SPECIAL MEETING / BOARD STUDY SESSION

Peninsula Corridor Joint Powers Board

Due to COVID-19, this meeting will be conducted via teleconference only (no physical location) pursuant to the Governor's Executive Orders N-25-20 and N-29-20.
Directors, staff and the public may participate remotely via Zoom at
https://us06web.zoom.us/j/94068795851?pwd=Y3NZUlBQRkRNUzRZaE5xSEFIRkRNdz09
or by entering Webinar ID: **940 6879 5851,** Passcode: **136108** in the Zoom app for audio/visual capability or by calling 1-669-900-6833 (enter webinar ID and press **#** when prompted for participant ID) for audio only. The video live stream will be available after the meeting at http://www.caltrain.com/about/bod/video.html

Public Comments: Members of the public are encouraged to participate remotely. Public comments may be submitted to publiccomment@caltrain.com prior to the meeting's call to order so that they can be sent to the Board as soon as possible, while those received during or after an agenda item is heard will be included into the Board's weekly correspondence and posted online at http://www.caltrain.com/about/bod/Board_of_Directors_Meeting_Calendar.html.

Oral public comments will also be accepted during the meeting through *Zoom or via the teleconference number listed above. Public comments on individual agenda items are limited to one per person PER AGENDA ITEM. Use the Raise Hand feature to request to speak. For public participants calling in, dial *67 if you do not want your telephone number to appear on the live broadcast. Callers may dial *9 to use the Raise the Hand feature for public comment and press *6 to accept being unmuted when recognized to speak for two minutes or less. Each commenter will be automatically notified when they are unmuted to speak for two minutes or less. The Board Chair shall have the discretion to manage the Public Comment process in a manner that achieves the purpose of public communication and assures the orderly conduct of the meeting.

Friday, August 20, 2021 **1:00pm – 5:00pm**

1. Call to Order/Roll Call
2. Caltrain Governance Special Meeting #4 (including governance process updates; overview of self-directed governance options and evaluation approach; financial and legal analyses; Board and leadership perspectives on options; and next steps)
   - PRESENTATION & DISCUSSION – Sebastian Petty, Howard Permut, Katie Miller
   - BOARD GUIDANCE AND DIRECTION
3. Adjourn

AGENDA ITEM #2
AUGUST 20, 2021

PENINSULA CORRIDOR JOINT POWERS BOARD
STAFF REPORT

TO: Joint Powers Board

FROM: Michelle Bouchard
Acting Executive Director

SUBJECT: **CALTRAIN GOVERNANCE SPECIAL MEETING #4**

ACTION

It is recommended that the Peninsula Corridor Joint Powers Board (Board) receive a staff presentation providing information for the fourth Caltrain governance special meeting of 2021, including information on governance process updates; overview of self-directed governance options and evaluation approach; financial and legal analyses; Board and leadership perspectives on options; and next steps.

SIGNIFICANCE

This is the fourth of six planned special Board meetings on Caltrain governance to support development of the Board's 2021 recommendation on governance by December 2021. At the fourth meeting on August 20, Sebastian Petty, Ratna Amin, Howard Permut, and Katie Miller will present and moderate the Board's discussion. The special meeting materials include an extensive powerpoint that presents information about the self-directed governance options for analysis, as well as the results from the evaluation of the options. The JPB's general counsel, James Harrison of Olson Remcho, will present on legal analysis findings, and Rodrigo Macias of MGO, Inc. will present on financial analysis findings. It will also include information about perspectives from Board members and member agency leadership on the options. Lastly, it will include information about next steps in the 2021 governance process.

This staff report includes four attachments:

- Attachment 1: Presentation slides for the August 20, 2021 Special Meeting;
- Attachment 2: Information regarding the interviews that were conducted with Board members and partner agency leadership;
- Attachment 3: A detailed report from Olson Remcho regarding legal analysis of the self-directed governance options; and,
- Attachment 4: A detailed report from Macias Gini & O'Connell (MGO) regarding financial analysis of the self-directed governance options for pension unfunded accrued liability, other post-employment benefit unfunded accrued liability, and compensated absences liability.

BACKGROUND

In August of 2019, the Board received a Caltrain Organizational Assessment report from Howard Permut as part of the Caltrain Business Plan effort. In November 2019, the

Board held a special workshop to discuss the Caltrain organization and governance issues in greater depth. Following the workshop, at its regular December 2019 meeting, the Board agreed to form a Governance Ad Hoc Committee and hire a special counsel to research and clarify key issues in a fact-finding report. The Governance Ad Hoc Committee met regularly in the first half of 2020, and in July 2020, the special counsel presented their fact-finding report to the full Board.

