

REGIONAL TRANSIT ISSUE PAPER

Agenda Item No.	Board Meeting Date	Open/Closed Session	Information/Action Item	Issue Date
22	06/28/10	Open	Information	06/18/10

Subject: Establishing a Comprehensive Reserve Policy

ISSUE

Whether or not to establish a comprehensive reserve policy for Regional Transit (RT).

RECOMMENDED ACTION

None. This item is presented as an information item.

FISCAL IMPACT

None. If adopted, future fiscal impacts will depend upon the level of funds committed annually through the budget process to build and maintain reserve funds.

DISCUSSION

Reserve funds are called by many names including rainy day funds, unreserved, undesignated fund balances, and contingency funds. These funds may be used at a government's discretion to address temporary cash flow shortages, emergencies, unanticipated economic downturns, and one-time opportunities. (*National Advisory Council on State and Local Budgeting Practice, Section 4.1.4*)

The Government Finance Officers Association's (GFOA) Best Practice recommendation is, at a minimum, that governments, regardless of size, maintain unrestricted fund balance (reserves) of no less than two months of regular general fund operating revenues or regular general fund operating expenditures, whichever is more predictable in a government's particular circumstances. Factors for the government to consider include; (1) the predictability of its revenues and the volatility of its expenditures; (2) its perceived exposure to significant one-time outlays such as disasters, immediate capital needs, and state budget cuts; (3) liquidity; and (4) prior commitments and assignments of funds.

The Federal Transit Administration (FTA) has advised RT that the identification of funds for an operating reserve of 1.5 months of expenditures will be an important element of a successful Financial Capacity Assessment (FCA) for the Blue Line to Cosumnes River College (formerly South Line Phase 2) New Starts project. RT is preparing to resubmit information for the FCA with a request to enter Final Design on the project. Since annual expenditures are expected to rise over time, the level of recommended reserves will also rise to meet the 1.5 months equivalent. The most recent run of the Financial Forecasting Model (FFM) indicates that 2012 is the first year funds will be available to apply toward funding reserves. Assuming all available funds are applied toward reserves, the first year that 1.5 months of operating reserves would be reached is 2013.

As a secondary reserve element of the FCA, the FTA has further advised that a capital reserve equivalent to 10% of the total project cost must also be identified. While the exact amount of that reserve is yet to be determined since some of the project costs have already been experienced, the total of that reserve may require as much as \$27 million by the end of the project in 2015.

Approved:

Presented:

General Manager/CEO

Chief Financial Officer

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History of RT Reserves

The concept of reserves is not new to RT. On June 25, 1990, the RT Board established a ***Reserve for Catastrophic Losses*** with the adoption of Resolution No. 90-06-1254. \$1 million was placed on deposit with a like amount dedicated to the fund until \$5 million was reached in 1994. All funds budgeted each fiscal year for the establishment of reserves were in addition to funds budgeted each fiscal year as reserves for routine general liability claims. A 2/3 majority vote of the full Board was required to use the funds on reserve.

On May 5, 1994, the RT Board repealed the above-noted resolution and replaced it with Resolution No. 94-05-2138, which established a ***Dedicated Combined Emergency Response Fund*** to be used for Underground Storage Tank Corrective Actions and Related Third Party Damages in Addition to General Emergencies. This action expanded the potential use of the unencumbered \$5 million on reserve for catastrophic losses. Expenditures from the fund required approval of the Board. Subsequent to this action, RT's underground storage tanks were removed, eliminating the need to retain the reserves for that purpose.

On July 24, 1995, the RT Board adopted Resolution No. 95-07-2424, establishing a ***Rail Development Fund*** (RDF). This action authorized the establishment of a permanent fund that would be a restricted cash account to meet capital replacement and service expansion needs. The source of the account was surplus operating funds at year-end that are derived from transit revenues or other operating funding sources that may be carried over. All expenditures and encumbrances from this account required Board authorization, such as appropriations through adoption of the annual budget or by separate action.

On January 23, 2006, the Board adopted Resolution No. 06-01-0018, adopting a ***Self-Insurance Reserve Policy***. This policy established a comprehensive level of District self insurance reserves in order to ensure that the District can withstand insurance losses specifically from workers' compensation and general liability claims. The policy establishes a goal of the Board to set the minimum Reserve balance at 75% and the maximum Reserve balance at 100% of the actuarially determined liability. In the event that the reserve balance is below the minimum level, in addition to the required budgeted amount for claims, an additional one half of one percent of the annual operating budget shall be appropriated to the Reserves until such time as the minimum reserve balance is achieved. Funding is achieved through the annual budget appropriation process.

Current Status of RT Reserves

Combined Emergency Response Fund: This fund was depleted to meet fiscal shortfall in FY 2007 through Board adoption of the FY 2008 Budget.

Rail Development Fund: Although maintained successfully for many years after its creation, the fund was depleted to meet the fiscal shortfall on the Amtrak Folsom project. Use of funds were authorized by Resolution No. 06-11-0204, Amending the Consolidated Capital Improvement Program and the FY2007 Capital Budget for the Amtrak/Folsom Project.

