

**MEMORANDUM**

October 11, 2016

**TO:** Education Committee

**FROM:** Aron Trombka<sup>A+</sup>, Senior Legislative Analyst  
Stephanie Bryant<sup>S</sup>, Legislative Analyst  
Office of Legislative Oversight

**SUBJECT:** Office of Legislative Oversight Report 2016-5: *MCPS Local Pension Plan and Supplement*

The Council released Office of Legislative Oversight (OLO) Report 2016-5: *MCPS Local Pension Plan and Supplement* on February 23, 2016. This report responds to the County Council's request that OLO prepare a report that examines the cost of the current pension benefit offered to employees of the Montgomery County Public Schools. The Report Summary for Report 2016-5 appears on © 1-4.

At this worksession, the Education Committee will consider the findings of Report 2016-5. At the worksession, OLO will present an overview of the report. Dr. Jack Smith, Superintendent of Schools, Susanne DeGraba, Chief Financial Officer, and Nicola Diamond, Chief Strategy Officer, will represent MCPS at the worksession.

**COUNCILMEMBERS PREVIOUSLY RECEIVED COPIES OF REPORT 2016-5 AND SHOULD BRING A COPY OF THE REPORT TO THE WORKSESSION.**

**REPORT SUMMARY**

This section summarizes the key findings of Report 2016-5. Comments of these findings from Chief Operating Officer Andrew Zuckerman are attached at © 5-6.

MCPS compensation costs, including benefits, are consuming an increasing portion of available resources and challenging the ability to increase funding for instructional, programmatic purposes. For FY17, the Board of Education budgeted a total of \$66.8 million for the annual contribution to the MCPS Pension fund. The majority of this cost is attributable to the supplemental pension benefit offered to all MCPS employees. MCPS is the only school system in Maryland to provide its employees with a supplemental benefit. The remaining cost is associated with the core pension benefit for non-teachers. Additionally, MCPS will contribute \$58.7 million to the State teachers' pension fund. MCPS' FY17 retirement cost obligations will total \$127.5 million.

## **A. MCPS Pension History**

OLO researched the history of pension benefits provided to MCPS employees and made the following four observations:

1. On multiple occasions, the State and MCPS enhanced pension benefits when economic conditions were favorable.
2. On multiple occasions, the State and MCPS reduced pension benefits during times of fiscal constraints or pension fund instability.
3. MCPS has a long-standing policy to preserve parity between teachers' and non-teachers' retirement benefits.
4. The MCPS pension supplement was originally designed as an adjustable mechanism to achieve parity among the retirement benefits offered to teachers, non-teachers, and County Government employees.

## **B. Overview of Pension Benefits Offered to MCPS Employees**

Eligible MCPS employees are members of either the Maryland State Teachers' Retirement and Pension Plan ("State Teachers' Plan") or the MCPS Employees' Pension Plan ("MCPS Local Plan"). The State Teachers' Plan provides a pension benefit to employees involved in instructional duties, including teachers, principals, educational administrators, and supervisors. MCPS provides a pension benefit for employees in job classifications that are not eligible for the State Teachers' Plan. As a matter of policy, MCPS offers Local Plan participants similar plan benefits and design as provided under the State plan.

The State Teachers' and MCPS Local Pension Plans are defined benefit plans wherein an eligible retiree receives an annual payment determined by an established formula. Employees hired on or before June 30, 2011 who work at least 30 years receive an annual pension equal to 1.8% of average salary for the final three years of service. Employees hired on or after July 1, 2011 who work at least 30 years receive an annual pension equal to 1.5% of average salary for the final five years of service.

MCPS is the only public school system in the State of Maryland to provide a supplemental pension benefit. In 1999, the Maryland General Assembly enacted legislation requiring MCPS to provide a supplemental pension benefit of 0.08% of salary per year of credited service. In 2006, MCPS elected to increase the pension supplement to equal to 0.2% of average final salary per year of credited service.

Before 1998, both the State Teachers' and the Local MCPS pension plans integrated with Social Security. In 1998, the General Assembly and the Board of Education modified their respective pension plans so that employee pensions no longer integrated with Social Security for service after July 1, 1998.

### **C. Retirement Costs in the Context of the MCPS Operating Budget**

MCPS retirement contributions increased by 200% from FY05 through FY15 (excluding the shift of teacher pension costs formerly paid by the State). Retirement contributions grew at a rate that far exceeded growth in enrollment, workforce size, payroll costs, or health benefit costs.

Future year MCPS pension cost trends are difficult to predict. Some of the factors affecting the growth are out of MCPS' control, such as market and economic conditions, the shift of State teacher pension costs to the County, and pension fund reporting standards. Further, plan changes at either the local or State level could increase or decrease the County's liability, as they have in the past.