In August 2020, the Board held a substantial discussion regarding the placement of Measure RR on the November 2020 ballot in San Francisco, San Mateo, and Santa Clara counties. If approved by two-thirds of the voters in all three counties, Measure RR would provide dedicated funding to Caltrain via a 1/8 cent sales tax in each county. At the August 2020 meeting, the Board approved Resolution 2020-42 to authorize placement of Measure RR on the ballot. This resolution also included provisions related to governance, including a commitment by the Board to develop and approve a governance recommendation by December 2021.

Over two-thirds of the voters in San Francisco, San Mateo, and Santa Clara counties approved Measure RR on November 3, 2020. Following its passage, the Board requested that Caltrain staff commence the 2021 governance process to support the Board in development of its governance recommendation by the end of 2021. A Governance Process Ad Hoc Committee of the Board was established to aid with the process, comprised of four Board members: Chair Davis, Director Chavez, Director Pine, and Director Walton. In addition to the Board members, JPA member agency staff also participated in the Governance Process Ad Hoc Committee meetings.

The special meeting on March 19, 2021 was the first special meeting intended to assist the full Board in the process of reaching a governance recommendation by the end of the year. At the first special meeting, the Board accepted the 2021 Governance Roadmap for the process, with the understanding that the Governance Process Ad Hoc Committee may come back with updates to refine the plan. Additionally, the Board accepted the 2021 Proposed Objectives for the Governance Outcome, with the amendment that 1) an additional objective be equitable decision making across the board for all JPB member agencies and 2) governance changes be focused on improving ridership of all income levels for Caltrain. The full minutes from the first special meeting can be found here.

The second special meeting on May 14, 2021 was focused on refinement of three self-directed governance options, as well as the approach to evaluating the self-directed options, which includes both quantitative and qualitative analyses. The presentation also discussed the resources required to support the governance process. The full minutes from the second special meeting can be found here.

The third special meeting on June 25, 2021 was intended to focus on the approach to regional and non-self-directed relationships; active and emerging regional discussions; strategic issues; and next steps. The meeting was adjourned early without discussion of the prepared materials on regional options.

The Governance Process Ad Hoc Committee met monthly to support the overall 2021 governance process. They met twice in advance of the Board's first special meeting, and they held two additional meetings in advance of the Board's second special meeting. One additional meeting was held in advance of the Board's third special meeting. In August of 2021, the Governance Process Ad Hoc Committee was disbanded because the committee had fulfilled its intended purpose of outlining a governance process for JPB consideration.

BUDGET IMPACT

There is no budget impact associated with receiving this report or taking any actions.

NEXT STEPS

Following the Board's third special meeting, it was determined that an additional special meeting on governance was needed in September, following the fourth special meeting on August 20, 2021. As a result, there are two more special meetings on governance scheduled in 2021:

- Special Meeting #5: TBD in September 2021
- Special Meeting #6: Friday, October 22, 2021, 1:00pm – 4:30pm.

Prepared by: Sebastian Petty, Deputy Chief, Caltrain Planning

Attachment 1: Presentation Slides for the August 20, 2021 Special Meeting

Attachment 2: Information Regarding the Interviews that were Conducted with Board Members and Partner Agency Leadership

Caltrain 2021 Governance Process
Round 2 Interviews

Background
Howard Permut and Ratna Amin conducted interviews with the Caltrain Board Members and Member Agency General Managers regarding the “self-directed” governance options.

The purpose of interviews was to:

1) gather assessments of these options and how they might perform against evaluation criteria which were selected by the Board at its May 2021 meeting
2) gather feedback on the importance of addressing issues or topics raised by Board members or key stakeholders as part of the 2021 JPB process to reach a recommendation on governance.

Key findings from the interviews are included in the August 20, 2021 Special Meeting #4 Presentation slides.

Attachment 3: A Detailed Report from Olson Remcho regarding Legal Analysis of the Self-Directed Governance Options

Attachment 4: A Detailed Report from Macias Gini & O'Connell (MGO) regarding Financial Analysis of the Self-Directed Governance Options for Pension Unfunded Accrued Liability, Other Post-Employment Benefit Unfunded Accrued Liability, and Compensated Absences Liability

CALCULATION OF UNFUNDED LIABILITIES
PENSION, OPEB, AND COMPENSATED ABSENCES

INTRODUCTION

Macias Gini & O'Connell (MGO) was requested by the Peninsula Corridor Joint Powers Board (JPB) to prepare an estimate of costs and obligations for the JPB based on a current baseline model and three separate options for modifying the entity's current organizational structure, in conjunction with the *Organizational Structure Options Financial Study Results* (Financial Study), which identified the annual operating and one-time costs for the JPB based on the proposed governance options. MGO, together with an Actuarial Specialist from Independent Actuaries, prepared the following memo, which discusses the estimated obligations for Caltrain based upon the three proposed governance options. The ongoing costs (or current benefit contributions for existing employees) are not included in this analysis, as they are reflected in the estimated annual operating costs within the Financial Study.

