# OLO Memorandum Report 2016-5

**February 23, 2016**

**To**: County Council

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**Subject: MCPS Local Pension Plan and Supplement**

This memorandum report responds to the County Council's request that the Office of Legislative Oversight (OLO) prepare a report that examines the cost of the current pension benefit offered to employees of the Montgomery County Public Schools (see Council Resolution 18-233). This report describes the design, history, and annual operating budget costs of the State Teachers' and Local MCPS pension plans. The report also introduces several potential options to reduce MCPS pension costs. To calculate the cost savings associated with alternative pension plan modification, OLO received assistance from Bolton Partners, the Council's actuarial advisor.

This report is organized in six sections:

- **Section I** provides an overview of pension benefits offered to MCPS employees;
- **Section II** describes the methods used to fund pension plans;
- **Section III** describes pension costs in the context of the MCPS operating budget;
- **Section IV** presents a history of pension benefits offered to MCPS employees;
- **Section V** compares MCPS pension benefits with those offered to other public sector employees; and
- **Section VI** presents potential options to reduce MCPS pension costs**.**
- **Section V** includes comments from the MCPS Chief Operating Officer.

A summary of the report follows on pages 2 through 5.

OLO received a high level of cooperation from MCPS in preparing this report. In particular, we note the assistance of Susanne DeGraba, MCPS Chief Financial Officer and Thomas Vicente of Aon Hewitt, the actuarial advisor to MCPS. We also acknowledge the invaluable assistance of Thomas Lowman, Vice President and Chief Actuary for Bolton Partners, Inc., the actuarial advisor to the County Council.

## 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.

## REPORT SUMMARY

### 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.

## REPORT SUMMARY

### 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.

## REPORT SUMMARY

### 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.

| Factors | % of Growth (FY05 – FY15) |
|---|---|
| **Pension Benefit Costs** | **200.0%** |
| 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's 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.

## SECTION I. OVERVIEW OF PENSION BENEFITS OFFERED TO MCPS EMPLOYEES

MCPS employees are eligible to receive a pension benefit upon retirement. This section details provisions of the pension benefit offered to MCPS retirees.

### A. Pension Plan Membership

MCPS provides a pension benefit to permanent employees who worked at least 500 hours during their first fiscal year with MCPS. Contractual or temporary employees are not eligible to participate in the pension plan.[1] 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").

**State Teachers' Plan.** Maryland State law establishes the provisions of the State Teachers' Pension Plan. The State Teachers' Plan provides a pension benefit to employees involved in instructional duties, including teachers, principals, educational administrators and supervisors. State law and regulations also allow employees in other public school job classifications to participate in the State Teachers' Plan, including:[2]

- Audiologists
- Bus Attendants for handicapped children
- Classroom Teacher Aides
- Dietitians
- Occupational and Physical Therapists
- Psychiatrists
- Psychologists
- Registered Nurses
- Speech Pathologists
- Social Workers
- Transportation, Building Operations; and Food Services Supervisors

**MCPS Local Plan.** 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.[3]

Once an employee is enrolled in either the State Teachers' or MCPS Local Plan, the employee will continue to participate in his/her original plan even if the employee changes to a job in MCPS assigned to the other pension plan.

***NOTE: For the purpose of this report, OLO broadly uses the term "teacher" to refer to MCPS employees who participate in the State Teachers' Plan. The term "non-teacher" in this report refers to employees who participate in the MCPS Local Plan.***

[1] Montgomery County Public Schools, "2015 Employee Benefit Summary," p. 34, available at http://www.montgomeryschoolsmd.org/uploadedFiles/departments/ersc/employees/benefits/employee_benefit_summary_current.pdf
[2] State Personnel and Pensions Article, 22-205(a)(1) and 23-206(a)(1); COMAR 22.04.03.02.
[3] Montgomery County Public Schools, "2015 Employee Benefit Summary," p. 34.

## B. Plan Design

Both 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.

