

MEMORANDUM

July 17, 2012

TO: Public Safety Committee
Government Operations and Fiscal Policy Committee

FROM: Leslie Rubin, Legislative Analyst 
Kristen Latham, Legislative Analyst 
Office of Legislative Oversight

SUBJECT: **Worksession on OLO Report 2012-5: *Montgomery County Deferred Retirement Option Plans***

On July 19, the Public Safety Committee and the Government Operations and Fiscal Policy Committee will hold a joint meeting to discuss OLO Report 2012-5, *Montgomery County Deferred Retirement Option Plans*, which was released on June 26th. This report responds to the Council's request for an overview and analysis of the County Government's deferred retirement option plans (DROP) for Montgomery County Fire and Rescue Services and Montgomery County Police Department employees.

In a DROP plan, an eligible employee receives retirement benefits while continuing to work (and receive a salary and benefits) for a set period of time before retiring. OLO Report 2012-5 provides a summary of the County's Government's DROP plans (including legislative history, participation rates, and cost), an overview of feedback on the plans, and a comparison of plans in other state and local jurisdictions.

The following participants are expected to attend the joint worksession:

Montgomery County Police Department	Assistant Chief Russ Hamill Lieutenant Laura Lanham Lieutenant Dave Anderson
Montgomery County Fire and Rescue Services	Division Chief David Steckel Assistant Chief Ed Radcliffe
Office of Human Resources	Joseph Adler, Director Steven Sluchansky, Manager of Labor & Employee Relations Belinda Fulco, Benefits Manager
Board of Investment Trustees	Linda Herman, Executive Director
International Association of Fire Fighters, Local 1664	John Sparks, President
Fraternal Order of Police	TBD

A. Report Highlights and Agency Comments

OLO Report 2012-5 examines the history and experience of the County Government's deferred option retirement plans (DROP) for police officers and firefighters, the costs and benefits associated with the plans over the past decade, and how the plans fit into the County Government's workforce management strategies. The report's 11 findings are listed below. The full executive summary of the report is available at ©1.

1. In general, a Deferred Retirement Option Plan (DROP) is a program where an employee is able to begin collecting a pension benefit while continuing to work as an active employee (and receive a salary) for a set period of time.
2. There are commonly-cited advantages and disadvantages to adopting and participating in DROP programs. Feedback from Montgomery County Government and union representatives echoes several of the advantages and disadvantages.
3. Montgomery County Government offers two DROP plans: one for firefighters and one for police officers.
4. While similar in many ways, the Fire and Police DROP plans differ with respect to eligibility, employee pension contributions, and DROP investment earnings.
5. The County Executive's Recommended FY13 Operating Budget proposes moving responsibility for all retirement plan administration – including the DROP plans – from the Office of Human Resources to the Board of Investment Trustees beginning in FY13.
6. When DROP plans were available, DROP retirements represented 43% of firefighter retirements and 39% of police officer retirements.
7. On average, Police and Fire DROP participants retire at an older age and have more years of credited service when compared to non-DROP police and firefighter retirees. *NOTE: Many variables, both professional and personal, can influence the timing of individual employee retirements. While OLO's analysis notes differences in age and years of service for DROP versus non-DROP retirees, additional statistical and/or actuarial analysis would be required to determine whether a causal connection exists between the timing of retirements and the DROP plans.*
8. As of September 2011, 96 firefighters and 85 police officers were participating in the DROP plans. Over the next five years, 17 percent of active police officers and 31 percent of active firefighters will become eligible to participate in a DROP plan.
9. Between January 2000 and September 2011, the County Government contributed \$48 million in pension benefits to DROP accounts. The fixed 8.25% interest paid on Fire DROP accounts represented \$3 million of the total.
10. It is difficult to calculate the marginal cost to the County of operating the DROP plans. The individual retirement decisions made by each participant determine the cost and it is impossible to know for sure how individuals' decisions would differ without the DROP plan.
11. Other state and local governments also offer DROP plans, primarily for public safety employees. Selected case studies show that DROP plans vary across jurisdictions. In recent years, several jurisdictions have closed their DROP plans, citing high costs.

Agency Comments. The Executive Branch provided OLO with official comments on OLO Report 2012-5. Overall, the Executive Branch concurred with the conclusions of the report, indicating that the DROP program is a key component in the Executive Branch’s succession management and recruitment strategies for public safety employees. The full Executive Branch response is available at ©5.

