

# REGIONAL TRANSIT ISSUE PAPER

Agenda Item No.	Board Meeting Date	Open/Closed Session	Information/Action Item	Issue Date
10	09/27/10	Open	Action	09/13/10

Subject: Establishing a Comprehensive Reserve Policy

## ISSUE

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

## RECOMMENDED ACTION

Adopt Resolution 10-09-\_\_\_\_\_, Repealing Resolution No. 94-05-2138; Resolution No. 95-07-2424; Resolution No. 06-01-0018; and Establishing a Comprehensive Reserve Policy.

## FISCAL IMPACT

None as a result of this action. Future fiscal impacts will depend upon the level of funds committed annually through the budget process to build and maintain reserve funds.

## DISCUSSION

On June 28, 2010, staff presented an information item on establishing a Comprehensive Reserve Policy (Policy) to the Board. Board members expressed opinions and asked questions on several aspects of the proposed policy. The proposed Policy remains as presented with multiple levels of reserves each for operating, capital, and self-insurance reserves.

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 which ever 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.

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Approved:

Presented:

FINAL 9/30/10

General Manager/CEO

Chief Financial Officer

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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.

### **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.

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.

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 (0.0025%) 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.

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## ***Current Status of RT Reserves***

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

Rail Development Fund: 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.

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 Property Liability Property Damage (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 was \$17,847,933 (at 100%), or \$12,385,433 (at 75%).

## **Determination of Self-Insurance Reserves:**

At the June 28<sup>th</sup> Board meeting, the question was asked whether or not the liability upon which the self-insurance reserve level is based on the amount of the claims or the actual payouts on claims. Below is an explanation of how the liability is determined at RT.

Self insurance claim reserves are recorded and reported in accordance with Governmental Accounting and Financial Reporting Standards. The two standards, GASB 10 & 30, require Districts to record an estimated loss from a claim as an expense and a liability when two conditions are met: the loss is probable and the loss can be reasonably estimated.

RT, like most Transit Agencies, is self-insured for General Liability and Worker's compensation claims. The liabilities are based on a combination of actual case reserves and IBNR (incurred but not reported) claims. The General Liability case reserves are based on an estimated claims payout determined by RT staff, whereas, Worker's Compensation claims are based on a third party administrator's estimation.

On an annual basis, RT engages an audit firm to test the adequacy of the estimated claim payouts. As required by the two standards noted above, IBNR claims are determined by an actuary. Therefore, the liability is based on estimates of the amounts needed to pay prior and current year claims and to allow accrual of estimated IBNR.

## ***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

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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.

### Availability of Funds for Reserves

The level of funds available to fund future reserves 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.

### Appropriation of Reserve Funds:

As funds are designated for reserves through annual budget appropriations of revenues in excess of Board approved expenditures, RT will apply funds first to the Operating Reserve, then to the Capital Reserve, and then to the Self-Insurance Reserve. Current indicators are that funding of reserves will start in FY 2012, and continue 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 capital and operating reserve funds will each serve as the secondary reserve for the other. Should the need for use of operating or capital reserves arise, staff will seek authorization from the Board for such use, which will require a 2/3 vote of the Board to approve.

Self-insurance reserves will only be used for the purposes for which the reserve was established and will not be used to support either capital or operating reserves. Use of self-insurance reserves will be governed by past practices regarding settlement of claims with self-insurance reserve funds and will not require advance Board approval.

The Policy is attached to the Resolution as Exhibit A.

Staff recommends adoption of the Policy as a demonstration of intent to fund reserves; it will become part of the development and approval process for the FY 2012 and future budgets.

RESOLUTION NO. 10-09-\_\_\_\_\_

Adopted by the Board of Directors of the Sacramento Regional Transit District on this date:

September 27, 2010

**REPEALING RESOLUTION NO. 94-05-2138; RESOLUTION NO. 95-07-2424;  
RESOLUTION NO. 06-01-0018; and ESTABLISHING A COMPREHENSIVE  
RESERVE POLICY**

BE IT HEREBY RESOLVED BY THE BOARD OF DIRECTORS OF THE  
SACRAMENTO REGIONAL TRANSIT DISTRICT AS FOLLOWS:

THAT, the Comprehensive Reserve Policy set forth in attached Exhibit A is hereby  
adopted.

\_\_\_\_\_  
STEVE MILLER, Chair

A T T E S T:

MICHAEL R. WILEY, Secretary

By: \_\_\_\_\_  
Cindy Brooks, Assistant Secretary

**COMPREHENSIVE RESERVE POLICY**  
**Sacramento Regional Transit District**

**September 27, 2010**

## **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**

*Purpose:* To maintain a minimum of 12.5% of the annual operating budget, which is the equivalent of 1.5 months of operating expenditures, up to 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 Policy applies to the Self-Insurance Reserve 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, as funds are available, 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, or the year project is completed, to provide additional contingent coverage for cost overruns as required by the FTA.

*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 be used for capital purposes; flexible funds can be directed to supplement the operating budget, operating reserves, self-insurance 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 capital and operating reserve funds will each serve as the secondary reserve for the other. Should the need for use of operating or capital reserves arise, staff will seek authorization from the Board for such use, which will require a 2/3 vote of the Board to approve.

Self-insurance reserves will only be used for the purposes for which the reserve was established and will not be used to support either capital or operating reserves. Use of self-insurance reserves will be governed by past practices regarding settlement of claims with self-insurance reserve funds and will not require advance Board approval.

## **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.