### 1. Calculation of Core Pension Benefit

The State Teachers' Plan and the MCPS Local Plan utilize an identical formula to determine a retiree's annual pension benefit. The amount of the pension benefit is a function of three variables: (1) average final salary, (2) credited service (years of service), and (3) the pension multiplier. These three variables are multiplied to determine the annual benefit for each retiree.

| | | | | | | |
|---|---|---|---|---|---|---|
| Average Final Salary | X | Credited Service | X | Multiplier | = | Annual Benefit |

- *Average Final Salary* (AFS) is the average of pay over the highest consecutive years of an employee's career. For MCPS employees hired on or before June 30, 2011, the average final salary is calculated based on the three highest consecutive years of salary; for MCPS employees hired on or after July 1, 2011, the average final salary is based on the five highest consecutive years of salary.
- *Credited Service* is the retiree's number of years with MCPS based on hours worked (i.e., 80 hours worked biweekly equals 10 months or one year of service). Credited service may also include purchased or transferred service (e.g., military service).
- *Multiplier* is the percent of salary earned per year of service. The larger a multiplier, the greater the retirement benefit. For most employees hired on or before June 30, 2011, the pension multiplier equals 1.8% of salary for each credited year of service. For employees hired on or after July 1, 2011, the multiplier is 1.5% of salary per year of credited service.[4]

The formula produces the amount for the retiree's "core" pension benefit. In addition, retirees receive a supplemental pension benefit as described below.

### 2. Pension Supplement

In addition to the core pension benefit, MCPS provides both teacher and non-teacher retirees with a "pension supplement." The pension supplement is a 0.2% add-on to the pension multiplier. For employees hired on or before June 30, 2011, the core multiplier of 1.8% combined with the 0.2% supplement results in a pension equal to 2.0% of average final salary for each year of credited service. For employees hired on or after July 1, 2011, the core multiplier of 1.5% combined with the 0.2% supplement results in a pension equal to 1.7% of average final salary for each year of credited service.

MCPS is the only public school system in the State of Maryland to provide a supplemental pension benefit.

[4] Montgomery County Public Schools, "Understanding Your Retirement," October 2015, pp. 4, 16, available at http://www.montgomeryschoolsmd.org/departments/ersc/employees/benefits/retirement-savings/pension.aspx.

As detailed in Section IV of this report, in 1999, the Maryland General Assembly enacted legislation requiring MCPS to provide a supplemental pension benefit of 0.08% per year of credited service. In 2006, MCPS elected to increase the supplement by an additional 0.12%, resulting in the current 0.2% multiplier.

### 3. Integration with Social Security

Social Security integration refers to whether a pension plan lowers the pension amount that a retiree collects when the retiree reaches Social Security retirement age (SSRA). In an integrated plan, the pension amount decreases when a retiree reaches SSRA. In a non-integrated plan, the pension amount does not decrease.

Both the State Teachers' and the Local MCPS pension plans integrated with Social Security until 1998. That year, 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. The pension benefit for service after that date is not reduced when a retiree becomes eligible for Social Security.

### 4. Vesting

Teachers and non-teachers must work a minimum number of years with MCPS (known as the vesting period) to receive a pension benefit upon retirement. If a teacher or non-teacher leaves MCPS prior to the end of the vesting period, the employee receives only their employee pension contributions. For pension-eligible MCPS employees, the vesting period is determined by the employee's hiring date:

- Employees hired on or before *June 30, 2011* vest with five or more years of service.
- Employees hired on or after *July 1, 2011* vest with 10 or more years of service.[5]

[5] *Ibid*. at 15.

### 5. Normal Retirement Age

Retirement eligibility is based on an employee's age and eligibility service. Teachers and non-teachers, who retire at the normal retirement age, receive full, unreduced pension benefits. Employees who choose to retire early receive reduced benefits. Similar to the benefit formula and vesting period, normal retirement age is dependent on an employee's hiring date.[6]

| Date of Hire | Retirement Age |
|---|---|
| Employees hired on or before *June 30, 2011* | • 30 years of eligibility service—at any age OR<br>• Age 62 with at least 5 years of eligibility service OR<br>• Age 63 with at least 4 years of eligibility service OR<br>• Age 64 with at least 3 years of eligibility service OR<br>• Age 65 with at least 2 years of eligibility service |
| Employees hired on or after *July 1, 2011* | • Age 65 with at least 10 years of eligibility service OR<br>• Age + Years of Eligibility Service = 90 |

### 6. Cost-of-Living Adjustments

To account for increasing prices or inflation, retirement benefits for teachers and non-teachers are adjusted during retirement years based on an annual cost-of-living adjustment (COLA). The calculation of COLAs is one of the few areas in which the State Teachers' Plan differs from the MCPS Local Plan. For the State Teachers' Plan, the COLA for credited service after July 1, 2011 depends on the pension trust's expected investment returns:

- If pension trust investment returns meet or exceed the assumed rate of return (currently 7.75%), the COLA is set to equal the one-year change in the consumer price index (CPI) up to a 2.5% maximum.
- If trust investments fail to meet expectations, the COLA for that year is set at the one-year change in CPI up to a 1.0% maximum.