B. Recommended Discussion Questions

In order to enhance the Council’s understanding, oversight and evaluation of the DROP plans, OLO recommends the following three questions for discussion with County Government representatives.

Question #1: How do the costs and benefits of the DROP programs compare?

When the County Government implemented the Fire and Police DROP plans, the intended purpose was to provide an incentive for retirement-eligible employees with many years of experience delay retirement for a number of years. The legislative record, however, does not include a detailed explanation of the long-term benefit to the County Government that comes from retaining staff for additional years through the DROP program. At the same time, it is difficult to calculate the marginal cost of a DROP plan because the individual retirement decisions of each employee drive the cost and it is not possible to know how each individual’s decision would have differed without the DROP plan.

Councilmembers could discuss with the Executive Branch the current goals of the DROP program and whether the benefit of retaining police officers and firefighters for three additional years through the program merits the costs associated with DROP.

Question #2: Is it equitable to offer DROP plans to a subset of County Government employees?

The current County Government DROP plans are limited to a subset of public safety employees. The County Council has had several discussions in recent years of “equitable” treatment of employee compensation and benefits across and within agencies. In addition, the DROP plans allow MCPD and MCFRS to track impending retirements and plan accordingly, a function not available to other departments without DROP plans. Councilmembers could discuss with Executive Branch staff the equity issues raised by providing DROP plans to only certain groups of public safety employees.

Question #3: Are there changes to the design of the DROP plans that would better align plan outcomes to the County’s program goals?

Overall, the County’s two DROP plans have many similar provisions; however the Fire and Police DROP plans differ on several key variables: eligibility, employee pension contributions, and mechanism for account growth. Councilmembers could discuss with Executive Branch staff whether changes to the DROP plans could further Executive Branch program goals and whether any benefits exist to consolidating the two plans. Aspects of the plans to examine could include:

- Minimum age/length of service requirements for participation;
- Length of participation period; and
- Mechanism for account growth (self-directed investments or guaranteed rates of return).

MONTGOMERY COUNTY DEFERRED RETIREMENT OPTION PLANS

OFFICE OF LEGISLATIVE OVERSIGHT REPORT 2012-5

June 26, 2012

This report responds to the Council's request for an overview and analysis of the County Government's Deferred Retirement Option Plans for Montgomery County Fire and Rescue Services and Montgomery County Police Department employees.

A Deferred Retirement Option Plan (DROP) allows an employee in a defined benefit (pension) retirement plan to continue to work and begin collecting a pension benefit at the same time. During DROP participation, usually limited to a set number of years, the pension benefit is deposited into an account on behalf of the employee. An employee who retires from a DROP program will receive the funds accumulated in the DROP account, and begin directly collecting his/her pension benefit.

DROP PLANS IN MONTGOMERY COUNTY

Montgomery County Government established two DROP plans in 2000 – one for firefighters and one for police officers. The original Police DROP plan sunset in 2003 and was reinstated in 2008. When originally implemented, the Office of Human Resources stated that the DROP plans sought to induce long-term employees to delay retirement for a period of time.

Many components of Montgomery County's Fire and Police DROP plans are similar, but the plans have some key differences. The table below summarizes the components of the County Government's two DROP plans.

Montgomery County DROP Plan Components

	Fire DROP	Police DROP
Dates of Program Operation	March 1, 2000 – present	<ul style="list-style-type: none">• March 1, 2000 – March 1, 2003• July 1, 2008 - present
DROP Eligibility	Firefighters in the ERS pension plan eligible for normal retirement	<ul style="list-style-type: none">• Police officers in the ERS pension plan• 25 years of service <u>and</u> at least age 46
Length of Participation	Up to 3 years	Up to 3 years
DROP Account Contributions	Monthly pension + Employee contribution	Monthly pension
DROP Account Earnings	8.25% annual interest, compounded quarterly	Employee-directed investment of funds
Pension Calculation	Based on length of service and average final salary at the time an employee enters the plan	
Pension Adjustments in DROP	None	
Pension Adjustments after DROP	<ul style="list-style-type: none">• Application of unused sick leave towards credited service time (if applicable)• Adjustment for pension COLAs given to retirees during the DROP participation	
Disability and DROP	<ul style="list-style-type: none">• Service-connected: disability benefit <u>or</u> DROP account balance and normal retirement• Non-service-connected: disability retirement benefit <u>and</u> DROP account balance	
Account Distribution Options	Lump-sum payment, direct rollover distribution, or annuity	
Exit From Program	<ul style="list-style-type: none">• Exit from plan and retire at any time without penalty• Cannot reenter normal County Government employment after entering DROP plan	

