Transportation Authority of Marin

DATE: February 28, 2019

TO: Transportation Authority of Marin Board of Commissioners

FROM: Dianne Steinhauser, Executive Director
Li Zhang, Chief Financial Officer

SUBJECT: Review and Approval of the Recommended Funding Plans for TAM's Pension and OPEB Liabilities (Action), Agenda Item No. 6d

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RECOMMENDATION:

The TAM Board reviews and approves the recommended funding plans for TAM's Pension and OPEB (Other Post-Employment Benefits) liabilities.

The Finance and Policy Executive Committee reviewed all funding options presented by staff for both the Pension and OPEB liabilities along with background information at its February 11, 2019 meeting. The Committee discussed the options presented and agreed to recommend the following options to the TAM Board for review and approval. It was also discussed at the Finance and Policy Executive Committee meeting that the funding policies for both the pension and OPEB liabilities will be formalized and reviewed at least every two years in the future.

- To address the pension liability, TAM will pay off its unfunded liability as of June 30, 2019, about $346,786 as estimated in the July 30, 2017 CalPERS Actuarial Evaluation Report released in August 2018, and put the Non-Asset Gain and Asset Gain, totaling $129,970 as a one-time contribution into a Section 115 Trust.
- To address the OPEB liability, TAM will set up a Section 115 Trust and fund it annually with the amount of health retirement account benefits that all employees hired through LGS/RGS gave up ($27,500 annually) during the transition from LGS/RGS to TAM

Staff would also recommend that the TAM Board authorize staff to select a Section 115 Trust provider and fund the trust as recommended.

BACKGROUND:

With LGS (Local Government Services) and RGS (Regional Government Services) being the employers of record for its staff and being directly responsible for benefits offered, TAM, as a public agency, was spared from the stress of dealing with pension and OPEB liabilities over the last decade. In 2018, with the guidance and support of the Board, TAM became its own employer of record and entered into direct contracts with CalPERS for both the retirement and healthcare services.

The Board and staff understood the potential pension and OPEB liabilities as the result of becoming a CalPERS retirement and healthcare agency. Over the last year, staff has been working with the CalPERS actuarial staff to fully understand TAM's pension liability and funding options. Staff also has been working with MacLeod Watts, a company that specializes in actuarial service for OPEB, to fully understand TAM's OPEB liabilities and funding options.

Staff presented all background information and various options for both the pension and OPEB liabilities to the HR Ad Hoc Committee at its January 24, 2019 meeting. The HR Ad Hoc Committee thoroughly reviewed the information and options presented by staff.

The Ad Hoc Committee also discussed the funding policies for both the pension and OPEB liabilities. It's agreed that the pension liability needs to be addressed aggressively from the aspects of both a totally unfunded liability and cash flow needs of the agency due to its potential long-term significant impacts. On the other hand, because TAM provides only the minimum required OPEB medical benefit to its retirees, the OPEB unfunded liability can be addressed from a cash flow point of view. Staff plans to incorporate the discussed guidance into a formal TAM pension and OPEB funding policy in the near future.

DISCUSSION/ANALYSIS:

TAM's Pension Liability:

Background Information:

As a small agency with 12.8 full-time equivalent employees and currently only two retirees with limited years of service credit, TAM's unfunded pension liability is very moderate at this point in time. According to the June 30, 2017 TAM Actuarial Evaluation Report published by CalPERS as of August 2018, TAM's unfunded pension liability as of June 30, 2019 will be $346,788. Please note, the unfunded liability TAM was exposed to was $404,823 according to the New Agency Actuarial Valuation published by CalPERS as of October 2017 during the LGS/TAM separation process. The reduction in the estimated unfunded liability is due, mostly, to a higher than expected investment return from last year.

On the other hand, CalPERS, as planned, will reduce its discount rate from 7.25% to 7% for its June 30, 2018 evaluation reports, as part of its three-year phased strategy to bring the discount rate from 7.5% to 7.0%. Lowering the discount rate, also known as the assumed rate of return, means employers that contract with CalPERS to administer their pension plans will see increases in their normal costs and unfunded actuarial liabilities. While this creates financial challenges for all CalPERS agencies, it is an important step to ensure the long-term sustainability of CalPERS. The table below illustrates the sensitivity of TAM's unfunded liability to the change of discount rate.

As discussed at the HR Ad Hoc Committee, the principle of addressing the pension liability is to aggressively fund it up front, provide the agency with a fresh start as of June 30, 2019, and also set up a long-term funding goal to manage the unfunded liability without causing a major disruption to the financial stability of the agency.