For MCPS Local Plan participants, the pension COLA for credited service after July 1, 2011 is based on the CPI with a 2.0% maximum (independent of investment returns). Similarly, the supplemental pension benefit for all employees is based on the CPI with a 2.0% maximum (independent of investment returns).

For both pension plans, the COLA for credited service before July 1, 2011 is capped at 3.0% annually.

Retirees in the State Teachers' Plan receive their COLA on July 1 of each year, while MCPS Local Plan retirees receive their COLA on January 1.

[6] *Ibid*. at 11-13.

## SECTION II. PENSION PLAN FUNDING

The State Teachers' Plan and the MCPS Local Plan employ similar methods to fund the pay out of pension benefits.

### A. Funding Sources

Three major sources contribute to a pension plan fund: (1) employee contributions, (2) employer contributions, and (3) investment earnings. Over time, the combined funding from these three sources must equal the cost of benefits paid and expenses charged to manage the pension system.[7]

- **Employee Contributions.** Members of the State Teachers' and MCPS Local plan contribute 7.0% of salary towards the core pension benefit and 0.5% of salary towards the supplemental pension benefit.

- **Employer Contributions.** The State and MCPS make annual contributions to fund future pension benefits paid by their respective plans. Their contribution is determined annually based on an actuarial evaluation of assets and liabilities called the Actuarially Required Contribution (ARC). The ARC funds annual pension costs and can be used to reduce any unfunded liabilities. (Unfunded liabilities are when the total plan obligations exceed projected plan assets).[8] The next section of this report provides further detail regarding MCPS pension fund contributions.

- **Investment Returns**. The State and MCPS each invest employee/employer contributions to maximize fund balances. The rate of return on investments impacts the total amount the State or MCPS is required to contribute to fund promised benefits. If the assumed rate of return on investments is high, assets are expected to earn more and the employer is able to contribute less money to fund benefits. Conversely, if the rate of return is low, assets are expected to earn less over time thereby increasing employer required contributions. The actuarially assumed rate of return for the State Teachers' Pension plan is 7.65% and for the MCPS Local Plan the rate of return is 7.5%.[9]

### B. MCPS Annual Required Contribution

MCPS makes an annual contribution to its pension fund to pay for the cost of: (1) the core pension benefit offered to non-teachers; and (2) the supplemental benefit for all permanent employees. The amount of the annual contribution is determined by the Board based on an actuarial assessment of plan assets and liabilities. In FY15, MCPS contributed $83.5 million to their Local Plan pension fund.

Pension contributions are a function, in part, of employee payroll. As such, annual increases in MCPS pension costs can be expected to increase as a result of increases in workforce size and employee salaries.

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[7] National Institute on Retirement Security, "Public Pension Basics," January 2010, available at http://www.nirsonline.org/storage/nirs/documents/final_module1_public_pension_basics.pdf.

[8] Maryland State Department of Legislative Services, "Actuarial Terms and Methodologies – A Guide in Plain English, June 2010.

[9] FY15 MCPS CAFR, pp. 62, 64.

### C. Financial Health of MCPS Pension Fund

Adequate funding of pension obligations is necessary to protect the County's credit-worthiness and to assure that sufficient resources are set aside to pay current and retired MCPS employees for a benefit they have already earned.

Rating agencies consider a pension fund's "funded ratio" (among other factors) in determining the bond ratings for local governments. The term, funded ratio, refers to the percentage of the plan's liabilities covered by the current actuarial value of the plan's assets. At the start of FY03, the MCPS pension fund held assets that were greater than its liabilities, that is, the funded ratio exceeded 100%. By FY10, the MCPS pension funded ratio had dropped to below 70% (as measured by the actuarial value of assets).[10] Two primary factors contributed to the sharp decline. First, in 2006, the Board of Education approved two pension plan enhancements that significantly raised the plan's unfunded liability. These plan enhancements mirrored those made to the State Teachers' Plan in 2006. Second, the MCPS pension fund incurred a combined investment loss of more than $265 million during FY08 and FY09.