Recently, the Board increased employee health care contributions to mitigate MCPS benefit costs; and the State's 2011 retirement plan modifications also produced measurable cost reductions. However, unless the growth rates change markedly, funding the requirements of the employee benefits — including health benefits, local pension, and the shifted State pension costs — will be a primary demand on resources that policy makers might prefer to invest more directly in classroom improvements.

### **D. MCPS Pension Plan Modification Options**

OLO asked the County Council's actuarial advisor to estimate the potential cost savings that would result from alternative modifications to the MCPS Local Pension Plan including:

- Eliminating the pension supplement;
- Reducing the pension supplement to level specified in State law;
- Increasing the employee cost share for the pension supplement; and
- Amending the core and supplement pension for non-teachers to integrate with Social Security.

All options described in the report would apply to future service and would not affect benefits earned before the effective date of the pension modification. Savings from the above options will vary depending on which employees are affected by the plan modification (i.e., all employees, existing employees, new hires). In addition, the actuary determined that cost savings will vary over time, with most options producing steadily increasing savings for many years after implementation.

The actuary estimates that the above pension modifications could produce annual savings ranging from \$0.1 million to \$10 million in the first year after implementation. Savings from the modifications would rise to a range of \$6 million to \$24 million annually after about twenty years. As detailed in the report, the options would have varying effects on MCPS employees and retirees. The potential cost savings presented in the report are intended to inform policy makers about the approximate savings that could be achieved by pension modification. A more formal and detailed actuarial analysis would be required should the Board of Education elect to implement a pension plan modification.

# MCPS Local Pension Plan and Supplement

OLO Memorandum Report 2016-5

February 23, 2016

## REPORT SUMMARY

MCPS compensation costs, including benefits, are consuming an increasing portion of available resources and challenging the ability to increase funding for instructional, programmatic purposes. This memorandum report responds to Council's request for a review of MCPS pension benefits including an analysis of pension plan modification options that, if implemented, could result in a cost savings.

For FY15, the Board of Education budgeted a total of \$83.5 million for the annual contribution to the MCPS pension fund. MCPS is the only public school system in the State of Maryland to provide its employees with a supplemental pension benefit. Approximately two-thirds of this cost is attributable to the supplemental pension benefit offered to all MCPS employees. The remaining cost is associated with the core pension benefit for non-teachers. While MCPS teachers receive their core benefit from a State-run pension fund, a significant portion of the cost of teachers' pension was shifted to the counties beginning in FY13. In FY16, Montgomery County was responsible for contributing \$44.4 million to the State teachers' pension fund. Beginning in FY17, MCPS retirement costs obligations will increase by the cost of the pension shift. Recently, the State informed MCPS that the updated FY17 estimated cost of the pension shift cost is \$58.7 million.

### Pension History

OLO researched the history of pension benefits provided to MCPS employees and made the following four observations:

1. On multiple occasions, the State and MCPS enhanced pension benefits when economic conditions were favorable.
2. On multiple occasions, the State and MCPS reduced pension benefits during times of fiscal constraints or pension fund instability.
3. MCPS has a long-standing policy to preserve parity between teachers' and non-teachers' retirement benefits.
4. The MCPS pension supplement was originally designed as an adjustable mechanism to achieve parity among the retirement benefits offered to teachers, non-teachers, and County Government employees.

### Overview of Pension Benefits Offered to MCPS Employees

Eligible MCPS employees are members of either the Maryland State Teachers' Retirement and Pension Plan ("State Teachers' Plan") or the MCPS Employees' Pension Plan ("MCPS Local Plan"). The State Teachers' Plan provides a pension benefit to employees involved in instructional duties, including teachers, principals, educational administrators, and supervisors. MCPS provides a pension benefit for employees in job classifications that are not eligible for the State Teachers' Plan. As a matter of policy, MCPS offers Local Plan participants similar plan benefits and design as provided under the State plan.

The State Teachers' and MCPS Local Pension Plans are defined benefit plans wherein an eligible retiree receives an annual payment determined by an established formula. Employees hired on or before June 30, 2011 who work at least 30 years receive an annual pension equal to 1.8% of average salary for the

final three years of service. Employees hired on or after July 1, 2011 who work at least 30 years receive an annual pension equal to 1.5% of average salary for the final five years of service.

As mentioned, MCPS is the only public school system in the State of Maryland to provide a supplemental pension benefit. In 1999, the Maryland General Assembly enacted legislation requiring MCPS to provide a supplemental pension benefit of 0.08% of salary per year of credited service. In 2006, MCPS elected to increase the pension supplement to equal to 0.2% of average final salary per year of credited service.