As noted in the Financial Study, the proposed governance options under consideration are:

- **Baseline:** No change in the current operational structure, all services associated with the JPB would continue to be provided by the San Mateo County Transit District (SMCTD).
- **Option 1:** Maintain SMCTD as managing agency of Caltrain with increased JPB oversight over Caltrain Executive Director (ED) and Caltrain oversight of shared services model.
- **Option 2:** Adjust SMCTD managing agency model to provide for greatly expanded JPB oversight and authority over Caltrain ED as well as Caltrain oversight of leadership and shared services.
- **Option 3:** Dissolve managing agency model and replace with separate, independent Caltrain agency to directly manage and administer Caltrain, by reorganizing JPB.

The estimated obligations for the JPB herein are as follows:

- **Pension Unfunded Accrued Liability (Pension Liability)**: The difference between a plan or pool's market value of assets and the total dollars needed as of the valuation date to fund all benefits earned related to service that has already been provided (including active and retired participants).
- **Other Post-Employment Benefit Unfunded Accrued Liability (OPEB Liability)**: Retiree medical benefits, which are paid in the period after employment and provided separately from a pension plan.
- **Compensated Absences Liability:** Absences (e.g., paid time off) for which employees will be paid.

In the current operational structure, SMCTD does not estimate the JPB's portion of the Pension, OPEB, or Compensated Absences Liabilities prior to making payments to CalPERS. Instead, SMCTD annually allocates a portion of those payments to the JPB for its share of the Pension, OPEB, and Compensated Absences Liabilities. For comparison purposes, we have estimated the JPB's portion of the outstanding Pension, OPEB, and Compensated Absences Liabilities utilizing the allocation percentages applied to the 2019 Pension and OPEB Liabilities per the 2019 General Ledger, which approximated 22%. The allocation percentages utilized can fluctuate from year to year as the basis of allocation is variable depending on the allocation methodology (e.g., the allocation methodology in FY 2021 is 12%). The 22% used in FY 2019 was an allocation based on Caltrain's percentage of total budgeted salaries.

- For Option 1, we allocated 22% of the estimated outstanding liabilities as there are no changes in governance structure.
- For Option 2, we allocated the Pension and OPEB Liabilities for those individuals remaining within SMCTD strictly on active participant headcount as of 2019.
- For Option 3, this methodology is not applicable as Caltrain will obtain full independence under this option.

CALCULATION OF UNFUNDED LIABILITIES
PENSION, OPEB, AND COMPENSATED ABSENCES

The ranges estimated by option are based upon certain factors including the fact that the actual individuals who transfer in Options 2 and 3 have not been specifically identified at this time (i.e., only the counts have been provided). Additionally, it was assumed that salaries and benefit levels will be maintained for all individuals transferring from SMCTD to Caltrain. We recommend additional studies be performed to increase the level of accuracy of the estimates once the actual individuals who transfer in Options 2 and 3 are identified, as well as the amount of Pension and OPEB liabilities associated with previously retired members allocable to Caltrain are quantified.

INFORMATION GATHERING

In determining the potential unfunded Pension and OPEB Liabilities allocable to Caltrain under each of the three governance options currently under consideration, Independent Actuaries undertook the following information gathering steps:

- Reviewed the Public Employees' Retirement Law (PERL).
- Met with Olson Remcho, LLP (OR), which has been retained to undertake a legal analysis of the three governance options, and consulted with their pension law expert.
- Reviewed SMCTD’s June 30, 2019 Actuarial Valuation Report for the pension plan, dated July 2020, supplemented by the most recent GASB 68 Accounting Report.
- Reviewed SMCTD’s June 30, 2019 Actuarial Valuation Report for the OPEB plan, dated July 2020, supplemented by the most recent GASB 75 Accounting Report.
- Reviewed the 2019 and 2020 SMCTD Annual Comprehensive Financial Report (ACFR).
- Met with the SMCTD financial team to understand the current relationship between the JPB and SMCTD.
- Met with OR, MGO, and the SMCTD financial team to understand the proposed governance options.
- Reviewed AB-1912 Public employees’ retirement: joint powers agreements: liability.