The MCPS pension fund has experienced steady improvement in recent years. As of July 1, 2014, the pension fund had a funded ratio of 82.9% (as measured by the market value of assets).[11] In other words, at present, the MCPS pension fund currently holds 82.9 cents of assets for every dollar of liability. As with most pension funds, the recent improvement in the MCPS funded ratio is a function of recent strong investment returns coupled with the change in the method of measuring fund assets. Despite the recent funded ratio improvement, as current pension liabilities exceed fund assets, MCPS will have to address the shortfall by making future year pension fund contributions that cover both newly earned employee benefits as well as the unfunded liability for benefits earned in previous years.

### D. Pension Shift

Since the pension plan's inception through 2012, the State contributed full funding for public school teacher pension benefits. In 2012, the Maryland General Assembly enacted legislation that required counties to begin contributing local funds toward the cost of the State Teachers' Pension Plan. Specifically, the State shifted the responsibility for funding teacher pension "normal costs"[12] to the counties. Under the 2012 legislation, the State remains responsible for costs associated with unfunded pension liability.

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[10] Prior to 2014, the funded ratios were calculated based on the "actuarial value of assets (AVA)." The AVA method is a mathematical calculation that measures asset value by considering the long-term performance of fund investments to smooth out annual variations.

[11] Beginning with pension plan valuations conducted last year, new accounting standards are in effect regarding the measurement of fund assets and liabilities. Governmental Accounting Standards Board (GASB) Statements #67 and #68 call for reporting of assets by on the "market value of assets (MVA)." The MVA method values a fund's assets based on the amount of money the fund would receive if it sold all its investments. Given recent rapid growth in stock and other investment values, current MVA-based funded ratio calculations exceed those resulting from an AVA-based calculation. However, the MVA method produces funded ratios that are highly sensitive to fluctuations in the investment market. A downturn in investment rates of return would cause greater declines in MVA-based funded ratios than in AVA-based calculations.

[12] The term "normal costs" refers to the actuarial value of compensation earned by employees in the current year that will be paid in future years.

The shift of pension costs to the counties was phased in over four years (FY13 through FY16). In FY16, Montgomery County was responsible for contributing $44.4 million to the State pension fund. When the legislature enacted this requirement in 2012, the normal cost that MCPS would be required to contribute to the State in FY17 was set at $49.7 million. Recently, the State informed MCPS that the updated FY17 estimated cost of the pension shift cost is $58.7 million.

