



Laguna Woods Village

Employee Incentive Plan Questions & Answers

1. What was the Incentive Plan for employees of the Managing Agent of Laguna Woods Village?

The Incentive Plan (Plan) was a program that allowed the managing agent of Laguna Woods Village (the Agent) to reward employees who created savings for Laguna Woods Village residents that would not exist without their extra effort and ingenuity. It was a way to objectively reward an employee for work performed above and beyond their job duties and at the same time, reduce costs to Laguna Woods Village residents. Incentive Plans are a standard business practice in most industries that encourage creation of innovative efficiencies. The Plan saved money and improved service to the Village residents.

2. Why doesn't the Agent just reward employees for simply doing good work?

The Agent's employees are rewarded for doing good work—by way of their annual reviews and any merit pay increase. According to the terms of the Plan, incentive bonuses were paid only when real, hard-dollar savings were achieved, only to employees whose initiative and ingenuity saved money for the community, and the work was above and beyond their normal work. This was a pay-for-performance program, not an automatic year-end bonus for employees, and is like most incentive programs offered to employees throughout the Country.

3. Can you give some examples of cost-saving measures that would qualify for the Plan?

Employees reduced staff; changed systems, procedures, methodologies; and obtained rebates and subsidies, among many other things. While these initiatives resulted in substantial savings, employees were rewarded for more modest savings as well. For example, if an employee covered the workload of someone on maternity leave, it saved the Village the expense of hiring a temporary worker.

4. Where did the money come from to pay these incentive bonuses?

Employees were paid only when they achieved savings, and only if the year-end results were under budget. The General Manager of the Agent, a fiduciary of each of the Village's boards, administered the Plan but did not receive any payout from the Plan.

Each year, the Agent tallied the net savings achieved by the organization as a result of the aforementioned extra effort and ingenuity and applied 30 percent of the total toward employee compensation. Half of that pool—or 15 percent of the savings--was used to reward employees who created those savings. The remaining half was divided among other employees who implemented improvements in service (also above and beyond their job duties) to the community without any increase in costs, even if that service did not result in cost savings. The other 70% of the savings benefited the Village and was used to offset future increases in assessments or added to the reserves.

It is important to note that there was no money budgeted for the Plan because incentives could only be paid if the employees' drove costs UNDER BUDGET. The Agent only paid its employees for the first year of savings; in subsequent years, if the employee's ingenuity resulted in ongoing cost savings, those cost savings *were* included in the budget and went entirely to the community.

5. How much did the Agent's Plan cost residents?

The Plan did not cost the community anything extra because bonuses were paid out of the existing budget and only from the savings achieved. Incentive bonuses were paid at the end of the year only if savings were achieved and the employee could demonstrate ingenuity that effected savings and the entire year-end expenses came in under budget.

6. Couldn't the Agent have simply inflated its budget each year, and then reported the excess as "savings" achieved?

The budget is approved by the boards—not the Agent—and the lengthy process takes six months, dozens of meetings, and is reviewed by board members and peers. While the Agent presents a draft budget as a starting point, it is closely scrutinized by the boards, which can change any line item and evaluate any cost increases to make sure the item reflects real, tangible costs. The boards also have complete control over any increase in assessments. These checks and balances ensure the budget is within an acceptable range of accuracy. Again, employees were only awarded when they demonstrated either the ingenuity or extraordinary effort that caused the savings. Employees are not paid just because a budgeted line item may have come in under budget. The incentive bonus payments were included in the independent audits each year.

7. How did the Agent determine who should receive an incentive bonus?

Employees who qualified for the Plan were required to submit an application at the end of each year outlining what they did and document the savings achieved. Management reviewed the applications and selected those that were worthy of recognition. Incentive bonuses were not paid to employees if the savings were not a direct result of the employee's ingenuity or effort, or if their work caused expenses to increase elsewhere in the budget. An incentive bonus for a particular project was typically shared by several employees or even an entire department who worked together to achieve savings.