Sensitivity Analysis				
As of June 30, 2017	**Plan's Total Normal Cost**	**Accrued Liability**	**Unfunded Accrued Liability**	**Funded Status**
7.25% (current discount rate)	17.127%	$3,125,408	$343,003	89.0%
6.0%	22.183%	$3,713,584	$931,179	74.9%
7.0%	17.812%	$3,217,225	$434,820	86.5%
8.0%	14.463%	$2,808,166	$25,761	99.1%

Recommended Funding Option:

The HR Ad Hoc Committee reviewed and discussed all funding options presented by staff and recommended the following to the Finance and Policy Executive Committee and Board for review and approval.

Under this option, TAM will make a one-time payment of $346,786 to totally pay off the liability projected as of June 30, 2019, as estimated in the July 30, 2017 TAM Evaluation Report, and put the Non-Asset Gain and Asset Gain, totaling $129,970 as a one-time contribution into the Section 115 Trust to address future unfunded liability.

- Fund sources: $337,769 from the LGS one-time payout for all accrued vacation and sick leave liability upon the LGS/TAM separation
- The remainder from TAM's indirect cost recovery funding pool, which is from the 50% indirect cost rate TAM is allowed to claim for all staff cost under RM2 (Balance as of June 30, 2018: $740,895, with additional $62,000 expected for current and future RM2 staff support)

Other than the one-time $129,970 contribution into the Section 115 Trust, TAM will also contribute up to a dollar value calculated as follows: 5% of the annual TAM Adm/Program Management Share (5% of the total revenue) of the Measure A/AA Revenue, or 100% of the Annual Unfunded Accrued Liability, whichever is less, into the Trust annually, starting in FY2019-20 to allow the agency to be better prepared for the expected future increase of unfunded liability due to various actuarial assumption changes and investment return volatility.

TAM's OPEB Liability:

Background Information:

In September 2018, staff engaged MacLeod Watts, who conducted an actuarial funding valuation of TAM's other post-employment benefit (OPEB) liabilities. The report provides detailed information on the annual cash payments as well as the potential unfunded actuarial liability TAM is now exposed to by joining the CalPERS Health Program.

Employees reflected in the report: 13 active employees and no retirees. TAM's only direct retiree is receiving post-employment medical benefits through her spouse's plan. The report is based on the census of the current group with typical assumptions for the likelihood of receiving retiree medical benefit from TAM.

Please note that TAM only offers the lowest level of retiree medical benefit to all employees hired after January 1, 2018. TAM's "unequal" resolution with CalPERS, effective July 2018, defines its contribution toward retiree medical plan premiums to be $1 per month during the first year as a PEMHCA (Public

Employees' Medical & Hospital Care Act) contracting agency. In subsequent years, TAM's contribution for retiree medical premiums will be 5% times the number of prior years' Minimum Employer Contribution (MEC). (2018 is $1 per month, increasing to 5% * $136 (2019 MEC) = $6.80 per month in 2019.)

For retirees hired prior to January 1, 2018, TAM will provide a benefit equal to 100% of the MEC, in exchange for the $2,500 annual health retirement account contribution that employees agreed to give up during the LGS/TAM separation.

Based on the report, TAM's unfunded OPEB liability as of July 1, 2018 is $308,351. However, this Unfunded Actuarial Accrued Liability (UAAL) number includes both explicit and implicit subsidies as shown in the table. A better understanding of the two different subsidies and their real impacts on TAM's financial picture is critical to the determination of the funding policy and ultimate funding option recommended.

Subsidy	Explicit	Implicit	Total
Discount Rate	6.0%	6.0%	6.0%
Actuarial Accrued Liability	$ 154,014	$ 154,337	$ 308,351
Actuarial Value of Assets	-	-	-
Unfunded Actuarial Accrued Liability	154,014	154,337	308,351
Funded Ratio	0.0%	0.0%	0.0%

- An "explicit subsidy" exists when the employer contributes directly toward retiree healthcare premiums. In this program, benefits include a monthly subsidy toward medical premiums for eligible retirees. Future excise taxes expected to be paid for "high cost" retiree coverage are also explicit costs and are included with explicit liabilities.
- Explicit subsidy - actual costs that requires TAM to have extra cash/funding to pay for.
- An "implicit subsidy" exists when the premiums charged for retiree coverage are lower than the expected retiree claims for that coverage. TAM's OPEB program includes implicit subsidy liabilities for retiree medical coverage prior to coverage under Medicare.
- Implicit subsidy – cost that TAM is paying ongoing as part of the premium payment for active employees, which is already included as part of ongoing staff benefit cost and require no extra cash/funding to pay for.
- GASB 75 required to prefund both explicit and implicit at the same time in order to use the trust fund return rate – 6%, otherwise lower discount return rate and higher OPEB liability.