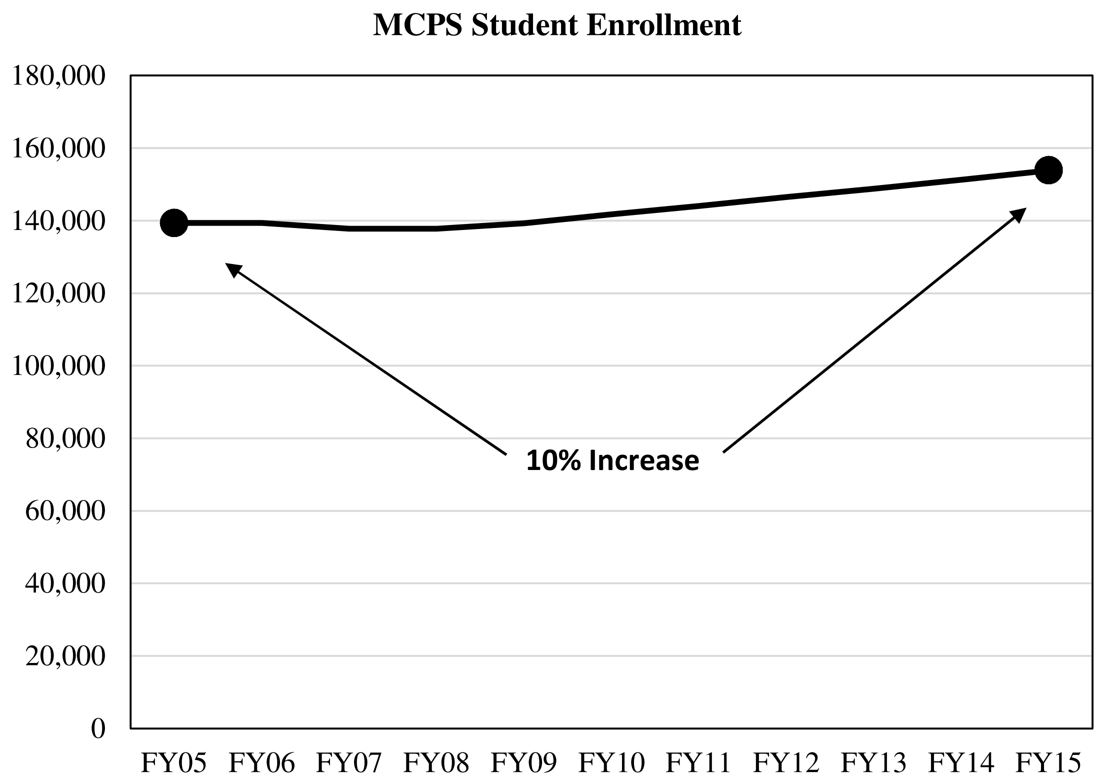
## SECTION III. RETIREMENT COSTS IN THE CONTEXT OF THE MCPS OPERATING BUDGET

Beginning in FY10, MCPS budget deliberations for both the Board of Education and the Council have been dominated by the fiscal constraints facing the County. Given the difficult budget allocation choices made during this time period as well as the continuing fiscal uncertainty, it is important to understand various cost drivers within the MCPS budget and how their growth affects the resources available for other important expenditures.

In the last decade (FY05-15), the total MCPS approved operating budget has grown 41.5%, from $1.6 billion in FY05 to $2.3 billion in FY15. The average annual growth rate during this period was 3.5%. This section analyzes the growth in several key factors affecting the MCPS budget between FY05-FY15: enrollment; workforce size; payroll costs; employee health benefits; and pension contributions.

### A. Enrollment

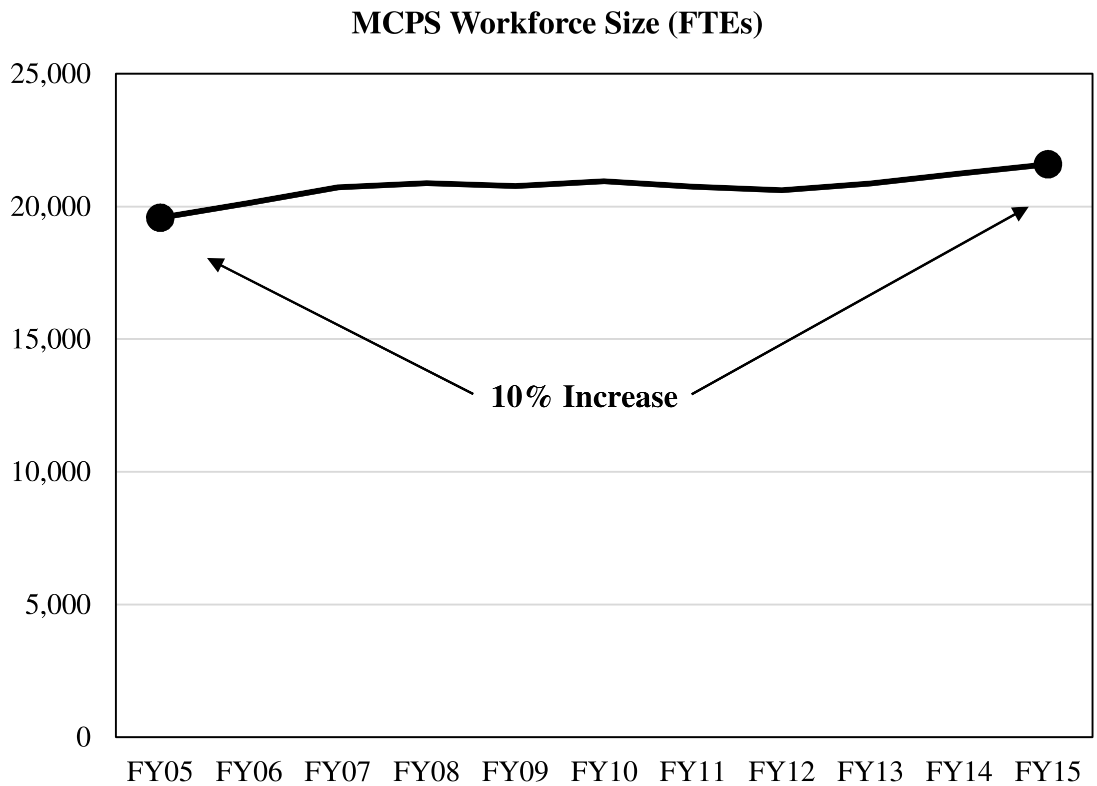
One of the primary starting points for building the MCPS budget is student enrollment.