In determining the potential Compensated Absences Liability allocable to Caltrain under each of the three governance options currently under consideration, MGO undertook the following information gathering steps:

- Reviewed the SMCTD compensated absences policy.
- Reviewed the 2019 and 2020 SMCTD ACFR.
- Reviewed the FY 2019 labor distribution report.
- Met with the SMCTD financial team to understand the current relationship between the JPB and SMCTD.
- Met with OR and the SMCTD financial team to understand the proposed governance options.

PENSION LIABILITY

- ***Background:*** All qualified permanent and probationary SMCTD employees, including those assigned to work for the JPB and the San Mateo County Transportation Authority (Transportation Authority), participate in the California Public Employees’ Retirement System (CalPERS), a defined benefit pension plan, which acts as a common investment and administrative agent for its participating member employers. Benefits are established by contract with CalPERS in accordance with the provisions of the Public Employees' Retirement Law. SMCTD is responsible for funding those benefits through its contributions to CalPERS, which cover both the so-called “Normal Cost” of ongoing benefit accruals as well as the amortization of existing unfunded accrued liabilities (UAL) that exist with respect to already-accrued benefits. CalPERS provides service retirement and disability benefits; annual cost of living adjustments; and death benefits to plan members, retirees, and beneficiaries. Benefits are based on years of credited service, equal to one year of full-time employment. For participants who transfer from one employer to another, yet remain within the CalPERS system, the total benefit that a participant earns under multiple participating employers will be split in proportion to the years of service earned under each employer. As such, the employers are legally responsible for the payment of the proportioned benefit related to that participant. Under Options 2 and 3, a new employer would be created; and certain participants would transfer from SMCTD to the new employer (Caltrain). The Pension Liability within CalPERS is directly tied to the plan sponsor (i.e., the legal employer of the individual, not who the individual reports to).

Liability for UAL Subject to Negotiation: Two points should be kept in mind when discussing Caltrain's potential liability for the UAL associated with SMCTD employees who become Caltrain employees under governance Options 2 and 3. First, the amount of Caltrain's liability and the payment terms will be the result of negotiations between Caltrain and SMCTD and, as the scenarios below indicate, there is a broad range of possible outcomes. Under the usual rules that apply when an employee moves between employers within CalPERS, the new employer has no obligation to pay any portion of the UAL that accrued when the employee was at their previous job. Thus, from CalPERS' perspective, Caltrain would not be responsible for the Pension Liability associated with SMCTD employees who move to Caltrain. That doesn't consider the fact that since Caltrain's inception, Caltrain and SMCTD have operated under a shared services model pursuant to which SMCTD employees provide all services to Caltrain. As a result, part of the UAL accrued by a SMCTD employee who moves to Caltrain would have been accrued while they worked for and provided services to Caltrain. In addition, the member agencies agreed to share in Caltrain's operating costs, including "[e]xpenses for personnel and resources of the Managing Agency to administer the affairs of the JPB . . ." *See* 1996 JPA, § 7. SMCTD has historically incorporated a portion of the amortized payments to CalPERS to cover the Pension Liability as part of the operating costs for which it is reimbursed by Caltrain. As a result, before employees move to Caltrain, the parties will need to agree on how much of the Pension Liability associated with those employees is attributable to Caltrain and settle on the manner (lump sum, annual payments) by which Caltrain's liability is calculated. The scenarios below show the potential ranges and methods of payment for that liability.

Second, the amounts below should not be viewed as additional costs created *because* of the proposed governance options. As noted above, through the shared services model currently in place between Caltrain and SMCTD, Caltrain makes annual payments toward SMCTD's Pension Liability for those employees who provide services to Caltrain. Because the governance options do not make significant changes to the number of employees providing Caltrain services, and instead just change where they are employed, the governance options alone should not cause a significant change in Caltrain's overall Pension Liability. Rather, significant changes would occur if the parties negotiated a change in the manner in which Caltrain pays that liability, for example, by agreeing that Caltrain would pay one lump sum amount to SMCTD when employees transfer to Caltrain instead of making annual payments.

- ***Results:*** As the Pension Liability within CalPERS is directly tied to the plan sponsor (i.e., the legal employer of the individual, not who the individual reports to), Caltrain may not be responsible for the unfunded accrued liability associated with past service related to Caltrain operations provided by employees of SMCTD from the viewpoint of CalPERS. However, as noted above, the parties will likely have to negotiate over the UAL for SMCTD employees who become employees of Caltrain.

While this negotiation would likely occur without input from CalPERS, CalPERS will ultimately be responsible for final approval of the apportionment of the retirement obligations.

Scenario A: The parties agree to transfer a portion of the Pension Liability from SMCTD to Caltrain within CalPERS, and as such Caltrain will be responsible for direct annual payments to CalPERS (assuming CalPERS approves the allocation). The following estimates were based strictly on active participant headcount.

