



CITY OF LAGUNA HILLS

City Council

September 9, 2014

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

RE: California Penal Code Section 933 Response to Orange County Grand Jury Report, "Orange County City Pension Liabilities – Budget Transparency Critically Needed."

Dear Judge Sanders:

As requested by Orange County Grand Jury letter dated June 18, 2014, the City of Laguna Hills is responding to the findings and recommendations of the Grand Jury Report entitled, "Orange County City Pension Liabilities – Budget Transparency Critically Needed." It should be noted that, as directed by the report, the City is responding to each finding and recommendation as it applies to itself only.

GRAND JURY FINDINGS

- F1. 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 of Laguna Hills disagrees wholly with the finding. While some cities throughout Orange County may have large unfunded pension liabilities, this is not the case with the City of Laguna Hills. This is the direct result of the City staying with the historical and sustainable 2% at 60 pension formula.

The City's unfunded liability as of June 30, 2012, was \$2,721,662. This amount does not take into account the lump sum payment of \$557,805 that was made by the City to CalPERS on June 21, 2013 to pay off the City's side fund. Accounting for this side fund pay off, the unfunded pension liability of \$2,163,857 represents a pension liability that is 81% funded. Furthermore, the unfunded pension liability is \$70.48 on a per capita basis, and as a percentage, represents approximately 10.9% of the City's General Fund revenues. More importantly, total pension costs for the City are projected to remain at, or below 3% of the City's operating budgets over the next seven years even after accounting for future impacts of changes in actuarial assumptions. For Laguna Hills, this

is achieved in part by a phased-in sharing of employee contributions, and the fact that Laguna Hills has maintained the 2% at 60 pension formula.

- F2. 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 of Laguna Hills agrees with the finding.

- F3. 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 of Laguna Hills disagrees partially with the finding. While there are risks, the City has taken these risks into account in its long range forecast of pension costs and the subsequent impact on the City's operating budget. As pointed out under F1 above, total pension costs for the City are projected to remain at or below 3% of the City's operating budgets over the next seven years.

- F4. 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 of Laguna Hills disagrees partially with the finding. The City's budget is easily found on the City's website under the Forms, Documents, and Maps section of the website. The City does not currently post prior year budgets.

- F5. 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 of Laguna Hills disagrees wholly with the finding. As a practice, the City includes within its budget prior year actuals, current year year-end estimates, and detailed revenues and expenditures two years in the future. In addition, general revenues and expenditures are included in the 8-Year Resource Allocation Plan, which can be found in the Budget Summaries section of the City's budget.

- F6. City budgets often lack footnotes explaining key assumptions, risks, and unusual changes in budgeted amounts or revenues and expenditures.**

Response: The City of Laguna Hills disagrees wholly with the finding. While the City does not include footnotes in its budget, the key assumptions, as well as the risks and unusual changes in budgeted amounts or in revenues and expenditures, are clearly explained in the Budget Message, located in the Introduction section of the City's budget.

- F7. 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 of Laguna Hills disagrees wholly with the finding. Within its biennial budget, the City makes a point of providing trend data regarding its reserves. Additionally, included as Appendix 1 in the budget, the City's Financial Policies explicitly address the City's operating ratios and reserve policies.

- F8. 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 of Laguna Hills agrees with the finding.

- F9. 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 of Laguna Hills disagrees wholly with the finding. The City includes within its biennial budget a lengthy discussion regarding pension costs, future risks to the City, and the impacts of planned and unplanned changes in required contributions.

- F10. 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 of Laguna Hills disagrees partially with the finding. Laguna Hills provides a 2% @ 60 retirement formula and, unlike most cities throughout the State, the City never modified or enhanced its pension formula. As a result, while the City will realize some savings as new employees replace legacy employees, the savings are not substantial, because the PEPRA retirement plan is only marginally less generous than the City's existing plan.