8. Why did the Agent need an Incentive Plan for its employees?

As the managing agent for the Village, the Agent does not make a profit on any of the work performed in the Village, other than the management fee. The Agent's goal is provide the services directed by the boards of directors at the lowest cost possible. Cost savings are essential to the Agent's mission and the Agent has brought millions of dollars of savings to the Village—savings that accumulate with time. Like most modern companies, the Agent used incentives to provide hard dollar-savings to encourage its employees to find more efficient, less expensive ways to provide the same high quality of service to the Village. Conversely, profit-oriented companies may base their incentive plans on increased revenues that were generated by increased sales or other earnings—the Agent does not “increase” its earnings.

9. How much money has the community saved overall as a result of the employee Plan?

The amount of savings varied widely year-to-year, as did the incentive bonuses. Since the program was established in 1996, innovative ideas to create efficiencies implemented by the Agent's employees have saved Laguna Woods Village over \$35,000,000. The average monthly savings are therefore nearly \$16 per manor per month. Incentive bonuses were based only on savings in the first year, even though the benefit to the community continues.

10. How much of that money was paid to employees through the Plan?

Over the past 12 years, approximately \$5.4 million in incentive bonuses have been awarded. The Agent has a payroll of approximately \$30 million a year. In general, incentive bonus payments ranged from \$250,000 to \$1 million a year, divided among all eligible employees. Even if the savings benefited the community for many years into the future, the employees involved received only one bonus based on savings in the first year.

11. How much did each employee receive?

The Agent cannot discuss the details of individual employee salaries or compensation due to privacy laws. The amount of individual bonuses varied widely, depending on the savings and the employee's involvement.

12. How did the incentive bonuses compare with the overall compensation of the Agent's employees who received it?

The average payout to Plan participants was about 4½% of their total compensation. According to salary.com, the typical bonus level for middle management is 10-15% of pay.

13. Critics claim that the Agent's Plan was a "closely guarded" secret and that the governing boards didn't even know it existed until it was "inadvertently discovered" by a board member in 2007. Is that true?

No. The Plan had been in existence for a dozen years. Its existence was reported in general to the boards and reflected in the minutes of board meetings and the terms were described in more detail to board presidents every year since its inception in 1996. Historically, the Agent and the boards regarded the incentive plan as a managerial function that was outside the policy functions of the boards.

14. "I've heard this Plan was kept a secret. Is that true?"

The existence of the Plan has been shared with directors every year since its inception in 1996 in an executive session meeting of each board, typically by the human resources director, as part of the annual presentation to the Boards on the Agent's compensation and benefits programs, and official minutes reflect that the human resources director presented the information. The Plan has also been discussed in more detail with board presidents every year. Savings to the community were recorded and reported in the financial reports presented each month to the boards at their respective open finance committee meetings.

15. Why didn't the boards take a more active role in deciding who received incentive bonuses and how much was paid out each year?

The Plan was administered by the employer, which is the Agent's responsibility—the Boards did not want to act nor be construed as an employer. This protected the boards from assuming an employer-employee relationship with the Agent's staff, which would expose them to legal liabilities. In 2007, Third Mutual decided to exercise limited oversight of the Plan, but all other boards determined that it was purely a managerial function of the Agent

and not part of their policy function. In fact, Cynthia Conners, past president of Third Mutual, wrote in a May 15, 2008 Director's Corner column that "The Directors have already recognized the challenge and difficulties involved in trying to decide what kind of performance should qualify for an incentive bonus."

16. How can residents be sure that nothing criminal was going on with the Plan?

The so-called Incentive Plan "scandal" was reported to the local District Attorney. The managing agent was fully cooperative, and legal counsel supplied all requested documentation to the District Attorney. No wrongdoing or malfeasance was revealed. Furthermore, the bonus payments were included in the annual financial audits of the Village's corporations every year.

17. Why did the Agent terminate the Plan in mid-2008?

The Plan was terminated because misinformation and inaccurate reporting by some Board Members, residents, and the OC Register caused some residents to believe that the Agent was being deceptive and that its employees did not deserve to receive any extra bonuses. The negative feedback discouraged employees from participating in the program and suggesting new ways to save, so the whole purpose of the Plan was undermined.