- **Baseline/Option 1:** No transfer would be made. The Pension Liability would remain with SMCTD as explained within the introduction. For comparison purposes, the JPB's estimated portion of the Pension Liability is approximately $17,700,000 based on the present value as of 7/1/22.
- **Option 2:** Approximately $600,000 of the outstanding liability would be transferred from SMCTD to Caltrain for the five participants transferred from SMCTD to Caltrain. No transfer would be made for the remaining participants continuing under the current governance structure (as explained within the introduction); however, for comparison purposes, the JPB's estimated portion of the Pension Liability for the remaining participants is $17,200,000. The sum of both Caltrain's transferred and the JPB's estimated portion of the Pension Liability remaining with SMCTD is approximately $17,800,000, or approximately $100,000 more than Baseline/Option 1 based on the present value as of 7/1/22.
- **Option 3:** Approximately $22,000,000 of the total outstanding Pension Liability would be transferred from SMCTD to Caltrain based on the present value as of 7/1/22.

Scenario B: The parties agree to Caltrain remitting a lump-sum payment to SMCTD for their portion of the Pension Liability, assuming a termination discount rate of 1.75% as identified in SMCTD's June 30, 2019 valuation. SMCTD would retain the entire Pension Liability and continue to be responsible for direct annual payments to CalPERS. The discount rate and payment terms would be subject to negotiation between the parties. The change in discount rate is non-linear in respect to the change in the estimated Pension Liability. For reference, the Pension Liability calculated at a discount rate of 6% is approximately 57% higher than the Pension Liability calculated at 7%; and conversely, the Pension Liability calculated at a discount rate of 1.75% is about 27% higher than the Pension Liability calculated at 2.75%. We recommend that further additional studies be performed to increase the level of precision of the estimates once potential discount rates are identified. For participants who remain with SMCTD, no lump-sum payment will be made. Note that the Pension Liability estimated on a termination basis is calculated differently from the plan's ongoing funding liability. For this hypothetical termination liability calculation, both compensation and service are frozen as of the valuation date; and no future pay increases or service accruals are assumed. The discount rate assumption used for termination valuations is a weighted average of the 10-year and 30-year U.S. Treasury yields where the weights are based on matching asset and liability durations as of the termination date. The discount rates used in the table are based on 20-year Treasury bonds, rounded to the nearest quarter percentage point equating to 1.75%.

- **Baseline/Option 1:** Annual payments would continue to be made from the JPB to SMCTD under the current governance structure. For comparison purposes, utilizing the 1.75% terminated agency discount rate, the JPB's estimated portion of the Pension Liability would be approximately $100,000,000.
- **Option 2:** A lump-sum payment of an estimated $3,100,000 would be payable from Caltrain to SMCTD for the five participants transferred from SMCTD to Caltrain. Annual

payments would continue to be made from JPB to SMCTD for the remaining participants continuing under the current governance structure (as explained within the introduction); however, for comparison purposes, the estimated portion of the Pension Liability (utilizing the 1.75% discount rate) for the remaining participants is approximately $97,300,000. The sum of both the lump-sum payment payable to SMCTD and the JPB's estimated portion of the Pension Liability remaining with SMCTD is approximately $100,400,000, or approximately $400,000 more than Baseline/Option 1.

  - **Option 3:** A lump-sum payment of approximately $122,000,000 would be payable from Caltrain to SMCTD.

- ***Methodology:*** Refer to Appendix A.

<u>OPEB LIABILITY</u>

- **Background:** In August 1993, the SMCTD's Board of Directors adopted the San Mateo County Transit District Retiree Healthcare Plan (Plan). The Plan provides lifetime post-retirement CalPERS medical care insurance benefits to qualified retirees — those who have attained at least 50 years of age, have at least five years of service, and who retire under CalPERS within 120 days of separation from SMCTD employment — and their eligible dependents and surviving spouses. Benefit allowance provisions are established, and may be amended, through agreements and memorandums of understanding (MOUs) between SMCTD, its management employees, and unions representing SMCTD employees. In April 2008, SMCTD's Board of Directors adopted an Other Post Employment Benefit (OPEB) funding plan; and in April 2009, as authorized by that plan, adopted the California Employers' Retiree Benefit Trust (CERBT), a tax-exempt Internal Revenue Code section 115 trust administered by CalPERS. SMCTD's net OPEB Liability includes all employees assigned to work for the JPB and the Transportation Authority. SMCTD provides qualified retirees with a cash subsidy in the form of fixed dollar SMCTD contributions directly to CalPERS for monthly medical insurance premiums. The amount of the subsidy is indexed each year. Retirees can select from various health plans offered through CalPERS from a variety of providers. If a qualified retiree waives coverage, the retiree will not receive SMCTD's contribution.