PAST DROP PARTICIPATION IN MONTGOMERY COUNTY

Since 2000, 92 police officers and 132 firefighters have retired from Montgomery County's DROP plans. Approximately 40% of police officers and firefighters retired through the DROP plans when they were available. Additionally:

- DROP retirees had **two to three more years of credited service**, on average, than normal retirees.
- DROP retirees were **three years older**, on average, than normal retirees.
- Firefighters **retired through DROP three times as often** compared to normal retirements.
- Police officers **retired through DROP twice as often** compared to normal retirements.
- DROP and disability retirements accounted for around 80% of all police and fire retirements.

Many variables, both professional and personal, can influence the timing of individual employee retirements. While OLO's analysis notes differences in age and years of service for DROP versus non-DROP retirees, additional statistical and/or actuarial analysis would be required to determine whether a causal connection exists between the timing of retirements and the DROP plans.

Highlights of Police Officer and Firefighter Retirements

Type of Retirement*	# of Retirements	%	Average Age At Retirement	Average Years of Credited Service
Police Officers	235	100%	50 years old	26 years
DROP Retirement	92	39%	54 years old	31 years
Disability Retirement	91	39%	45 years old	21 years
Normal Retirement	43	18%	51 years old	29 years
Firefighters	304	100%	50 years old	26 years
DROP Retirement	132	44%	53 years old	30 years
Disability Retirement	116	38%	45 years old	21 years
Normal Retirement	43	14%	50 years old	27 years

Note: Police data are from March 2000 to March 2003 and July 2008 to December 2011. Firefighter data are from March 2000 - December 2011. Total retirements also include discontinued service retirements and early retirements.

The Office of Human Resources currently administers the DROP plans; however, administration of all County Government retirement plans, including the DROP plans, will move to the Board of Investment Trustees in FY13.

CURRENT AND FUTURE DROP PARTICIPATION IN MONTGOMERY COUNTY

In September 2011, 96 firefighters and 85 police officers were currently participating in the DROP plans. According to OHR, 6% of police officers and 21% of firefighters will be eligible to retire (and eligible for DROP) by the end of FY12. By the end of FY17, 17% of police officers and 31% of firefighters will be eligible to retire.

MONTGOMERY COUNTY DROP PLAN COSTS

Between January 2000 and September 2011, the County Government contributed \$48 million to employee DROP accounts. Interest paid by the County Government on Fire DROP accounts represents \$3 million of the total.

County Government Pension and Interest Payments to DROP Accounts

Costs	Police DROP	Fire DROP	Total
Pension Payments to DROP Accounts	\$18,956,833	\$25,885,226	\$44,842,059
8.25% Interest Paid to DROP Accounts	Not Applicable	\$2,971,898	\$2,971,898
Total	\$18,956,833	\$28,857,124	\$47,813,957

Source: OHR, BIT, Department of Finance

Cost Examples. The most accurate measure of the cost of a DROP plan would be an analysis of how employees' retirement decisions would have differed if a DROP plan did not exist and calculating the cost difference. An analysis of this sort, however, was beyond the scope of available data for this report.

Consequently, OLO developed examples that compare the cost to the County Government of employees who participate in the DROP plans and those who do not. OLO's cost analysis shows that an employee who retires through DROP:

- Would cost the County Government over 200% more while participating in DROP and 18-19% more throughout retirement if the employee would have retired instead of entering DROP; and
- Would cost the County Government 17% more during DROP participation but 3-4% less throughout retirement if the employee would have worked for three more years in active employment instead of entering DROP.

DROP PLANS IN OTHER JURISDICTIONS

OLO looked at DROP plans in eight other jurisdictions:

Anne Arundel County, MD	Howard County, MD	City of Philadelphia, PA
Baltimore County, MD	Maryland State Police	State of Ohio
Baltimore City, MD	Fairfax County, VA	

OLO found that:

- Five of eight plans are limited to public safety employees, three are available to all employees;
- The minimum number of years of service required for participation ranges from 10 to 32 years;
- The maximum length of participation ranges from 3 to 10 years;
- Half of the programs required employees to continue their pension contributions; and
- Seven of the programs pay a fixed rate of interest on DROP accounts, ranging from 3% to 10%.

