

## INTER OFFICE MEMO

**To:** Administration & Finance Committee

**Date:** 1/25/2023

**From:** Amber Johnson, Chief Financial Officer

**Reviewed by:** WC.

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**SUBJECT: Pension Funding Framework**

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### **Background:**

At the November 2022 Administration and Finance (A&F) Committee meeting, the Committee directed staff to review the Authority's current pension funding policy and recommend improvements, specifically the potential creation of a 115 trust for pensions to help mitigate future impacts of rising pension costs. In December 2022, staff presented an analysis of the Authority's current pension funding policy framework and alternative options.<sup>1</sup> After a thorough discussion, the Committee directed staff to explore the creation of a 115 trust for pensions and return at a future meeting with proposed details on how to seed the trust, and a proposed new pension policy that includes ongoing funding options for consideration.

### **Creation of a Pension 115 Trust:**

Since June 2010, the Authority has participated in an Internal Revenue Code Section 115 trust for Other Post Employment Benefits (OPEB) established by Public Agency Retirement Services (PARS), to set aside funds to pay for future OPEB benefits that will be collected by current employees (the "OPEB 115 Trust"). As of December 2022, there was approximately \$4.7 million in the Authority's OPEB 115 Trust. Since inception, the OPEB 115 Trust account has earned approximately 4% return on investment. No funds have been withdrawn from the trust to pay benefits to date.

PARS also offers a Pension Rate Stabilization Program (PRSP) 115 trust specifically designed to address GASB 68 pension liabilities and stabilize future costs. Furthermore, PARS has created an IRS-approved, tax-exempt combination Section 115 trust that can be used by local agencies to set aside funds for both future OPEB and pension expenses.

Staff recommends the establishment of a new combination irrevocable Trust to replace the existing OPEB 115 Trust, with one that will have two accounts (the "Combination 115 Trust"). One account will be for the existing OPEB assets (the "OPEB 115 Account") and the other account will be for prefunding pension liabilities (the "Pension 115 Account"). In the Combination 115 Trust, funds contributed for pre-funding OPEB and pension liabilities are separately accounted for, although combined under one trust, resulting in administrative and cost efficiencies. The IRS Private Letter Ruling that verifies the tax-exempt status of the PARS Combination 115 Trust program is included as Attachment 1. A draft Administrative Services agreement with PARS is included as Attachment 2.

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<sup>1</sup> [December 2022 A&F Item #5](#)

### **Source of Funding:**

Due to the restrictive nature of most of the Authority's external funding sources, passenger fares are the Authority's logical source of funding the Pension 115 Account. In the year just ended (FY 2022), the Authority collected \$2.2 million in passenger fares. As post-pandemic ridership continues to recover, this amount is projected to grow in future years.

### **Initial Funding Options:**

Staff recommends seeding the Pension 115 Account with an initial investment of at least \$500 thousand. The Authority has two sources from which it can transfer these initial funds: the Safe Harbor Reserve (with a balance of \$1.5 million), or FY 2024 budgetary savings (up to \$1 million, as outlined in the December 2022 A&F staff report). Use of Safe Harbor Reserve funds would have a net zero effect on the Authority's total reserve funds, as this would merely transfer funds from one reserve designation to another. Use of FY 2024 budgetary savings would increase the Authority's total reserve funds. Additionally, any transfer of funds to the Pension 115 Account would restrict their use to pension expenses only.

Because the goal of the pension funding framework is to set aside additional funds for pensions, Staff recommends using FY 2024 budgetary savings as the source of these initial funds.

### **Ongoing Funding Policy Options:**

The current pension funding policy for discretionary payments directly to CalPERS compares actual pension costs to budgeted pension costs and permits staff to contribute any budgetary savings up to \$100,000 in a given year as an additional payment directly to CalPERS. Additionally, payments greater than \$100,000 can be approved during the budget approval process. Should the Authority wish to retain this policy, a simple edit could be made to indicate that these payments would be sent to the Pension 115 Account, rather than directly to CalPERS.

Since the Authority will utilize fare revenue as its source of funds, an alternative policy for ongoing funding of the Pension 115 Account could be tied to fare revenues. For example, "If fare revenues exceed \$2.5 million in a given fiscal year, the General Manager is allowed to authorize a contribution to the Pension 115 Account in an amount up to 3% of the fare revenues collected. If this amount exceeds \$100,000, A&F and Board authorization would be required."

Another alternative would be to set a flat contribution amount of \$100,000 per year.

### **Use of Funds:**

Funds that are set aside in the Pension 115 Account will be restricted for use solely on pension costs. The PARS Combination 115 Trust structure would allow the Authority to reimburse itself for prior and current year pension payments to CalPERS – both normal cost and unfunded accrued liability payments. This gives the Authority a lot of flexibility in case of future budgetary constraints that would necessitate withdrawing funds from the trust. However, it is the recommendation of staff that the Authority take a "long view" on this account and refrain from withdrawing from the account unless absolutely necessary. Staff recommends that Board authorization should be required to withdraw from the account. This authorization could take place during the budgetary approval cycle, or, on an emergency basis if circumstances warrant an emergency withdrawal.

**Summary of Proposed Framework:**

In summary, staff recommends the following pension funding framework to be considered by the Committee, with three options for an ongoing funding policy:

<b>Framework Element:</b>	<b>Staff Recommendation:</b>		
<b>Pension Funding Vehicle</b>	Pension 115 Account under a Combination 115 Trust		
<b>Source of Pension Funds</b>	Fare Revenues		
<b>Initial Funding</b>	\$500,000 from FY 2024 budgetary savings		
<b>Ongoing Funding</b>	Current policy of actual pension costs vs. budgeted pension costs	New policy of 3% of fare revenues when fare revenues exceed \$2.5 million	New policy of \$100,000 flat per year
<b>Use of Funds</b>	Must be authorized by the Board either through the budget approval process or on an emergency basis		

**Financial Implications:**

The Authority is presently in a strong position to implement this set of pension-related policies. While the long-term impact of this pension-related set of actions is impossible to quantify, it is fair to conclude that reserving funds for pension costs now and into the future will bring significant budgetary benefits over time.

**Recommendation:**

Staff recommends that the Committee select a funding policy direction and forward it to the full Board of Directors for approval.

**Attachments:**

Attachment 1: IRS Letter Ruling

Attachment 2: Draft Agreement for Administrative Services with PARS

























EXHIBIT 1C  
DATA REQUIREMENTS

PARS will provide the Services under this Agreement contingent upon receiving the following information. Agency is solely responsible for ensuring that all information and documentation provided to PARS is true, correct, and authorized:

1. Executed Legal Documents:
  - (A) Certified Resolution
  - (B) Adoption Agreement to the Public Agencies Post-Employment Benefits Trust
  - (C) Trustee Investment Forms
  
2. Contribution – completed Contribution Transmittal Form signed by the Plan Administrator (or authorized Designee) which contains the following information:
  - (A) Agency name
  - (B) Contribution amount
  - (C) Contribution date
  - (D) Contribution method (Check, ACH, Wire)
  
3. Distribution – completed Payment Reimbursement/Distribution Form signed by the Plan Administrator (or authorized Designee) which contains the following information:
  - (A) Agency name
  - (B) Payment reimbursement/distribution amount
  - (C) Applicable statement date
  - (D) Copy of applicable premium, claim, statement, warrant, and/or administrative expense evidencing payment
  - (E) Signed certification of reimbursement/distribution from the Plan Administrator (or authorized Designee)
  
4. Other information pertinent to the Services as reasonably requested by PARS and Actuarial Provider.