ORANGE COUNTY'S
$4.5 BILLION UNFUNDED PENSION LIABILITY & RETIREMENT PLANS

GRAND JURY 2015-2016

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EXECUTIVE SUMMARY

Orange County's (County) unfunded pension liability exploded from 2000 to 2012, going from a surplus in 2000 to a $4.5 billion liability in 2012. In January 2016 the County issued pension obligation bonds in the amount of $334 million. The numbers are huge. The fact that the County has an unfunded liability is no secret. Unfunded pension liabilities are very well known to the public.

The Grand Jury and the public are well aware that local units of government have unfunded pension liabilities, but the magnitude of Orange County's liabilities is, at first glance, difficult to understand. During the Grand Jury's investigation into the County's unfunded pension liability it discovered a number of elements that, in part, mitigated concerns over these very large amounts. These included:

- When compared to its peer units of government in California, Orange County at 70% funded is in the median range (70-80%) of pension liability funding;
- Unfunded pension liabilities of the County have been reduced by over $500 million (11%) since 2012 after many years of dramatic increases;
- Effective with this year's audit, the Government Accounting Standards Board (GASB) has new accounting standards requiring that government entities clearly state their unfunded pension liability as a line item on their balance sheet, making it easy to identify the actual unfunded pension liability;
- Orange County Employees' Retirement System (OCERS) has reduced the amortization of the unfunded liabilities from 30 years to 20 years, helping to reduce the liabilities faster; and
- Short term bonds that were issued so that County could avail itself of a sizable discount offered by OCERS.

The reduction of unfunded liabilities in recent years is contrary to OCERS actuary's forecast, which projects increases totaling 8% in the next four years, followed by declining levels. This contradiction needs to be resolved.

This Grand Jury appreciates the manner in which the unfunded pension liabilities are being administered, but the County should be more aggressive in reducing the unfunded pension liabilities and urge OCERS to do the same.

Over the years the County has adopted several restricted defined contribution retirement plans, one of which is provided exclusively for County elected officials and senior executives. The latter plan is funded exclusively by the County with no contribution required by the individual.

The Grand Jury is also concerned that County employees are not treated equally in pension/retirement choices offered. The Grand Jury has provided a number of findings and recommendations that should allow the County to further reduce its unfunded pension liability and provide for a more equitable pension/retirement choice.

BACKGROUND

Public concern regarding potentially unsustainable government pension obligations, nationally, and particularly in California, has intensified during the past decade. The gap between a government entity's pension assets and its liabilities for current and future pensions is known as the Unfunded Actuarial Accrued Liability (UAAL) or Unfunded Pension Liability.

Most public jurisdictions in California (i.e., states, counties, school districts, special districts and cities) have accrued large unfunded pension liabilities. The public is affected whether the unfunded pension liabilities is growing or whether it is being reduced. If the liability is increasing, then less is being spent on County services; if it is being reduced, more of the annual budget can be used for services to the taxpayers.

According to many interviews conducted by the Grand Jury, factors affecting increases in unfunded pension liabilities include:

- Changes in labor agreements
- Legislation
- Not achieving assumed investment returns
- Changes in mortality rates
- Enhanced retirement benefits for public safety employees and general employees
- Retirement and hiring rates
- Assumptions regarding the economy

The 2013-2014 Orange County Grand Jury reported that as of December 2012, the 34 cities in Orange County had an aggregate of $3.3 billion in unfunded pension liabilities which will need to be funded over the next several decades. Since Orange County was not assessed as part of that report, the 2015-2016 Grand Jury took the opportunity to investigate the unfunded pension liability of the County.

In January 2016 a web search for "unfunded pension liabilities" in the *Orange County Register* resulted in 3,538 articles, commentaries and editorials published during the past 10 years. These spoke to all levels of local government jurisdictions, plus state and federal government pensions systems, and unfunded liabilities. In addition, there has been massive exposure in other media, locally and nationally, including a segment on the CBS "*60 Minutes"* television show. Thus, the subject matter of unfunded pension liabilities is not only well-known to the general public, it is cause for great concern.

The County's UAAL grew from a surplus of approximately $130,000 in 2000 to a liability of over $4.5 billion, 80% of OCERS' UAAL in 2012 (OCERS 2015). Further, the Grand Jury discovered that the County issued short term Pension Obligation Bonds in the amount of $339 million in early 2015 and $334 million in early 2016 to pay the required annual County contribution into the retirement system (County Official Statement, 2016).

Four and a half billion dollars is a huge obligation which ranks Orange County in the lower end of the range when compared to other large California jurisdictions as shown in Table 1 below.

Jurisdiction	% of Liabilities Funded
City of Los Angeles	67
Los Angeles County	75
Orange County	**70**
Riverside County*	73-93
San Bernardino County	82
City of San Diego	70
San Diego County	75
City and County of San Francisco	80

*Reported separately by each Riverside County Department. Other information extracted from 2013-2014 Financial Reports. Does not take into account any long term Pension Obligation Bonds that may have been issued.

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Table 1. Percent of Pension Liabilities Funded by Jurisdictions

As a general comparison, according to an article issued by Bloomberg Business on November 12, 2015, "the median state pension last year had 70% of the assets needed to meet promised benefits" (Bloomberg.com, Mar 08, 2016). The Grand Jury believes that this does not relieve the County from its obligation to increase the funded portion of the liability.

Orange County had 18,135 full- and part-time employees as of late 2015, and a 2015-16 fiscal year budget of nearly $6 billion. This employment figure includes the Sheriff/Coroner department, but excludes the Orange County Fire Authority, which is a separate public jurisdiction.