Due to the fact that the implicit subsidy, which is half of the total unfunded liability, is being addressed annually as part of the ongoing premium payment, and also due to the fact that TAM currently has no retirees that require any premium contribution into their medical benefit, staff feel the projected annual benefit payments are a more appropriate guiding factor in the case of selecting OPEB unfunded liability funding option.

The following Projected Annual Benefit Payments Table illustrates the annual cash payment required for TAM to cover its OPEB liability over the next 15 years. The payment schedule on the left is based on the assumption that 75% of future retirees will elect the CalPERS medical coverage. The payment schedule on the right shows the explicit subsidy based on the assumption that 100% of future retirees will elect the CalPERS medical coverage.

After a thorough review of the background information and the potential impact of the OPEB liability on TAM's overall financial picture, the Ad Hoc Committee agreed that a less aggressive cash flow needs based funding policy is more appropriate and will be sufficient, as well, to address TAM's unfunded OPEB liability.

Projected Annual Benefit Payments					Total Explicit Only if 100% Enroll
Fiscal Year Ending June 30	Explicit Subsidy	Implicit Subsidy	Total		
2019	$ 134	$ 423	$ 557		$ 179
2020	2,828	13,070	15,898		3,771
2021	4,531	16,325	20,856		6,041
2022	5,002	9,513	14,515		6,669
2023	5,553	13,225	18,778		7,404
2024	6,162	17,847	24,009		8,216
2025	6,852	23,342	30,194		9,136
2026	7,678	22,911	30,589		10,238
2027	8,546	29,301	37,847		11,395
2028	9,518	37,135	46,653		12,691
2029	10,602	27,327	37,929		14,137
2030	11,845	35,763	47,608		15,794
2031	13,191	36,644	49,835		17,588
2032	14,635	26,697	41,332		19,513
2033	16,073	34,230	50,303		21,430

Recommended Funding Option:

Under the funding principal, the HR Ad Hoc Committee reviewed and discussed all funding options presented by staff and recommended the following to the Finance and Policy Executive Committee and Board for review and approval.

Under this option, TAM will set up a Section 115 Trust for the OPEB liability and fund it annually to cover the amount of health retirement account benefit that all employees hired through LGS/RGS gave up. The total annual amount is $27,500 which is more than sufficient to cover the cash flow needs of the annual explicit subsidy payments to retirees over the next 15 years based on the Projected Annual Benefit Payments Table.

TAM will accrue interest revenue (6% assumed) with the excess funds in the Trust and use those to reduce the total unfunded liability.

Please note that since TAM is not fully funding 100% of the recommended annual Actuarially Determined Contribution (ADC) amount, a low return rate will have to be used and therefore, total unfunded liability will increase. However, both staff and the HR Ad Hoc Committee fully understand the actuarial number change and are confident that this approach is sufficient to address the very limited OPEB liability to which the agency is exposed.

FISCAL CONSIDERATION:

Funds for the one-time CalPERS payment and the initial Section 115 Trust contribution for both the pension and OPEB accounts will be from the LGS one-time payout for all accrued vacation and sick leave liability and the indirect cost recovery funds TAM accumulated over the years from the RM2 funds. TAM's FY2018-19 Budget will be revised to reflect the pension and OPEB contribution costs for FY2018-19.

All future pension and OPEB contributions will be evaluated and approved during TAM's annual budget development cycle.

NEXT STEPS:

With the approval of the TAM Board, staff will work with CalPERS staff to obtain the final payment amount and make the one-time special payment to CalPERS to pay off TAM's unfunded pension liability as of June 30, 2019. Early payment will bring more interest savings for the agency. The amount will be $338,254, instead of $346,786 if payment can made prior to March 1, 2019. If the Board approves staff's recommendation at its February 28, 2019 meeting, staff will wire the funds to CalPERS on March 1, 2019.

Staff will also review and select a Section 115 Trust fund management team and fund the pension and OPEB trust accounts accordingly.

ATTACHMENTS:

Copies of the July 30, 2017 TAM Actuarial Evaluation Report released on August 2018 and the July 1, 2018 TAM OPEB Actuarial Valuation Report are available upon request