OLO also found that several jurisdictions (including Baltimore County, State of Alabama, and City of Jackson, Mississippi) have closed their DROP plans to new employees, citing the high cost of the plans.

MONTGOMERY COUNTY DROP DISCUSSION QUESTIONS

OLO recommends that Councilmembers discuss with County Government representatives the following issues to enhance the Council's understanding, oversight, and evaluation of the DROP program.

Question # 1: How do the costs and benefits of the DROP programs compare?

There are limits to quantifying the costs and benefits of the DROP programs. Nonetheless, it is possible to hold an informed discussion about the known and comparable costs and perceived benefits of the two DROP plans. The Executive Branch's stated intent in 2000 was for the DROP plans "to operate as incentives to induce employees with many years of experience, and eligible for retirement, to remain active employees and delay retirement for a number of years."

The legislative record, however, does not include a detailed explanation of the long-term benefit to the County Government that comes from retaining employees through DROP. At the same time, an OLO cost analysis shows that a DROP retiree can cost the County Government significantly more during the three years of DROP participation compared to an employee who takes a normal retirement.

Councilmember could ask Executive Branch staff to summarize the current goals of the DROP program and discuss whether the benefit of retaining police officers and firefighters for three additional years through the program merits the costs associated with DROP.

Question # 2: Is it equitable to offer DROP plans to a subset of County Government employees?

Providing DROP plans only for two groups of employees raises questions of equity. Recent County Council discussions (in particular during budget deliberations in FY11-FY13) have focused on the "equitable" treatment of employee compensation and benefits across and within agencies.

The current County Government DROP plans are limited to a subset of public safety employees – firefighters and police officers in the County Government's pension plan. In addition to functioning as a retirement benefit, the DROP plans provide MCPD and MCFRS impending retirement data for succession management purposes – a tool not available to any other County Government departments.

Question # 3: Are there changes to the design of the DROP plans that would better align plan outcomes to the County's program goals?

Compiling information from more than a decade of experience with the DROP program, this report provides the Council another opportunity to review the design of the DROP plans.

The Council could discuss with Executive Branch staff whether changes to the DROP plans could further Executive Branch goals for the plans and whether any benefits exist to consolidating the two plans. Aspects of the plans to examine could include: (1) minimum age/length of service requirements for participation; (2) length of participation period; (3) mechanism for account growth; and (4) employees contributions.

Assessing whether changes to the design of the plans would increase or decrease plan costs would require the assistance of an actuary.

For a full copy of the this report, please visit www.montgomerycountymd.gov/olo
Available in alternative formats upon request.



OFFICE OF THE COUNTY EXECUTIVE

Isiah Leggett
County Executive

Timothy L. Firestine
Chief Administrative Officer

MEMORANDUM

July 3, 2012

TO: Chris Cihlar, Director
Office of Legislative Oversight

FROM: Timothy L. Firestine, Chief Administrative Officer TLF/KMS

SUBJECT: OLO Report 2012-5: Montgomery County Deferred Retirement Option Plans

Thank you for providing an opportunity to comment on the comprehensive review of the Montgomery County Deferred Retirement Option Plans (DROP) prepared by the Office of Legislative Oversight (OLO). The report is thorough and clearly outlines the advantages and disadvantages of the plans to employees and the County.

I would stress that the DROP program has allowed the County to retain institutional knowledge and is a key component in the County's ability to forecast public safety staffing requirements. It has been used to ensure succession planning in the Fire and Rescue Service and Police Department as well as continuity of emergency services to the community. Having the ability to know how many employees will retire, and the date of termination from service, allows public safety managers to conduct an orderly replacement process. This is a significant benefit for County managers. Additionally, the County competes with many agencies in the area for the same limited pool of public safety entry level candidates and struggles to keep senior people from being lured to work in other law enforcement agencies. The DROP program enhances our ability to recruit and retain qualified public safety applicants and employees.

In general, the Executive branch concurs with the conclusions of the report. As noted in the report, the DROP program can be changed only through the collective bargaining process or legislation and it would be difficult to find any economies of scale in consolidating the DROP plans.

We appreciate the hard work and diligence of OLO staff. They took great care to reflect the perspectives of all stakeholders in the report. We look forward to continuing discussions with the County Council on this subject.

c: Joseph Adler, Director, Office of Human Resources
J. Thomas Manger, Police Chief
Richard Bowers, Fire Chief
Marc Hansen, County Attorney