In 2012, OCERS, which manages portions of the pension money for the employees of the County and other jurisdictions, adopted a more aggressive 20 year amortization schedule to retire the unfunded pension liability. It previously used a 30 year amortization schedule. This choice is similar to choosing to pay off a 30 year home loan in 20 years. This approach costs more annually, but the homeowner is out of debt 10 years sooner. OCERS has also reduced its anticipated annual investment return from 7.75% to a more realistic 7.25%. (See Figure 1)

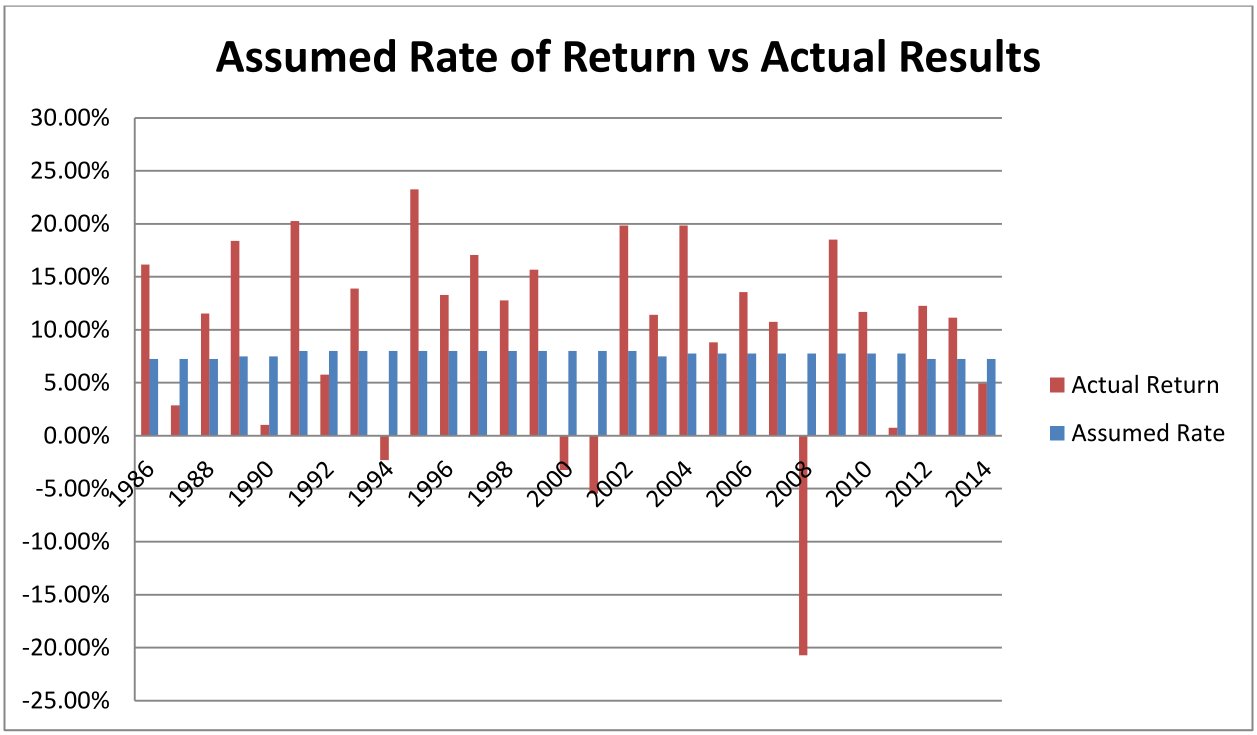


Figure 1. Generated from OCERS Data in a Report "*By the Numbers*" 2014

Funding Levels of UAAL

The level at which pension obligations should be funded is the subject of some debate. However, discussions conducted by the Grand Jury with retirement sources at both OCERS and the County suggest that an 80% funded level of pension liability is a reasonable short term objective. When the funding level increases above 80%, it can create pressure by employee bargaining units to increase benefits and or wages.

There are many variables that affect the level of liabilities of a pension system, but the Grand Jury agrees that the County and OCERS are using reasonable assumptions in their forecasts. As of June 30, 2015 OCERS (and therefore the County) has funded approximately 70% (or 30% unfunded) of its total liabilities (OCERS). The County must be vigilant in maintaining the current direction of reducing the unfunded liability.

Figure 2 presents the dramatic range of the 30 year history of OCERS funded level from 57% in 1985 to 103% in 2000, a boom year in the stock market. During the first 10 years of this century the unfunded dollar amounts grew significantly from year-to-year causing the percent funded to decline. However, in recent years, the percent funded has risen, due primarily to the effects of Public Employees' Pension Reform Act (PEPRA), an improved economy, and investment returns. As a result there has been an improvement in the funded level of pension liability since 2012 of approximately $569 million (62% up to 70%) as reflected in Figure 1 (OCERS).

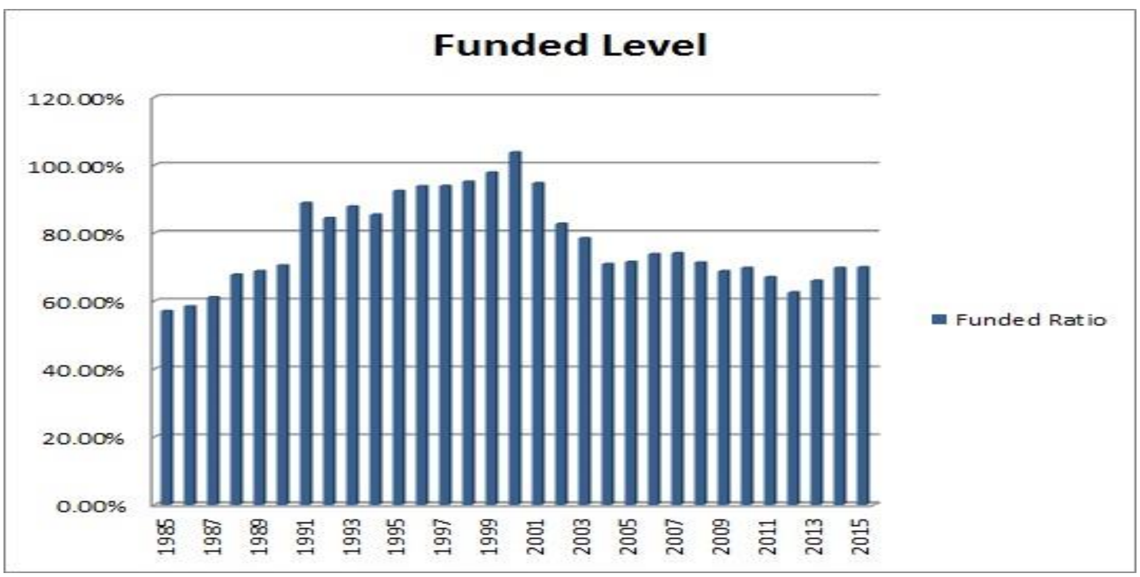


Figure 2. Percent of Funded Pension Liability

Early Payment Discount Plan

For 10 years, OCERS has offered an early payment discount to its member organizations. Orange County represents approximately 80% of OCERS members and assets. If a participating government entity provides OCERS with at least 50% of the projected employer contribution for the year by January 15th of any year, that entity is currently entitled to a 5.8% discount. This discount percent has varied over the past 10 years. The County chose for FY 2015-16, as it has done in prior years, to contribute the Actuarially Determined Contribution (ADC), (previously known as the Annual Required Contribution [ARC]) through the proceeds from the issuance of short term bonds (12-18 month maturities).