Before 1998, both the State Teachers' and the Local MCPS pension plans integrated with Social Security. In an integrated plan, the pension amount decreases when a retiree reaches Social Security retirement age. In 1998, the General Assembly and the Board of Education modified their respective pension plans so that employee pensions no longer integrated with Social Security for service after July 1, 1998.

### **Value of Full Retirement Benefit**

Based on the current MCPS salary schedule, a ten-month MCPS teacher hired before July 1, 2011 with a Master's Degree and 35 years of service would receive a pension benefit of about \$68,400 per year. A similar teacher hired on or after July 1, 2011 would receive an annual pension of about \$56,600. In addition, the retired MCPS teacher would receive an annual Social Security benefit of about \$23,000 over and above the MCPS pension benefit, raising the total annual payment to \$91,400 for a teacher hired before July 1, 2011 and about \$79,600 for a teacher hired on or after this date.

MCPS actuarial data further indicate that the median life expectancy for a retired teacher is about 87 years. Therefore, on average, a teacher retiring from MCPS would receive a pension for 23 years. OLO calculated the present value of 23 years of pension payments adjusting for inflation and cost of living adjustments. OLO found the present value of the pension benefit to equal about \$1.4 million for the average teacher (at full retirement) hired before July 1, 2011 and about \$1.2 million for the teacher (at full retirement) hired on or after July 1, 2011.

### **Comparison of Public Sector Retirement Benefits**

Historically, the Board of Education and MCPS superintendents have compared MCPS employee retirement benefits with those of three other employee groups: Montgomery County Government employees, teachers in other Maryland public school systems; and teachers in Fairfax County Public Schools.

Montgomery County Government Employees: The County Government discontinued the pension benefit for new general government (non-public safety) employees in 1994. Since that date, new County Government employees receive a defined contribution retirement or cash balance benefit. In the defined contribution plan, the employee manages account investments; in the cash balance plan, the County Government guarantees a 7.25% annual return. At present, about 80% of the general government workforce participates in a defined contribution or cash balance retirement plan.

Public School Employees in Other Maryland Counties: MCPS is the only public school district in Maryland that provides teachers with a supplemental pension benefit. Since all public school teachers participate in the State Teachers' Plan, there is no difference between the core pension benefit received by MCPS teachers and by teachers in other counties. However, since the maximum salaries on the MCPS salary schedule are higher than in other counties, the dollar value of the core pension earned by

MCPS teachers with 30 or more years of experience will exceed the dollar value earned by a teacher with similar credentials elsewhere in the State.

MCPS provides non-teachers with a similar pension benefit offered to teachers. In 19 of the 23 Maryland school districts, non-teachers participate in the State Employees' Pension Plan. As the State Employees' Pension Plan has a similar design to the State Teachers' Pension Plan, non-teachers in these 19 counties effectively receive the same benefit as teachers. MCPS is the only school district to offer a pension supplement to non-teachers.

Fairfax County Public School Employees: Fairfax County Public Schools (FCPS) employees participate in different retirement plans depending on job classification. Full-time educators, administrators, support employees participate in two retirement plans – one Statewide and one specific to FCPS. The Virginia Retirement System serves public school (and other public sector) employees throughout Virginia. FCPS educators receive an additional pension benefit from Fairfax County. FCPS maintenance, custodial, food service, transportation employees as well as part-time educational, administrative, and support employees participate in the pension plan offered to Fairfax County Government general (non-public safety) employees.

### **Retirement Costs in the Context of the MCPS Operating Budget**

MCPS retirement contributions increased by 200% from FY05 through FY15 (excluding the shift of teacher pension costs formerly paid by the State). Retirement contributions grew at a rate that far exceeded growth in enrollment, workforce size, payroll costs, or health benefit costs.

<b>Factors</b>	<b>% of Growth (FY05 – FY15)</b>
<b>Pension Benefit Costs</b>	<b>200.0%</b>
Enrollment	10%
Workforce Size	10%
Payroll Costs	37%
Employee Health Benefit Costs	69%

Future year MCPS pension cost trends are difficult to predict. Some of the factors affecting the growth are out of MCPS' control, such as market and economic conditions, the shift of State teacher pension costs to the County, and pension fund reporting standards. Further, plan changes at either the local or State level could increase or decrease the County's liability, as they have in the past.

Recently, the Board increased employee health care contributions to mitigate MCPS benefit costs; and the State's 2011 retirement plan modifications also produced measurable cost reductions. However, unless the growth rates change markedly, funding the requirements of the employee benefits – including health benefits, local pension, and the shifted State pension costs – will be a primary demand on resources that policy makers might prefer to invest more directly in classroom improvements.

## **MCPS Pension Plan Modification Options**

OLO asked the County Council's actuarial advisor to estimate the potential cost savings that would result from alternative modifications to the MCPS Local Pension Plan including:

- Eliminating the pension supplement;
- Reducing the pension supplement to level specified in State law;
- Increasing the employee cost share for the pension supplement; and
- Amending the core and supplement pension for non-teachers to integrate with Social Security.