  Liability for OPEB Subject to Negotiation: OPEB works differently from pension benefits in that the benefit is not guaranteed if an employee separates from service prior to his or her retirement. If an employee separates service any time after becoming vested (generally, after reaching five years of service), the pension benefit that he or she has earned at that point can never be forfeited. In contrast, if an employee separates from SMCTD at age 49 with 20 years of service, SMCTD has no obligation for any OPEBs on behalf of that retiree. It's only the last CalPERS employer that an individual works for immediately preceding retirement that is responsible for paying that person's OPEBs. As such, from CalPERS' perspective, SMCTD would not be responsible for the OPEB Liability associated with SMCTD employees who transfer to Caltrain. That doesn't consider the fact that since Caltrain's inception, Caltrain and SMCTD have operated under a shared services model pursuant to which SMCTD employees provide all services to Caltrain. As a result, before employees move to Caltrain, the parties will need to agree on how much of the OPEB Liability associated with those employees is attributable to SMCTD and settle on the manner (lump sum, annual payments) by which SMCTD's liability is calculated.

- **Results:** Since OPEB benefits are not "vested" (i.e., nonforfeitable) as are pension benefits, neither SMCTD nor Caltrain will recognize an accrued liability for any transferred participants as of the transfer date. Caltrain will be responsible for the ultimate payment of OPEB benefits through

CalPERS. While no accrued liability is recognizable as of the date of transfer, SMCTD's reduction in estimated OPEB Liabilities outstanding as noted in the June 30, 2019, Actuarial Valuation Report would be as follows:

Scenario A: Caltrain adopts a California Employers' Retiree Benefit Trust (CERBT) as administered by CalPERS. The estimated liability associated with those SMCTD employees who become employees of Caltrain based strictly upon active participant headcount for the purposes of financial and actuarial valuation reporting is as follows:

- **Baseline/Option 1:** While the entirety of the OPEB Liability is recognized on SMCTD's financial statements and within their OPEB valuation, for comparison purposes, we have estimated the amount of the OPEB Liability for Baseline/Option 1 to be approximately \$5,100,000 based on the present value as of 7/1/22.
- **Option 2:** Approximately \$200,000 of the OPEB Liability would be recognized within Caltrain's financial statements and within their OPEB valuation for the five participants transferring from SMCTD to Caltrain. While the entirety of the OPEB Liability for the remaining participants continuing with the JPB will be recognized on SMCTD's financial statements and within their OPEB valuation, for comparison purposes, the estimated portion of the OPEB Liability for the remaining participants is approximately \$5,000,000. The sum of Caltrain's recognized and the JPB's allocated portion of the OPEB Liability is approximately \$5,200,000 based on the present value as of 7/1/22.
- **Option 3:** Approximately \$6,200,000 of the OPEB Liability would be recognized within Caltrain's financial statements and within their OPEB valuation based on the present value as of 7/1/22.

Scenario B – Caltrain adopts an irrevocable trust outside of CalPERS, and the trust's assets are invested in lower risk investments resulting in a 1.75% discount rate. This rate would be subject to negotiation. For reference, the OPEB Liability calculated at a discount rate of 5.75% is approximately 17% higher than the OPEB Liability calculated at 6.75%; and, conversely, the OPEB Liability calculated at a discount rate of 1.75% is approximately 15% higher than the OPEB Liability calculated at a discount rate of 2.75%. The estimated liability associated with those SMCTD employees who become employees of Caltrain, based strictly upon active participant headcount, for the purposes of financial and actuarial valuation reporting is as follows:

- **Baseline/Option 1:** While the entirety of the OPEB Liability is recognized on SMCTD's financial statements and within their OPEB valuation, for comparison purposes, we have estimated the amount of the OPEB liability based upon the 1.75% discounted rate for Baseline/Option 1 to be approximately \$10,700,000.
- **Option 2:** Approximately \$300,000 of the OPEB Liability would be recognized within Caltrain's financial statements and within their OPEB valuation for the five participants transferring from SMCTD to Caltrain. While the entirety of the OPEB Liability for the remaining participants continuing with the JPB will be recognized on SMCTD's financial statements and within their OPEB valuation, for comparison purposes, the estimated portion of the OPEB Liability based upon the 1.75% discounted rate for the remaining participants is approximately \$10,400,000. The sum of Caltrain's recognized and the JPB's allocated portion of the OPEB Liability is approximately \$10,700,000.
- **Option 3:** Approximately \$12,700,000 of the OPEB Liability would be recognized within Caltrain's financial statements and within their OPEB valuation, assuming that Caltrain elects not to pre-fund these benefits.