The graph above shows that MCPS enrollment grew approximately 10% in this period, from 139,337 students in FY05 to 153,852 students in FY15. The average annual rate of growth was 1%. This time frame includes a brief period of flat and slightly declining enrollment from FY05-09. Since FY10, enrollment has been steadily increasing by approximately 2,000 students per year. MCPS projects that enrollment will continue to increase at roughly the same pace for at least the next six years.

## B. Workforce Size

An important correlated factor in the MCPS budget is workforce size. MCPS adds positions to its workforce both to provide new or different services and initiatives as well as to expand existing services to support increasing numbers of students.



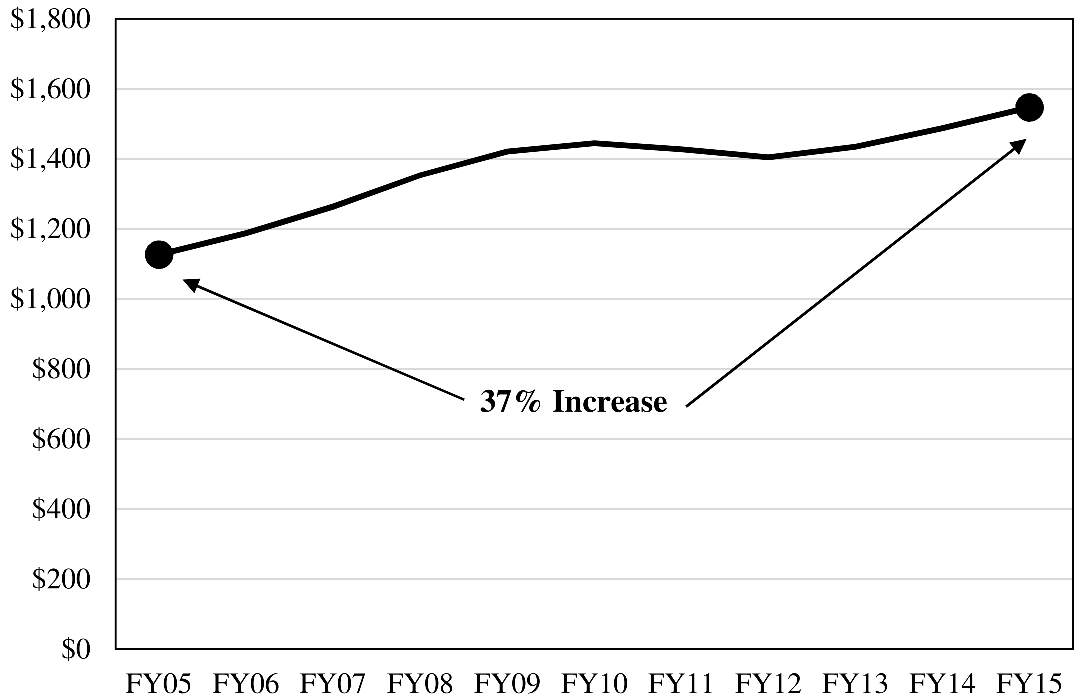

The graph shows that workforce size increased at about the same rate as enrollment in the last decade (10% with an average annual growth rate of 1%), from 19,575 FTE in FY05 to 21,588 FTE in FY15. The growth in the graph above does not fully mirror the same trajectory of enrollment. For example, increases in FTEs in FY05-07 coincided with enrollment declines, but reflected in part implementation of new initiatives.

Growth in workforce size was dampened twice in recent years to achieve budget savings due to fiscal constraints. In both FY11 and FY16, the Board of Education approved an increase in class size of one student on average to reduce the amount of new positions needed in the budget for that fiscal year.

### C. Payroll Costs

Employee compensation is another key cost driver. The graph below shows that payroll costs grew at a slightly lower rate than the operating budget as a whole, a total of 37% in this period with an average annual growth rate of 3.2%. The rise in payroll costs is a function of both increased workforce size and higher salaries.[13] During the period from FY05 through FY15, the inflation rate was about 31%, or about 2.7% per year.