The most recent Pension Obligation Bond Issue, completed January 15, 2016, had a blended interest rate of approximately 1.13%, making the prepayment cost effective considering the 5.8% discount offered by OCERS. The 2016 bond issue and the early payment to OCERS generated a net budget savings of $16.2 million to the County for FY 2016-2017. Table 2 reflects the net savings, by year, generated through the discount program for the past 10 years.

FY Prepaid	Year Issued	Discount	Net Budget Savings
2016-17	2016	5.80%	$16,235,749
2015-16	2015	5.80%	$17,917,713
2014-15	2014	7.25%	$22,147,628
2013-14	2013	7.75%	$20,026,078
2012-13	2012	7.75%	$17,968,302
2011-12	2011	6.14%	$16,443,160
2008-11	N/A		
2007-08	2007	7.75%	$6,148,971
			$116,887,601

Source: Orange County Public Finance Department

Table 2. Ten Year History of Savings

OCERS and other pension systems allow participating government entities to make additional payments above the required contribution. Such additional payments would further reduce the unfunded pension liabilities. Several other jurisdictions within Orange County, including the Orange County Fire Authority, the City of Irvine, the City of Lake Forest, and the Orange

County Sanitation District have made such advance payments to their pension systems. The Orange County Cemetery District has now paid off their unfunded liabilities. The Board of Supervisors (BoS) has the same prerogative to make additional payments beyond the ADC. Had the BoS committed to this policy, the unfunded debt would not have reached the levels actually experienced.

Finally, in 2014, the Government Accounting Standards Board (GASB), which regulates the method of presenting governmental financial audits, issued new accounting standards (GASB website, 2015). These Standards require all units of government to disclose the dollar amount of the unfunded pension liability in their balance sheets, thus improving financial transparency at all levels of government.

The State of California recognized that local government retirement systems such as OCERS were facing financial stress, so the Legislature passed and the Governor signed the Public Employees' Pension Reform Act of 2013 (PEPRA). The Act mandates reduced benefits for individuals hired after January 1, 2013 and should make OCERS and pension systems throughout the State financially stronger going forward.

As part of the annual Strategic Financial Plan, the County Budget Office provides a forecast that includes an estimate of the expected Actuarially Determined Contribution to OCERS in a line item titled "Retirement Costs," as depicted in Table 3. The 2015 County's Strategic Financial Plan projects the expected retirement costs for the next five years and includes an average of 1.3% annual increase, as depicted in Table 3. It is also worth noting that of the 37 priority goals listed in the County's 2015-16 Strategic Financial Plan, reducing the unfunded pension liability is not one of them.

Projected Retirement Costs				
FY 2016-17	FY 2017-18	FY 2018-19	FY 2019-20	FY 2020-21
$387m	$406m	$418m	$425m	$432m

Source: 2015 Orange County Strategic Financial Plan.
Excludes Pension Prepayment & Retirees Medical Plans.

Table 3. Forecasted Actuarially Determined Contribution

SCOPE OF REPORT

As referenced previously, the 2013-2014 Grand Jury report documented the Unfunded Actuarial Accrued Liability (UAAL or unfunded pension liability) at the cities level in Orange County but did not assess the UAAL at the County level. The 2015-2016 Grand Jury identified this opportunity to review how the County is dealing with the issue of pension liabilities and other elements of the County's retirement plans that the public might have an interest in knowing.

METHODOLOGY

In researching the unfunded pension liabilities of the County, the Grand Jury interviewed numerous individuals in senior and executive management positions and reviewed many documents and financial reports as identified below:

- Senior management of Orange County Employee Retirement System (OCERS)
- Senior management of Orange County government
- Board Member of OCERS
- Senior management of Orange County Employees Association (OCEA)
- Board Member of OCEA
- California Legislative Analyst Office
- Senior management of League of California Cities
- Literature reviewed as listed in "Works Consulted"

INVESTIGATION AND ANALYSIS

The magnitude and influence of Orange County is not easily understood by its residents. The County is one of the major metropolitan areas in the State and nation. The County's population of over 3 million inhabitants is larger by population than 80 countries and 21 U.S. states. Orange County is the third most populous county in California and ranks sixth in the nation. It occupies 789 square miles with a coastline of 42 miles. As shown in Table 4, Orange County government is the third largest employer.

Employer	Number of Employees
Walt Disney Company	27,000
University of California, Irvine	22,385
County of Orange	**18,135**
St. Joseph Health System	12,227
Kaiser Permanente	7,000
Boeing Company	6,890
Wal-Mart Stores, Inc.	6,000
Memorial Care Health System	5,650
Bank of America	5,500
Target	5,400

Source: 2016 Official Statement w/Pension Obligation Bonds.

Table 4. County of Orange Top Ten Employers

Orange County's FY 2015-2016 operating budget approaches $6 billion. The County government is comparable to a major corporation in size and complexity, and the annual budget is equivalent to the entire annual budget for the State of Mississippi (Wikipedia 2015). Given these comparisons, the size of the County's unfunded pension liabilities are not the overwhelming amounts that initially concerned the Grand Jury. Nevertheless, the County's level of funded pension liabilities is still too low compared to its peer governments as evidenced in Table 1.

Pension System

Pension administration and investment management for Orange County employees is provided, in the main, through the Orange County Employees Retirement System (OCERS) which was approved by the voters and the County Board of Supervisors in 1945 pursuant to a California State law passed in 1937. Orange County government represents approximately 80% of OCERS assets and member employees. The 20% balance of assets represents other public jurisdictions that have elected to have their pension funds managed by OCERS.

Shortly after the Orange County bankruptcy in 1994, OCERS, previously a department of the County government became independent from County government. At the time, there was concern that County officials might want to invade OCERS funds to assist in satisfying other County obligations in dealing with the bankruptcy (OCERS).