- **Methodology:** Refer to Appendix B.

COMPENSATED ABSENCES LIABILITY

- **Background:** Employees accrue compensated absence time by reason of tenure at annual rates ranging from 169 to 344.5 hours per year. Employees are allowed to accumulate from 800 hours up to 1,440 hours of compensated absence time, depending upon the number of years of service. Under the current governance structure, annual costs associated with compensated absences for those SMCTD employees providing services to Caltrain are allocated to the JPB.

- ***Liability for Compensated Absences Subject to Negotiation:*** Similar to OPEB, it's only the employer that an individual works for immediately preceding termination that is responsible for paying that person's compensated absences. As such, SMCTD would not be responsible for the Compensated Absences Liabilities associated with SMCTD employees who transfer to Caltrain, assuming the transferred individuals retain their benefits subsequent to transfer. That doesn't consider the fact that since Caltrain's inception, Caltrain and SMCTD have operated under a shared services model pursuant to which SMCTD employees provide all services to Caltrain. As a result, before employees move to Caltrain, the parties will need to agree on how much of the Compensated Absences Liability associated with those employees is attributable to SMCTD and settle on the manner (lump sum, annual payments) by which SMCTD's liability is calculated.

- **Results:** If the parties agreed to allocate the liability for the outstanding compensated absences for SMCTD employees who become employees of Caltrain based strictly on the number of full-time employees, then we would expect the amount allocable to Caltrain and ultimately payable by Caltrain to SMCTD (assuming Caltrain is responsible for 100% of the transferring employees' compensated absences) at the employee's termination to be as follows:
    - **Baseline/Option 1:** While the entirety of the Compensated Absences Liability is recognized on SMCTD's financial statements, for comparison purposes, we have estimated the liability associated with the SMCTD employees providing services to Caltrain for Baseline/Option 1 through the JPB to be approximately $2,046,000.
    - **Option 2:** Approximately $55,000 of the outstanding liability would be transferable to Caltrain for the 5 employees transferring from SMCTD to Caltrain. While the entirety of the liability for the remaining employees continuing with the JPB would be recognized on SMCTD's financial statements, for comparison purposes, we have estimated the amount of the liability for the remaining employees to be $1,991,000. The sum of both Caltrain's transferred and the JPB's estimated portion of the Compensated Absences Liability remaining with SMCTD is approximately $2,046,000.
    - **Option 3:** Approximately $2,112,000 of the outstanding liability would be transferable to Caltrain from SMCTD.

- **Methodology:** For the purposes of this estimation, it is assumed that the transferred individuals will retain their benefits and as such all of the outstanding Compensated Absences Liability will transfer to Caltrain from SMCTD. As the individuals to be transferred are unknown, the Compensated Absences Liabilities were estimated by determining the average compensated absences balance per full-time employee (FTE) based on the FY 2019 SMCTD ACFR and the FY 2019 labor distribution report and projecting the estimated liabilities by option based on the calculated average and number of FTEs by option.

  In addition, we have made the following assumptions:

Baseline/Option 1

Of the 209 FTE count identified in the Financial Study, it is assumed that:

- 186 positions will continue to provide services to Caltrain through SMCTD
- 23 vacant positions will be filled through SMCTD

Option 2

Of the 227 FTE count identified in the Financial Study, it is assumed that:

- 5 positions available at Caltrain will be filled by participants transferring from SMCTD
- 181 positions will continue to provide services to Caltrain through SMCTD
- The remaining 41 vacant positions will be filled through SMCTD

Option 3

Of the 227 FTE count identified in the Financial Study, it is assumed that:

- 105 positions will be filled by participants transferring from SMCTD rail (Rail)
- 92 positions will be filled by participants transferring from other SMCTD operations
- 30 positions will be filled by new participants directly hired by Caltrain

APPENDIX A – PENSION LIABILITY METHODOLOGY

CalPERS is a "defined benefit" retirement plan, meaning that the benefit that a participant is entitled to at retirement is defined by the plan. For most SMCTD participants, that formula (if retiring at age 60) is: 2% x final pay x years of service.

For example, a participant retiring at age 60 with 20 years of service and a salary of $6,000 per month will receive a benefit of 2% x $6,000 x 20 = $2,400/month, payable for life. The present value of that future expected payment stream is called the Present Value of Future Benefits (PVFB), since it reflects the entire benefit that the participant is expected to receive in retirement.