**MCPS Employee Salary Costs ($ millions)**

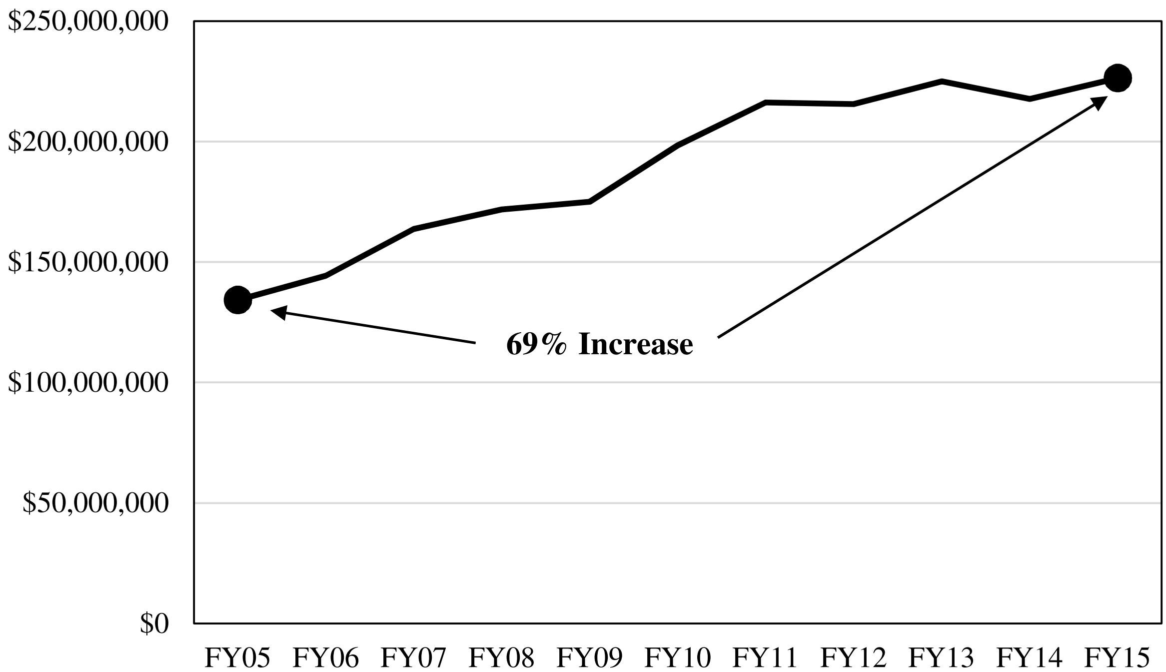



[13] As workforce size is a contributing factor to the increase in payroll costs, the growth rate shown in the chart above does not represent the growth rate in MCPS employee pay.

**D. Employee Health Benefit Costs**

The graph below reflects the employer contribution for active employee health benefits only. Currently, MCPS employees pay 12% of their premium costs for HMO plans and 17% of premium costs for POS plans. In response to difficult fiscal conditions, the Board increased the employee cost share over the last two fiscal years as a way to contain cost growth in this area. In FY14, employees paid 5% or 10% of their premium costs. Beginning in FY15, MCPS initiated a program to reduce health benefits costs by offering a reduction in the employee health care contribution for employees who voluntarily complete biometric screenings or complete an online health risk assessment. In addition, effective January 2017, MCPS will impose a 3% surcharge to the total health insurance costs (medical, prescription, dental, and/or vision) of plan subscribers and/or covered spouses if they smoke or use other forms of tobacco.