OCERS is headquartered in Santa Ana and has a staff of 73. As of December 31, 2015, OCERS managed slightly over $12 billion dollars in pension funds on behalf of its beneficiaries (i.e., current and future retirees) (OCERS, April 2016). OCERS is governed by a ten member Board of Retirement (OCERS Board), bound by the County Employees'1937 Retirement Law. Of the ten members, four are appointed by the Orange County Board of Supervisors, four (including the Public Safety alternate) are elected by OCERS' active (still employed) members, and one is elected by the retired membership. The County Treasurer serves as an ex-officio member. Board members serve three-year terms, with the exception of the County Treasurer, who serves for his or her tenure in office (OCERS, 2015).

There are a variety of formulas that determine an employee's pension benefit including the employee's date of hire, and job classification as either a public safety employee or a general employee. Annually OCERS provides the Actuarially Determined Contribution to its participating 15 governments, including Orange County, to use in budgeting for the upcoming year.

Types of Pension Plans

There are two primary forms of retirement plans in this country: defined benefit and defined contribution. Although the defined benefit plan through OCERS historically has been the main retirement plan available to County employees and elected officials, the Grand Jury discovered the County has other, additional retirement plans which are discussed later in this report.

Defined Benefit Plan

The OCERS managed retirement plan is a Defined Benefit Plan in which the employee's contribution and the monthly retirement benefit is based on a formula of years of service and final compensation. Regardless of how much the employee actually invested in the fund, the benefit continues until the death of the employee and/or the employee's surviving beneficiary. This monthly amount is adjusted for inflation as determined by the OCERS Board. See Appendix C for a further description of Defined Benefit.

OCERS Board manages the retirement funds and is responsible for adopting numerous "assumptions," or projections, including: investment rate of return, inflation rate, cost of living adjustments (set by State law), projected general county employees and safety employees wage increases and mortality. These assumptions are reviewed annually and approved triennially by the OCERS Board. The County Staff and OCERS Staff then provide data to OCERS' private actuary firm. The actuary uses the data to develop the annual Actuarially Determined Contribution (ADC). Table 5 shows the past five years of the ADC amounts.

Actuarially Determined Contribution	
Fiscal Year	$ in millions
2012-13	267
2013-14	320
2014-15	372
2015-16	384
2016-17	387

Source: Orange County Public Finance Dept.

Table 5. Five Year Actuarially Determined Contributions

The County again took advantage of the OCERS 5.8% discount by issuing 2016 Pension Obligation Bonds in the amount of $334 million to fund the 2016 ADC payment. In order to size the bond issue, County departments have a choice of participating in the bond issue or using cash on hand within the department. A few County departments use their cash on hand which is deducted from the ADC.

In 2012 the OCERS Board reduced the amortization period from 30 years to 20 years. This decision requires the County to make a higher annual contribution, but reduces the unfunded pension liability more quickly.

Likewise, in the same year, the OCERS Board made a decision to lower its expected annual investment return from 7.75% to a more realistic 7.25%. There have been many years in the past when OCERS did not achieve its projected investment return. In fact, OCERS did not achieve its investment target one third of the time since 1986 as illustrated in Figure 1.

The OCERS Board made the decisions to reduce the amortization schedule and lower its expected annual investment return based on input and recommendations from its independent actuary firm and other sources.

Defined Contribution Plan

Gaining in political support, but not necessarily gaining popularity with County employees, the primary alternative pension plan that the County could adopt is a Defined Contribution Plan. In a Defined Contribution Plan, the employee funds the account through a deduction from salary and the funds are invested at the direction of the employee from the plan's investment alternatives. The employer has the discretion of making a contribution on behalf of the employee to the individual's retirement account. At retirement, the dollar value of the employee's retirement funds are distributed at the direction of the employee, much like a "401 K" plan used in most private sector companies. Pension payments cease when the fund is exhausted. See Appendix C for a further description.

Defined Contribution Plans have been growing in the private sector, as they are less expensive to the employer and have predictable, fixed pension costs, while the defined benefit plans are a variable cost.

OCERS brought to the Grand Jury's attention the fact that three state governments have converted their Defined Benefit Plans into a Defined Contribution Plans: Michigan in 1997, Alaska in 2006 and Oklahoma in 2015. Conversely, three cities with Defined Contribution Plans have reverted to Defined Benefit Plans based on financial pressure from both the employees and the employers: New London, CT, Davie, FL and Alexandria, VA.

Other Retirement Plans in Orange County Government

In addition to the defined benefit retirement plan managed by the OCERS Board, there also exist other, smaller, additional restricted retirement plans inside the County. These are Defined Contribution Plans and are administered by the County Human Resources Department rather than OCERS.

401(a) Executive and Elected Officials Retirement Plan

This Plan was adopted in 1999, years after OCERS became independent. The Plan is available to elected officials, Executive Management Groups 1, 2, 3 and eight non-County employees (including selected OCERS management), as depicted in Appendix D. These individuals are automatically enrolled in this 401(a) Defined Contribution Plan. According to interviews, this Plan was adopted to maintain competitive compensation packages for executive leadership and management staff from other public agencies or from the private sector. Appendix D also shows the County's contribution to the participants' retirement accounts. There is no matching contribution required by the employee, the elected officials, or the non-County employees.

On February 23, 2016 the Board of Supervisors granted a 2.75% raise to County Executives in Groups 2 and 3, shown in Appendix D, and to Executive Aides/Assistants. Based on the pay ranges County Executives may receive compensation up to $252,000. The result is that in addition to a $7,000 raise, Executives at the top level will receive an additional contribution into their 401(a) Plan.

Currently there are 642 employed or retired participants in this Plan, which has $13.6 million in assets as of February 2016. This retirement benefit is in addition to the OCERS Defined Benefit Plan for these select individuals.

457 Defined Contribution Program

The County offers all full-time and part-time employees the ability to enroll in a Defined Contribution Program administered through a private company.

The 457 Defined Contribution Program is a voluntary retirement savings program that allows the employee to contribute a portion of their bi-weekly salary on a pre-tax basis. All of the savings grow tax-free until the employee removes money from the account at retirement or separation of employment. The Program offers a wide variety of professionally managed investment options. The employee can choose from among a diverse array of investment options.