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Self-Insurance Reserve: As of June 30, 2009, RT had \$4,002,067 in cash reserves designated for Self-Insurance claims. As of May 31, 2010, the balance increased to \$4,150,386. These reserves, along with the budgeted current year Self-Insurance expense are used to pay current and past general liability (PLPD) and workers compensation claims. The actuarially determined Self-Insurance liability as of June 30, 2009 was \$21,850,000. Therefore, the **unfunded** Self-Insurance Reserve balance liability as of June 30, 2009 (at 100%) was \$17,847,933, or \$12,385,433 (at 75%).

Rationale for a Reserve Policy

In a concerted effort to keep service on the street, RT has directed all resources toward this purpose. As revenues have declined, funds that may have been available for reserves have been used to cover operating costs. The identification of funds that could be designated for reserves at the close of the fiscal year in RT's cumulative, unrestricted net assets, has not been possible since 2006.

Having now experienced the full impact of multiple, simultaneous fiscal emergencies without reserves, RT's current administration advises that a program of fiscal restraint and responsibility must be developed and maintained through the adoption and adherence to a comprehensive reserve policy. A sound reserve policy is necessary to provide the framework for the designation of future funds received in excess of expenditures in order to plan for a fiscally responsible future for the District. A table of how potential future funds may be accumulated and designated toward the proposed categories of reserves is provided as Attachment 1.

The level of funds depicted in Attachment 1 is based upon projections from the updated Financial Forecasting Model (FFM). The FFM projects balances of revenues over expenses starting in FY 2012. The projections are based on a model that moderately increases operating expenses and restores recently cut service over time, while also providing for the operation of the Green Line to the River District and the Blue Line to Cosumnes River College upon their completion.

When this item is proposed for adoption by the Board on July 26, 2010, the Policy below will be attached to the Resolution as Exhibit A.

Proposed Comprehensive Reserve Policy (Policy)

Recognizing the need to move forward with a fiscally responsible strategy for the use of future revenues in excess of expenditures, the Board of Directors hereby adopt a comprehensive approach to establishing, maintaining and building reserves to meet the levels adopted with this proposed action. The Policy designates three reserve funds as follows:

- Operating Reserve : 1.5 - 2 Months of Operating Expenditures
- Self-Insurance Reserve: Minimum of 75%; Maximum of 100% of Actuarial Liability
- Capital Reserve: 10% of BLRCC Project Cost

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Operating Reserve

Purpose: To maintain a minimum of 12.5% of the annual operating budget, which is the equivalent of 1.5 months of operating expenditures, or a maximum of 16.7% of the annual operating budget, which is equivalent to 2 months of operating expenditures in reserve for operations to be used if necessary to meet emergencies or unexpected operating contingencies.

Authorization: Use of operating reserves will require a 2/3 vote of the RT Board.

Replacement: Use of operating reserves such that the balance falls below the minimum threshold will require replacement to the minimum level as soon as possible but no less than within the next three budget years immediately following the year funds are used.

Self-Insurance Reserves

The District chooses to be self-insured up to the amounts stated in RT's excess insurance coverage for both workers' compensation and general liability claims and practices appropriate risk management techniques to administer and minimize the cost of all claims, including those falling within RT's self-insured retention level. This section of the Comprehensive Reserve Policy applies to the Self Insurance Reserve Policy for RT's workers' compensation and general liability self insurance programs.

Purpose: To set a prudent and financially sound Self-Insurance Reserve balance. The minimum balance shall be set at 75% and the maximum Reserve balance shall be set at 100% of the actuarially determined liability.

Authorization: The Self-Insurance Reserve is funded through annual budgeted appropriation based on an actuarial study performed each year to determine the rate as a percentage of operating budget to be budgeted to pay for expenses incurred for the following:

1. Workers' Compensation Reserve for Claims Incurred and Claims Incurred, but Not Reported
2. General Liability Reserve for Claims Incurred and Claims Incurred, but Not Reported

Replacement:

In the event that the Reserve balance is below the minimum level, in addition to the required budgeted amount, a minimum of an additional one half of one percent of the annual operating budget shall be appropriated to the Self-Insurance Reserves until such time as the minimum reserve balance is achieved.

Capital Reserve

Purpose: The initial purpose of this fund is to build and maintain a level of reserves equal to 10% of the total project cost for the Blue Line to Cosumnes River College (BLCRC) project by 2015,

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or the year project is completed, to provide additional contingent coverage for cost overruns as required by the FTA.

Capital Reserve (Continued) :

Authorization: Use of capital reserves will require a 2/3 vote of the RT Board.

Replacement: Use of capital reserves to pay for BLCRC project contingencies before the end of the project must be restored to the required funding level as soon as possible, commencing with the next budget year or sooner if funds become available.

