributions on behalf of City employees.

- 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.

Response: The City makes no recommendations as to what other cities should do. As for Lake Forest, the City's budget includes a summary of financial reserve funds, while the City's Five Year Strategic Plan provides trend data for reserve funds. Use of the reserves is reviewed on an annual basis. The City's Reserve Policy has always been available as a public record, and to promote ease of use will be posted to the City's website.

- 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.

Response: The City makes no recommendations as to what other cities should do. As for Lake Forest, Footnote 13 of the City's Comprehensive Annual Financial Report (CAFR) documents the City's Contributions and Funding Policy related to the City's CalPERS Pension Plan. The last five CAFR documents can be found on the City's website at <http://www.lakeforestca.gov/depts/finance/statements.asp>.

- 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.

Response: The City makes no recommendations as to what other cities should do. Due to the complexity of the recommendation and the City's relationship with the various entities involved, this recommendation can best be addressed by dealing with each of the aforementioned agencies individually. As for Lake Forest, as of 08/12/2014, OCSD has provided information related to projections of future costs of service, including projected pension costs and amortization of unfunded liabilities. The City will review the provided information and incorporate it into the budget development process per the City's policies and procedures.

Lake Forest is a Structural Fire Fund (SFF) city, meaning fire protection services are funded through an allocation of property taxes pursuant to a post-Proposition 13 allocation formula. Because the SFF revenues constitute a portion of ad valorem property taxes, the amount collected varies according to property values in each tax rate area and from property to property. As is the case with all property taxes, there is no relationship between the amount collected and the value of services received. Since the City cannot independently decide to provide said services differently, the City does not include the cost of fire protection services in its budget. In contrast, Cash Contract city members do pay an

annual service charge which includes annual costs for operational services, including projected pension costs.

- 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.

Response: The City makes no recommendations as to what other cities should do. As for Lake Forest, CalPERS already posts their Annual Valuation Report online at

<http://www.calpers.ca.gov/index.jsp?bc=/about/forms-pubs/calpers-reports/actuarial-reports/browse-results.xml&strCatId=2&q=lake-forest-city>.

Thank you for the opportunity to respond to the recommendations prepared by the 2013-14 Orange County Grand Jury in their report entitled "Orange County City Pension Liabilities – Budget Transparency Critically Needed." Should you have any questions, please contact Debra Rose, Deputy City Manager/Director of Management Services, at (949) 461-3414.

Sincerely,

CITY OF LAKE FOREST



Dwight Robinson
Mayor

c: Robert C. Dunek, City Manager
Scott C. Smith, City Attorney
City Council