1.62%@65 Hybrid Plan

Employees enrolled in the "1.62 at 65" retirement benefit (OCERS) formula are eligible to enroll in the 1.62 Hybrid Plan. The 1.62 Plan combines a traditional defined benefit plan pension with a defined contribution component so they can work together to help achieve an adequate and secure retirement. The 1.62 Hybrid Plan includes a voluntary retirement savings program that allows an employee to contribute a portion of their bi-weekly salary on a pre-tax basis, currently up to $18,000 per year, and receive employer matching contributions to the Plan, up to 2% of base salary per pay period.

Employee contributions are made on a pre-tax basis and go into a 457 account. Employee contributions vest immediately on behalf of the employee. The employer matching contributions go into a 401(a) account for the employee to manage. Employer contributions vest on behalf of the employee after five (5) years of continuous employment with the County. Employees may choose from among an array of investment options.

Extra Help 3121 Plan

The 3121 Plan is the only retirement plan available to employees who work for the County and are classified as Extra Help. This Defined Contribution Plan is also known as 3121 FICA Alternative Compensation Plan. This Plan was adopted in 2002 to comply with a federal IRS code since the County does not participate in the Federal Social Security system. Extra Help employees are automatically enrolled and 7.5% of their base salary is contributed to the Plan. There are 3,690 participants in the Plan with $7.3 million in assets as of February 2016. Prior to this Plan, Extra Help employees contributed to a 1992 Defined Benefit Plan but it has been closed to new employees since 1992 and is "winding down" as participants pass away.

Advisory Committee

The County has established a Defined Contribution Advisory Committee (Committee) which meets at least quarterly. With the assistance of the County's independent investment consultant, the Committee evaluates and monitors the various defined contribution plans, the investments, services, assets and market trends. The Committee recommends action on items such as changing investment alternatives choices for the participants. When modifications in services are proposed they are submitted to the County's Chief Financial Officer for approval. The County's Chief Financial Officer is the fiduciary for the Plans.

Improved Disclosure/Transparency

The Government Accounting Standards Board (GASB) is the independent organization that establishes and improves standards of accounting and financial reporting for U.S. state and local governments. Established in 1984 by agreement of the Financial Accounting Foundation and 10 national associations of state and local government officials, GASB is recognized by government, the accounting industry, and capital markets as the official source of generally accepted accounting principles (GAAP) for state and local governments.

In 2014 GASB issued two related statements (rules) that substantially changed the accounting and financial reporting of pension liability. GASB Statements No. 67 requires more extensive reporting by pension plan administrators, like OCERS. Statement 67 establishes a definition of a pension plan that reflects the primary activities associated with the pension arrangement—determining pensions, accumulating and managing assets dedicated for pensions, and paying benefits to plan members as they come due.

Statement 68 requires the County, and all other public jurisdictions to report their unfunded pension liabilities in their balance sheets as a line item. The 2014-15 Orange County audit is the first time unfunded pension liability was presented in this manner. Prior to the new rules, each government employer’s liability was simply considered to be the amount that the employer was contributing toward the Defined Benefit Plan(s) on an annual basis.

For government financial reporting, GASB now requires that the Net Pension Liability (this amount is similar to what was previously referred to as the Unfunded Pension Liability) be presented using “market value” instead of “actuarially smoothed value” of assets on the balance sheet. Market value means using market quotes at year-end for all invested assets, rather than the previously used actuarial projections. The benefit of the current method of reporting is that unfunded liabilities all are more transparent and understandable than in the past for all units of government, nationally.

State Legislation

As public awareness of unfunded pension liabilities at the local level was developing, during the past decade, there was also growing awareness that the State of California government was experiencing the same problem of growing pension liabilities. The primary pension system for State government employees is the California Public Employee Retirement System (CALPERS). CALPERS disclosed in its 2014 annual financial report that its unfunded pension liabilities rose from $27.5 billion in 2004 to $113.4 billion in 2013. As a result of this increase, the State Legislature was sufficiently concerned with the retirement benefits and liabilities that it passed the Public Employees’ Pension Reform Act of 2013 (PEPRA). PEPRA applies to most new hires in local government. Existing employees are referred to as classic employees.

There are various reforms in the PEPRA law. Among them is a cap on pensionable compensation for the purpose of calculating retirement benefit. In 2015 the cap was $117,020 for individuals who participate in Social Security and $140,424 for those who do not. Both limits are subject to increases in the Consumer Price Index. Additionally, new hires are now required to pay at least 50% of the "normal cost" of their retirement benefits. "Normal cost" means the amount that it will cost to pay for future benefits. The following is excerpted from a summary of the law on the CALPERS website:

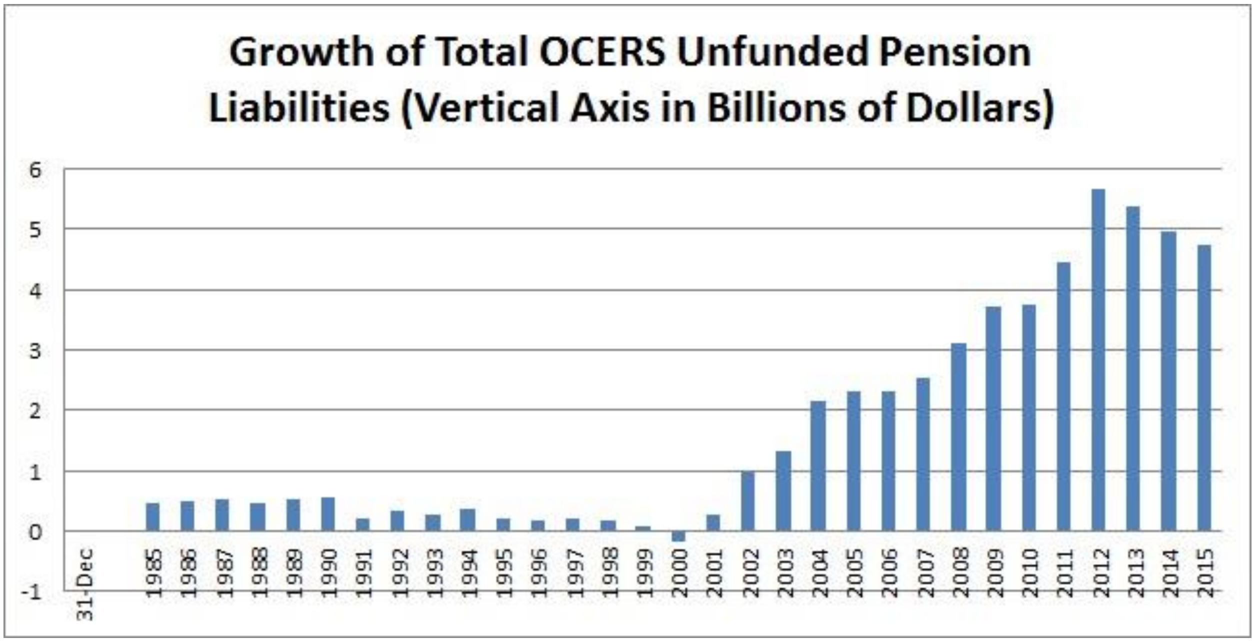
- Creates a new defined benefit formula of 2% at age 62 for all new miscellaneous (non-safety) members with an early retirement of 52 and a maximum benefit factor of 2.5% at age 67. The County's 1.62% at age 65 benefit formula is considered PEPRA compliant and continues to be offered to most employees with a few exceptions, as well as to the Sheriff's Special Officers (general members) whose only option is the 2.5% at age 67.