Building off the prior example, let's say this participant is currently age 50 with 10 years of service, earning $5,000 per month. Their accrued benefit, if they were to terminate employment today, is 2% x $5,000 x 10 = $1,000/month, payable for life beginning at age 60. It's only if they continue to work for SMCTD that they'll earn the full $2,400/month. The present value of the $1,000 per month earned to date is called the Present Value of Accrued Benefits (PVAB).

That said, employers use yet a third measure of liability to determine cash funding requirements and financial accounting obligations associated with the pension plan: the Accrued Liability. This liability measure is essentially based on the participant's current years of service, but taking future salary increases into account. In our example, the Accrued Liability would essentially be the present value of 2% x $6,000 x 10 = $1,200/month (this is a gross simplification, but close enough for discussion purposes).

For inactive participants (i.e., current retirees and terminated vested participants entitled to future payments), the PVFB, PVAB, and Accrued Liability are all equal. However, for active participants, the PVFB is greater than the PVAB, with the Accrued Liability falling somewhere in between.

As such, the estimates were based on the results shown in SMCTD's June 30, 2019 Actuarial Valuation Report, dated July 2020, supplemented by the most recent GASB 68 Accounting Report. As described in detail below, we have used the liabilities, participant demographics, and actuarial assumptions presented in that report as the basis for the estimates presented here.

As of June 30, 2019, there were 725 active SMCTD employees participating in CalPERS. Dividing the projected June 30, 2022 Pension Liability by this headcount provides an average Pension Liability per active participant as of the anticipated transfer date.

For each of Options 2 and 3, we have multiplied this average Pension Liability by the number of SMCTD employees expected to be transferred, to arrive at the estimated allocation of Pension Liability between SMCTD and Caltrain based simply on active headcount. Under both options, we have assumed that the average pay, age, and years of service for the transferring group are the same as the averages for SMCTD employees as a whole; and that the transfer date will be July 1, 2022.

For purposes of this analysis, we have relied on results presented in SMCTD's 2019 actuarial valuation report. As such, we have implicitly relied on the data, assumptions, and plan provisions summarized in that report. In addition, we have made the following assumptions:

Baseline/Option 1

Of the 209 FTE count identified in the Financial Study, it is assumed that:

- 186 positions will continue to provide services to Caltrain through SMCTD
- 23 vacant positions will be filled through SMCTD

Option 2

Of the 227 FTE count identified in the Financial Study, it is assumed that:

- 5 positions available at Caltrain will be filled by participants transferring from SMCTD
- 181 positions will continue to provide services to Caltrain through SMCTD
- The remaining 41 vacant positions will be filled through SMCTD

Option 3

Of the 236 FTE count identified in the Financial Study, it is assumed that:

- 105 positions will be filled by participants transferring from SMCTD rail
- 92 positions will be filled by participants transferring from other SMCTD operations
- 39 positions will be filled by new participants directly hired by Caltrain

APPENDIX B – OPEB LIABILITY METHODOLOGY

- Our calculations are based on the results shown in SMCTD's June 30, 2019 Actuarial Valuation Report for the Retiree Healthcare Plan, dated July 1, 2020. As described in detail below, we have used the liabilities, participant demographics, and actuarial assumptions presented in that report as the basis for the estimates presented here.

  As of June 30, 2019, there were 734 active SMCTD employees. Dividing the Accrued Liability associated with active participants by this headcount provides an average Accrued Liability per active participant.

  For each of Options 2 and 3, we have multiplied this average Accrued Liability by the number of Rail employees expected to transfer, to arrive at the estimated reduction in Accrued Liability (also equal to the reduction in OPEB Liability). Once the makeup of the transferring group is more closely known, we can potentially refine that baseline liability by considering the expected average age and average years of service for the transferring group to the average age and average years of service of the total population. Under both options, we have assumed that the average pay, age, and years of service for the transferring group are the same as the averages for SMCTD employees; and that the transfer date will be July 1, 2022.

  For purposes of this analysis, we have relied on results presented in SMCTD's 2019 actuarial valuation report. As such, we have implicitly relied on the data, assumptions, and plan provisions summarized in that report. In addition, we have made the following assumptions:

  <u>Option 2</u>
  Of the 227 FTE count identified in the Financial Study, it is assumed that:
  - Positions available at Caltrain will be filled by participants transferring from SMCTD.
  - The remaining 225 positions would continue to be employed by SMCTD.

  <u>Option 3</u>
  Of the 227 FTE count identified in the Financial Study, it is assumed that:
  - 105 positions will be filled by participants transferring from SMCTD Rail
  - 92 positions will be filled by participants transferring from other SMCTD operations
  - 39 positions will be filled by new participants directly hired by Caltrain