Subsequent Use of Capital Reserve: Once the BLCRC project is closed out, funds remaining in this reserve may be allocated for other budgeted purposes of the District depending upon the nature of the funds. Inflexible funds can only used for capital purposes; flexible funds can be directed to supplement the operating budget, operating reserves, other capital purposes, or maintained within a capital reserve for future projects, replacements, or to meet local match requirements of project grants.

Appropriation of Reserve Funds:

Through annual budget appropriations of revenues in excess of board approved expenditures, RT will commit available funds first to the Operating Reserve, then to the Capital Reserve, and then to the Self-Insurance Reserve, starting in FY 2012 and continuing until the maximum funding levels have been reached in each reserve account.

Applicability and Authorized Use of Reserve Funds:

RT will strive to meet the adopted funding levels in each of the reserve accounts in the shortest timeframe possible. Until those levels are maximized, the reserve funds will each serve as the secondary and tertiary reserves for the others. Should the need for use of reserves arise, staff will seek authorization from the Board for such use, which will require a 2/3 vote of the Board to approve.

Financial Reporting of Reserves:

All reserves will be designated within the undistributed net assets of the District as either Operating, Capital, or Self-Insurance Reserves for financial reporting purposes.

Conclusion:

Although funds are not currently available to apply to the reserves established by the proposed Policy, the item is brought forward at this time to receive Board input its design and feasibility. If adopted on July 26th as a demonstration of intent to fund the reserves, it will become part of the development process for the FY 2012 and future budgets.

POTENTIAL RESERVE FUNDING SCHEDULE BASED ON FINANCIAL FORECASTING MODEL

(In Millions)	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Total Revenues	\$122,187	\$125,659	\$133,307	\$143,008	\$158,610	\$164,751	\$171,021
Total Expenses	\$109,962	\$116,607	\$125,076	\$138,466	\$150,045	\$161,622	\$169,519
Annual Oper. Surplus (Deficit)	\$12,225	\$9,052	\$8,231	\$4,542	\$8,565	\$3,129	\$1,502
Transfers to Operating Reserve	12,000	2,800	1,050	1,500	7,000	2,000	500
Transfers from Operating Reserve							
Operating Reserve cum.balance	12,000	14,800	15,850	17,350	24,350	26,350	26,850
Transfers to Self-Insurance Reserve		-	-	-	-	-	1,399
Self-Insurance Res Cum Balance		-	-	-	-	-	1,399
Transfers to Capital Reserve	225	6,252	7,181	3,042	1,565	1,129	-
Capital Reserve cum. Balance	225	6,477	13,658	16,699	18,264	19,393	20,000
Ending Cash Balance	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Cumulative Reserve Balance (All)	\$ 12,225	\$ 21,277	\$ 29,508	\$ 34,049	\$ 42,614	\$ 45,743	\$ 48,249

Operating Reserve requirement (Min 1.5x)	\$13,745	\$14,576	\$15,635	\$17,308	\$18,756	\$20,203	\$21,190
Operating Reserve requirement (Max 2.0x)	\$18,327	\$19,435	\$20,846	\$23,077	\$25,008	\$26,937	\$28,253

TABLE CONTINUED:

(In Millions)	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025
Total Revenues	\$178,958	\$187,243	\$203,804	\$215,526	\$247,649	\$275,553	\$289,629
Total Expenses	\$177,829	\$186,576	\$195,614	\$206,140	\$239,935	\$273,428	\$293,290
Annual Oper. Surplus (Deficit)	\$1,128	\$668	\$8,190	\$9,386	\$7,714	\$2,125	(\$3,662)
Transfers to Operating Reserve	120	510	5,122	1,755	5,632	593	-
Transfers from Operating Reserve							(3,662)
Operating Reserve cum.balance	26,970	27,480	32,602	34,357	39,989	40,582	36,920
Transfers to Self-Insurance Reserve	1,008	158	3,690	10,131	2,082	1,532	
Self-Insurance Res cum Balance	2,407	2,565	6,255	16,386	18,468	20,000	20,000
Transfers to Capital Reserve	-	-	(2,500)	(2,500)	-	-	-
Capital Reserve cum. Balance	20,000	20,000	17,500	15,000	15,000	15,000	15,000
Ending Cash Balance	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Cumulative Reserve Balance (All)	\$ 49,377	\$ 50,045	\$ 56,357	\$ 65,743	\$ 73,457	\$ 75,582	\$ 71,920

Operating Reserve requirement (Min 1.5x)	\$22,229	\$23,322	\$24,452	\$25,768	\$29,992	\$34,178	\$36,661
Operating Reserve requirement (Max 2.0x)	\$29,638	\$31,096	\$32,602	\$34,357	\$39,989	\$45,571	\$48,881

NOTE 1: ASSUMES POTENTIAL RESERVE ACCUMULATION WITHOUT DEPLETION FOR CONTINGENCIES.

NOTE 2: PRELIMINARY ESTIMATES OF AVAILABLE FUND BALANCE IN FY 2012 FOR RESERVES ARE DEPENDENT UPON THE REALIZATION OF ALL PROJECTIONS IN FY 2011 ON REVENUE GENERATION AND COST CONTAINMENT.