- Creates a new defined benefit formula of 2.7% at age 57 for all new safety members with an early retirement of 2% at age 50.

- Other areas affected by the law include:
    - Revised Definition of "New Members";
    - Pensionable Compensation Cap;
    - Equal Sharing of Normal Cost;
    - Prohibits Retroactive Pension Benefit Enhancements;
    - Prohibits Pension Holidays; and
    - Pensionable Compensation.

History and Forecast of Unfunded Pension Liability

Figures 3 and 4 create a mental disconnect from the current declining unfunded pension liabilities. Figure 3 illustrates OCERS' unfunded pension liabilities history and the dramatic rise in the unfunded liability up to 2012 with a modest decline commencing in 2013. Orange County, as a participant in OCERS, is estimated to be 80% of each of the bars with a liability of $4.5 billion in 2012.



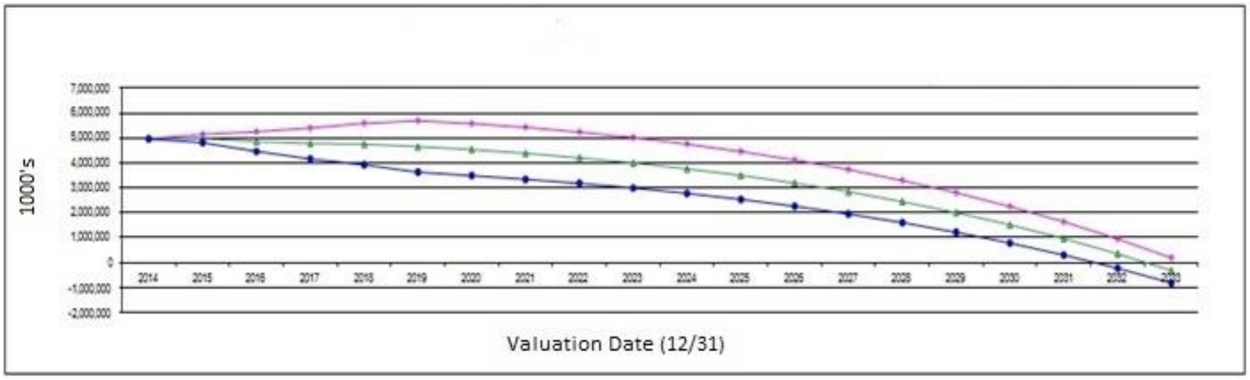
Source: The Evolution of OCERS Unfunded Actuarial Accrued Liability, December 31, 2014

NOTE: Orange County government represents approximately 80% of each bar. The other 20% are other public jurisdictions such as the City of San Juan Capistrano, Orange County Transportation District and 12 other entities.

Figure 3. Unfunded Pension Liabilities

Figure 4 is a forecast by OCERS' independent actuary showing that all its participating governments can expect 4-5 years of increasing unfunded liabilities. It illustrates three possible results for future unfunded liabilities. The chart uses three different investment return rate assumptions:

RED (top line)	0.00% rate of return in 2015 and 7.25% return each year thereafter
GREEN (center line)	7.25% rate of return in 2015 and 7.25% return each year thereafter
BLUE (bottom line)	14.5% rate of return in 2015 and 7.25% return each year thereafter



(Prepared by OCERS Independent Actuary-July 2015)

Figure 4. Illustrative Projection of OCERS Unfunded Pension Liabilities

Unaudited year end 2015 results of OCERS' investment returns, when mapped on the chart, most closely approximate the top red line. Based on that result, the illustration suggests that Orange County's unfunded liability will rise 8.4% ($438 million) over the next 4 years and then begin a steady decline ending with 100% funded in 2033. As unfunded liabilities grow, County budget officials will have to reduce funding to existing programs and services or raise revenue. With a much improved economy the Grand Jury hopes the actuarial projection is wrong and liabilities will continue to shrink. (The projections were prepared by OCERS Independent Actuary. The illustrations are not a guarantee of the actual outcome.)

Conclusion

Through the process of conducting personal interviews, reviewing numerous financial documents, and comparing data from other large California governmental entities, the Grand Jury concludes that Orange County is taking adequate, but not aggressive action to reduce the unfunded liability and therefore, is adversely affecting the level of service to the public that it could provide if the liability was eliminated. There is a distinct disconnect between the reductions of the unfunded pension liability in recent years and the actuarial projection of the pension liabilities increasing for the next several years by nearly $500 million.

FINDINGS

In accordance with California Penal Code §933 and §933.05, the 2015-2016 Grand Jury requires (or as noted, requests) responses from each agency affected by the findings presented in this section. The responses are to be submitted to the Presiding Judge of the Superior Court.

2016 Orange County Grand Jury has arrived at nine principal findings, as follows:

F.1. The County, in part, is responsible for the unfunded pension liabilities to increase from a surplus of $130,000 in 2000 to $4.5 billion as of December 2012. This represents an increase of more than 4,500% since year 2000.

F.2. The County should have developed a plan to curb the growth in unfunded pension liability independent of OCERS.