- F11. 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 of Laguna Hills disagrees wholly with the finding. While many cities do not include CalPERS Annual Valuation reports on their City websites, the reports are available for all cities that contract with CalPERS on its website: <http://www.calpers.ca.gov/index.jsp?bc=/about/forms-pubs/calpers-reports/actuarial-reports.xml>

- F12. OCERS provides pension plans for OCFA and OCSD employees, but there is no way to trace through publically available resources OCERS unfunded pension liabilities to the city budgets which outsource to OCFA and OCSD for fire and police services.**

Response: The City of Laguna Hills agrees with the finding.

GRAND JURY RECOMMENDATIONS

- R1. 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)**

Response: The recommendation has been implemented. Utilizing a biennial budget process, the City's budget includes a total of four years' worth of budgeting, including prior year actuals, current year-end estimates, and two years in the future.

Typing "budget" in the City website's search function returns a number of results related to the City's budget, including the City's budget documents.

- R2. 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)**

Response: The recommendation will not be implemented because it is not warranted or is not reasonable. The City utilizes a biennial budget process, which includes not only current year-end estimates but also provides detailed projections of revenues and expenditures two years out in the future. The City also prepares an 8-Year Resource Allocation Plan which provides projected revenues and expenditures for the next eight years, albeit not at the level of detail requested.

- R3. 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)**

Response: The recommendation has not yet been implemented, but will be implemented in the future. The City currently provides one line item in the City's budget that shows the sum of retirement costs. With the development of the next biennial budget, the City will detail the predicted employee and employer contributions, most likely in the Budget Message section or as an Appendix to the budget.

- R4. 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)**

Response: The recommendation has been implemented. It is the City's practice to provide trend data on the accumulation and drawdown of reserves, as well as provide details on the City's policies related to its reserves. Furthermore, the City regularly evaluates the use of reserves to reduce its unfunded liability. For example, this led to the City paying down its side-fund on June 30, 2013. Additionally, included as Appendix

1 in the budget, the City's Financial Policies explicitly address the City's operating ratios and reserve policies.

It should be further noted that the City did explore the possibility of accelerating amortization of its unfunded pension liability and it did not deem it prudent at the time. Up until FY 2015/2016, it has been CalPERS' practice to place contracting agencies in "pools" based on their benefits formula. With this structure, any funds the City paid towards its unfunded pension liability would not have resulted in a credit towards the City's unfunded pension liability but rather would be credited to the pool's liability. With the changes CalPERS is implementing in FY 2015/2016, in the future, any payments made by the City to pay down its unfunded liability, will directly reduce the City's unfunded pension liability.

- R5. 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)**

Response: The recommendation will not be implemented because it is not warranted or is not reasonable. The City has always paid its Annual Required Contributions and therefore has no catch-up contributions based on ARCs.

- R6. 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 on the city's budgets. (F.6) (F.12)**

Response: The City of Laguna Hills contracts with both OCFA and OCSD for fire and police services, respectively. 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.

Pertaining to OCSD, the recommendation has been implemented. The City has requested and received projections of future costs of service five years out. Additionally these projections include projected pensions costs. The City has also requested that future projections include amortization of unfunded liabilities.

Pertaining to OCFA, the recommendation will not be implemented because it is not warranted or is not reasonable. At the time of incorporation in 1991, the City of Laguna Hills was required to allocate a defined percentage of its 1% Basic Levy property tax revenues to the O.C. 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 and cannot independently decide to provide said services differently. Consequently, the City does not include the cost of fire protection services in its budget.

- R7. Each city that has CalPERS as a provider for pensions should include a provision in their agreement with CalPERS that CalPERS will post their Annual Valuation Reports online. (F.11)**

Response: The recommendation will not be implemented because it is not warranted or is not reasonable. Annual Valuation Reports for all cities that contract with CalPERS are already posted on their website and can be found on the following webpage: <http://www.calpers.ca.gov/index.jsp?bc=/about/forms-pubs/calpers-reports/actuarial-reports.xml>. Additionally, the City will include a link to its Annual Valuation Report in its future budget documents.

Should you have any questions or need additional information, please feel free to contact Donald White, Assistant City Manager, at (949) 707-2620.

Sincerely,



ANDREW BLOUNT
Mayor

Cc: Dave Baker
Foreman, 2013-2014 Orange County Grand Jury
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Santa Ana, CA 92701