All options described in the report would apply to future service and would not affect benefits earned before the effective date of the pension modification. Savings from the above options will vary depending on which employees are affected by the plan modification (i.e., all employees, existing employees, new hires). In addition, the actuary determined that cost savings will vary over time, with most options producing steadily increasing savings for many years after implementation.

The actuary estimates that the above pension modifications could produce annual savings ranging from \$0.1 million to \$10 million in the first year after implementation. Savings from the modifications would rise to a range of \$6 million to \$24 million annually after about twenty years. As detailed in the report, the options would have varying effects on MCPS employees and retirees. The potential cost savings presented in the report are intended to inform policy makers about the approximate savings that could be achieved by pension modification. A more formal and detailed actuarial analysis would be required should the Board of Education elect to implement a pension plan modification.



**MONTGOMERY COUNTY PUBLIC SCHOOLS**  
MARYLAND  
www.montgomeryschoolsmd.org

February 16, 2016



Dr. Chris Cihlar, Director  
Montgomery County Office of Legislative Oversight  
Stella B. Werner Council Office Building  
100 Maryland Avenue  
Rockville, Maryland 20850

Dear Dr. Cihlar:

Montgomery County Public Schools (MCPS) appreciates the opportunity to respond to the *OLO Memorandum Report 2016-4: MCPS Local Pension Plan and Supplement*. I want to thank your staff for the collaboration shown throughout the preparation of this report and their consideration of the information we provided about the pension benefits our employees receive.

As you know, the women and men who devote their lives to educating our children do so because they are dedicated to their profession and believe that there is no greater calling than preparing the next generation. A standard part of the teaching profession is the provision of pension benefits for their retirement. In Montgomery County, we have always taken pride in ensuring that our professionals are compensated fairly, and that we provide an appropriate retirement for them.

As the report details, the competitiveness of a pension benefit is a major factor in attracting and retaining great teachers. Maryland's history in pension benefits is not a particularly glowing one. The improvements made to the Maryland State Teachers' pension plan in 2006 stemmed from the fact that Maryland's plan was one of the worst in the nation for teachers, and changes were needed in order to become more competitive within the education industry. We appreciate that you attempt to compare the pension we provide with other locally provided retirement benefits, but we believe it is not an apt comparison. Comparisons within the education sector are what matter most to us when considering the increasingly competitive teacher and public education job market.

When viewing the MCPS core pension benefit over a given period of time, as the report does, it is important to note that the time frame selected matters significantly when examining the relative cost of the pension benefit. In the report, the years studied—Fiscal Year (FY) 2005 to FY 2015—is a very short period in the long-term perspective of a pension. The particular period selected in the report contained two extremely unusual events—the financial market crash of 2008 as well as the unfunded 2006 retroactive improvement of the pension to 1998, which was done in alignment with the state pension plan's amendment. These events distort the long-term picture of what is and has been a cost-effective program.

Office of the Chief Operating Officer

850 Hungerford Drive, Room 149 ♦ Rockville, Maryland 20850 ♦ 301-279-3626

The report concludes that the benefits provided are very expensive and suggests that the costs are growing at an unsustainable rate. That simply is not the case in the long term. For example, teachers with an average career typically contribute to the pension program for 35 years and then receive set benefits for the remainder of their lives. Mandatory contributions from the teachers fund a significant portion of this benefit. Importantly, the benefit that teachers hired since 2011 will receive has been reduced, yet they will continue to pay what their more experienced peers pay in contributions. This will have significant implications on reducing the overall cost of pension benefits in the long term, an important point to highlight.

As you know, we are committed to being excellent fiscal stewards of the public dollar as well as an employer which can attract the absolute best in the education profession. While we appreciate the discussion and analysis in the report of the core pension benefit, we must keep pace with the rest of the education sector to ensure a high-quality workforce. In the final analysis, however, the report's conclusions concerning the supplemental pension benefit requires further discussion. The options presented by the Office of Legislative Oversight to reduce or eliminate the supplemental pension, some of which require legislative action, will need further evaluation and analysis as we continue to pursue avenues to reduce our overall operating costs while remaining competitive within public education.

Again, we appreciated the opportunity to work with your staff throughout this process and look forward to further discussion on this issue.

Sincerely,



Andrew M. Zuckerman, Ed.D.  
Chief Operating Officer

AMZ:sro

Copy to:

Mr. Leggett  
Ms. Floreen  
Members of the Board of Education  
Mr. Bowers  
Dr. Navarro  
Dr. Statham  
Mrs. DeGraba  
Mr. Ikheloa  
Ms. Bryant  
Mr. Trombka