F.3. The County and OCERS have taken recent actions to control and slightly reduce the unfunded liabilities by 11% from $4.5 billion in 2012 to $3.8 billion in 2015, but the County could be more aggressive.

F.4. Issuing short term Pension Obligation Bonds (7 of past 10 years) to achieve taxpayer's savings of over $100 million during the past decade was a good decision by the County.

F.5. OCERS Board of Retirement made a solid financial decision to reduce the amortization period of the UAAL from 30 years down to its current period of 20 years, resulting in increased annual payments from the County.

F.6. Passage of the state Public Employees' Pension Reform Act of 2013 should improve the financial stability of the County's retirement system.

F.7. The State and local governments have the ability to implement Defined Contribution Plans, or hybrid plans, instead of the traditional Defined Benefit Plan. Much of the private sector has transitioned to the Defined Contribution Plans such as 401K plans and more than 30 jurisdictions in California use Defined Contribution Retirement Plans, including Orange County.

F.8. County employees are not treated equally as relates to retirement benefits. Orange County utilizes and contributes to several Defined Contribution Plans as supplemental retirement plans to OCERS and one of the plans is restricted to "select" employees and all elected County officials. Additionally, the County has eight non-County employees in the exclusive 401(a) plan.

F.9. Orange County has not designated unfunded liability reduction as a priority either by action or in its Strategic Financial Plan.

RECOMMENDATIONS

In accordance with California Penal Code §933 and §933.05, the 2015-2016 Grand Jury requires (or as noted, requests) responses from each agency affected by the recommendations presented in this section. The responses are to be submitted to the Presiding Judge of the Superior Court.

Based on its investigation titled "Orange County's $4.5 Billion Unfunded Pension Liability & Retirement Plans", the 2015-2016 Orange County Grand Jury makes the following seven recommendations:

R.1. The County should encourage the OCERS Board of Retirement to maintain financially sound assumptions and to oppose any relaxation of current assumptions. (F1)(F3)

R.2. The County should establish and adopt a plan, working with OCERS, to increase the pension percent funded liability to 80% from its current level of 70% by making additional payments to OCERS. This plan should be developed as part of the County Strategic Financial Plan is being updated in late summer 2016. As the 2017-2018 budget is being developed, the first advance payment of the Plan should be included. (F1) (F2)

R.3. The County should develop a policy to continue issuing short term Pension Obligation Bonds, so long as the discount from OCERS is available and there is enough net savings (which should be defined) after paying for cost of issuance and underwriter's discount. (F4)

R.4. The County should direct its lobbyists or work through the California State Association to find support in the legislature for a bill with additional pension reforms, beginning with the next legislative session that would further reduce the impact of unfunded pension liabilities. (F6)

R.5. The County should conduct a thorough analysis including the financial impact of implementing a Defined Contribution Retirement Plan or a hybrid plan, replacing the current Defined Benefit Plan, before January 2017. (F1) (F7)

R.6. The County should review the current practice of using taxpayer money to benefit eight non-County employees through the 401(a) retirement plan by the end of 2016. (Executive Director LAFCO; Executive Manager- Children & Family Commission and six OCERS executives). (F8)

R.7. The Board of Supervisors should, by the end of calendar year 2016, publicly revisit and determine if the Executive Compensation package 401(a) supplemental retirement plan for 44 County elected officials and top executives is still justifiable. (F8)

REQUIRED RESPONSES

The California Penal Code §933 requires any public agency which the Grand Jury has reviewed, and about which it has issued a final report, to comment to the Presiding Judge of the Superior Court on the findings and recommendations pertaining to matters under the control of the agency. Such comment shall be made no later than 90 days after the Grand Jury publishes its report (filed with the Clerk of the Court); except that in the case of a report containing findings and recommendations pertaining to a department or agency headed by an elected County official (e.g. District Attorney, Sheriff, etc.), such comment shall be made within 60 days to the Presiding Judge with an information copy sent to the Board of Supervisors.

Furthermore, California Penal Code Section §933.05 (a), (b), (c), details, as follows, the manner in which such comment(s) are to be made:

(a) As to each Grand Jury finding, the responding person or entity shall indicate one of the following:

(1) The respondent agrees with the finding

(2) The respondent disagrees wholly or partially with the finding, in which case the response shall specify the portion of the finding that is disputed and shall include an explanation of the reasons therefore.

(b) As to each Grand Jury recommendation, the responding person or entity shall report one of the following actions:

(1) The recommendation has been implemented, with a summary regarding the implemented action.

(2) The recommendation has not yet been implemented, but will be implemented in the future, with a time frame for implementation.

(3) The recommendation requires further analysis, with an explanation and the scope and parameters of an analysis or study, and a time frame for the matter to be prepared for discussion by the officer or head of the agency or department being investigated or reviewed, including the governing body of the public agency when applicable. This time frame shall not exceed six months from the date of publication of the Grand Jury report.

(4) The recommendation will not be implemented because it is not warranted or is not reasonable, with an explanation therefore.

(c) If a finding or recommendation of the Grand Jury addresses budgetary or personnel matters of a county agency or department headed by an elected officer, both the agency or department head and the Board of Supervisors shall respond if requested by the Grand Jury, but the response of the Board of Supervisors shall address only those budgetary /or personnel matters over which it has some decision making authority. The response of the elected agency or department head shall address all aspects of the findings or recommendations affecting his or her agency or department.

Comments to the Presiding Judge of the Superior Court in compliance with Penal Code section §933.05 are required from:

Responses Required:
Responses are required from the following governing body within 90 days of the date of the publication of this report:

The County of Orange Board of Supervisors:

90 Day Required Responses:	F1	F2	F3	F4	F5	F6	F7	F8	F9
Orange County Board of Supervisors	X	X	X	X	X	X	X	X	X

90 Day Required Responses:	R1	R2	R3	R4	R5	R6	R7
Orange County Board of Supervisors	X	X	X	X	X	X	X

Responses Requested:

Responses are requested from the following non-elected agency or department head:

Requested Responses:	F1	F2	F3	F4	F5	F6	F7	F8	F9
OC Employees Retirement System			X		X	X	X		

Requested Responses:	R1	R2	R3	R4	R5	R6	R7
OC Employees Retirement System	X	X	X			X	X

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APPENDICES

Appendix A Acronyms

ARC	Annual Required Contribution
ADC	Actuarially Determined Contribution
COLA	Cost of Living Adjustment
CAFR	Comprehensive Annual Financial Report
GASB	Governmental Accounting Standards Board
GFOA	Governmental Finance Officers Association
OCEA	Orange County Employee Association
OCERS	Orange County Employees Retirement System
OC	Orange County, California
OCSD	Orange County Sheriff/Coroner's Department
PEPRA	Public Employees' Pension Reform Act
UAAL	Unfunded Actuarial Accrued Liability

Appendix B Glossary

Actuarial Gain (Loss) - A measure of the difference between actuarial and expected experience based upon a set of actuarial assumptions. Examples include higher than expected salaries increases (loss) and a higher return on fund assets than anticipated (gain).

Amortization - (1) The portion of the cost of a limited-life or intangible asset charged as an expense during a particular period. (2) The reduction of debt by regular payments of principal and interest sufficient to retire the debt by maturity.

Auditor's Report - In the context of a financial audit, a statement by the auditor describing the scope of the audit and the auditing standards applied in the examination, and setting forth the auditor's opinion on the fairness of presentation of the financial information in conformity with generally accepted accounting principles (GAAP) or some other comprehensive basis of accounting.

Comprehensive Annual Financial Report (CAFR) – CAFR is the official annual financial report of a government. It includes the basic financial statements and their related notes prepared in conformity with GAAP. It also includes supporting schedules necessary to demonstrate compliance with finance-related legal and contractual provisions, required supplementary information, extensive introductory material and a detailed statistical section.

Defined Benefit Pension – Determined by a set formula, rather than depending on investment returns. An employee's pension payment is typically calculated based on length of service and salary earned and often contains provisions periodic for cost of living adjustments.

Defined Contribution Pension – Does not commit a specific amount of benefits at retirement. Employers and/or employees contribute to the employee's retirement account up to annually defined limits.

Normal Cost - The ongoing annual cost allocated to the system by a particular actuarial cost method for providing benefits (future cost). Normal cost payments are made during the working lifetime of the member.

Pension - A regular payment made during a person's retirement from an investment fund to which that person or their employer or both have contributed during their working life.

Pension Contribution - The amount paid into a pension plan by an employer and/or employee, pursuant to the terms of the plan, state law, actuarial calculations or some other basis for determinations.

Pension Trust Fund - A fund used to account for public employee retirement benefits. Pension trust funds, like nonexpendable trust funds, use the accrual basis of accounting and have a capital maintenance focus.

UAAL Amortization Payment - The portion of pension contributions designed to pay off (amortize) the unfunded actuarial accrued liability in a systematic fashion. Equivalently, it is a series of periodic payments required to pay off a debt.

Unfunded Actuarial Accrued Liability (UAAL) - The excess of the actuarial accrued liability over the actuarial value of assets conformity with GAAP.

Appendix C Basic Forms Pension Plans

Defined benefit plans

A defined benefit plan is a plan in which an employee's benefit on retirement is determined by a set formula, rather than depending on investment returns on that employee's savings. Traditionally, retirement plans have been administered by institutions which exist specifically for that purpose. A typical form of a defined benefit plan is the final salary plan, under which the pension paid is equal to the number of years worked, multiplied by a percentage of the member's salary at retirement usually adjusted for inflation. Normally a minimum number of years worked and/or a minimum retirement age are specified.

The employer's cost of a defined benefit plan is not easily predicted since it depends so much on the plan's ability to achieve the predicted rate of return on investment of the plan's assets as they are accrued. Since the pension benefit to the employee is defined, any shortfall in investment returns or longer than actuarially predicted employee life span post retirement for example must be made up by the employer. The employer assumes all the risk in providing the defined benefit.

Defined contribution plans

In a defined contribution plan, contributions are paid into an individual account for each member. The contributions are invested, for example in the stock market, and the returns on the investment (which may be positive or negative) credited to the individual's account. During retirement, the member's account is used to provide retirement benefits, sometimes through the purchase of an annuity which then provides a regular income. Defined contribution plans have become widespread all over the world in recent years, and are now the dominant form of plan in the private sector in many countries.

In a defined contribution plan, investment risk and investment rewards are assumed by each individual/employee/retiree and not by the plan sponsor or the employer, and these risks may be substantial. In addition, participants do not necessarily purchase annuities with their savings upon retirement, and bear the risk of outliving their assets.

Despite the fact that the participant in a defined contribution plan typically has control over investment decisions, the plan sponsor retains a significant degree of fiduciary responsibility over investment of plan assets, including the selection of investment options and administrative providers.

Appendix D 401(a) Executive & Elected Officials Retirement Plan County Contributions

Groups with contributions in 401(a)	Job Titles	Contribution Percentages
Executive Management Group 1	Member, Board of Supervisors	8%
	Treasurer-Tax Collector	
	Sheriff-Coroner	
	County Clerk/Recorder	
	Assessor	
	District Attorney	
	Auditor-Controller	
Executive Management Group 2	Chief Financial Officer	5%
	Human Resources Director	
	Chief Executive Officer (OCERS)*	
	Deputy County Executive Officer	
	Director Child Support Services	
	Director OC Community Resources	
	Director Dana Point Harbor	
	Registrar of Voters	
	County Executive Officer	
	Chief Information Officer	
	County Counsel	
	Public Defender	
	Director Health Care Agency	
	Airport Director	
	Director Social Services Agency	
	County Probation Officer	
	Director of Public Works	
	Clerk of the Board of Supervisors	
	Director OC Waste & Recycling	
Executive Management Group 3	Assistant CEO of External Operations (OCERS)*	4%
	Assistant CEO of Finance (OCERS)*	
	Assistant Sheriff	
	Assistant Treasuer-Tax Collector	
	Chief Bureau of Investigations, DA	
	Chief Deputy Probation Officer	
	Chief Investment Officer (OCERS)*	
	Chief Legal Officer (OCERS)*	
	Commander	
	County Librarian	
	Director/Chief Engineering	
	Director of Investment Operations (OCERS)*	
	Director of Mental Health	
	Director of Public Health	
	Executive Manager	
	UnderSheriff	
Other: Non-County Employees	Executive Manager (Children & Families Commissior	3%
	Executive Officer (LAFCO)*	

*** The County adminsters benefits for Courts, OCERS and several Special Districts (these are non-County employees) through Memorandums of Understandings (MOUs)**