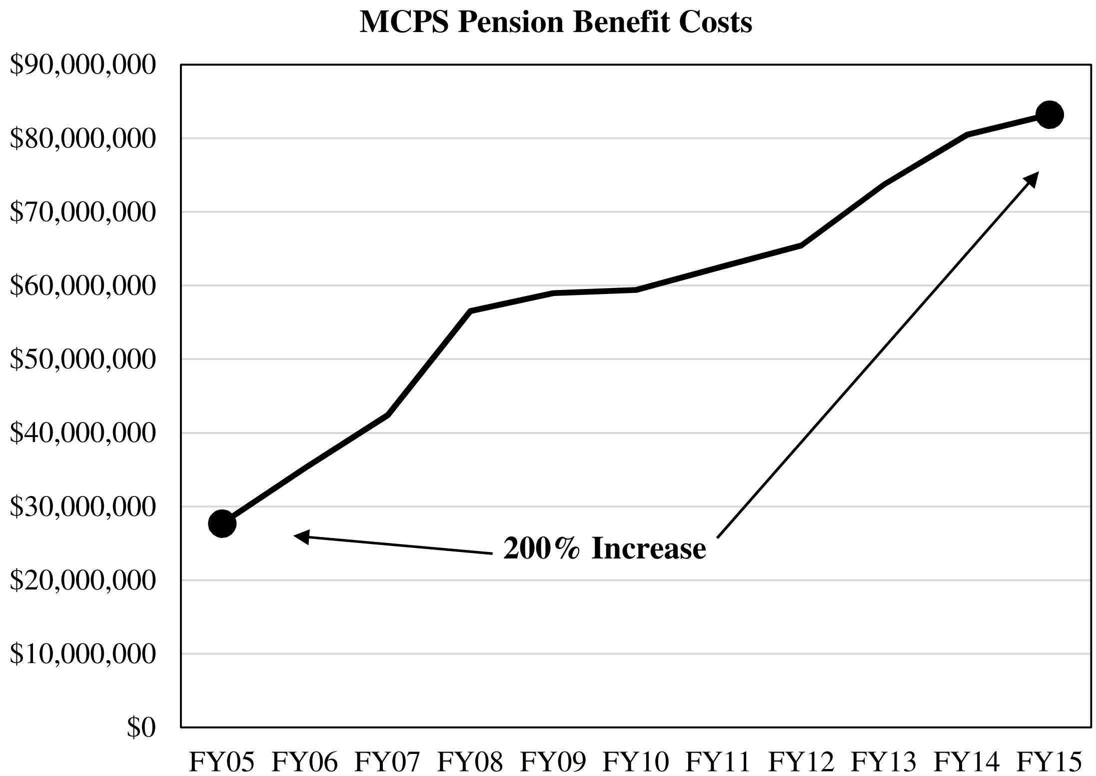
**MCPS Employee Health Benefit Costs**



### E. Pension Benefit Costs

The graph below shows the MCPS retirement contribution for the local plan and supplement. In 2011, the employee contribution for the core benefit of both the State Teachers' and MCPS Local plans increased from 5.0% to 7.0% of annual salary.

The data displayed in the graph below *does not* include the amount required since 2012 for the shift of normal pension costs for employees in the State Teachers' plan.




MCPS retirement contributions increased by 200% in the last decade with an average annual growth rate of 11.6%, from $27.7 million in FY05 to $83.5 million in FY15. Again, this does not include the shift of teacher pension costs formerly paid by the State, which added $27.2 million in FY13 and $37.8 million in FY15.

Although it is not the largest dollar amount among these cost drivers, the required retirement contribution for the local plan and supplement has been by far the fastest growing of these cost drivers in the MCPS budget. The local costs for retirement have grown out of proportion to enrollment, workforce size, or salary.

A brief overview comparison of other jurisdictions in the region showed that government pension plan contributions have experienced an average annual growth rate between six and 12 percent over the same period. All systems were affected by the FY09-10 market downturn, which required increased contribution to account for market losses. Public sector employer pension plan costs in Maryland were additionally affected by both State and local unfunded plan enhancements.

### F. Analysis of Retirement Costs in the Context of the MCPS Operating Budget

The trends of the last decade illuminate the structural challenge of funding the required increases in employee benefits when the rates of growth for these benefit costs outstrip the growth in the enrollment, workforce, and budget of the system overall. In addition to the class size increases of FY11 and FY16 noted above, the Board of Education has taken reductions in, or constrained the growth of, other instructional and student support positions to address limited resources and increasing costs.

Future year MCPS pension cost trends are difficult to predict. Some of the factors affecting the growth are out of MCPS's control, such as market and economic conditions, the shift of State teacher pension costs to the County, and pension fund reporting standards. The Board will need to continue to monitor the funded ratio of its pension fund and plan contributions to close the gap between assets and liabilities. 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 have also produced measurable cost reductions. However, unless the growth rates of the last decade change markedly, funding the requirements of 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.

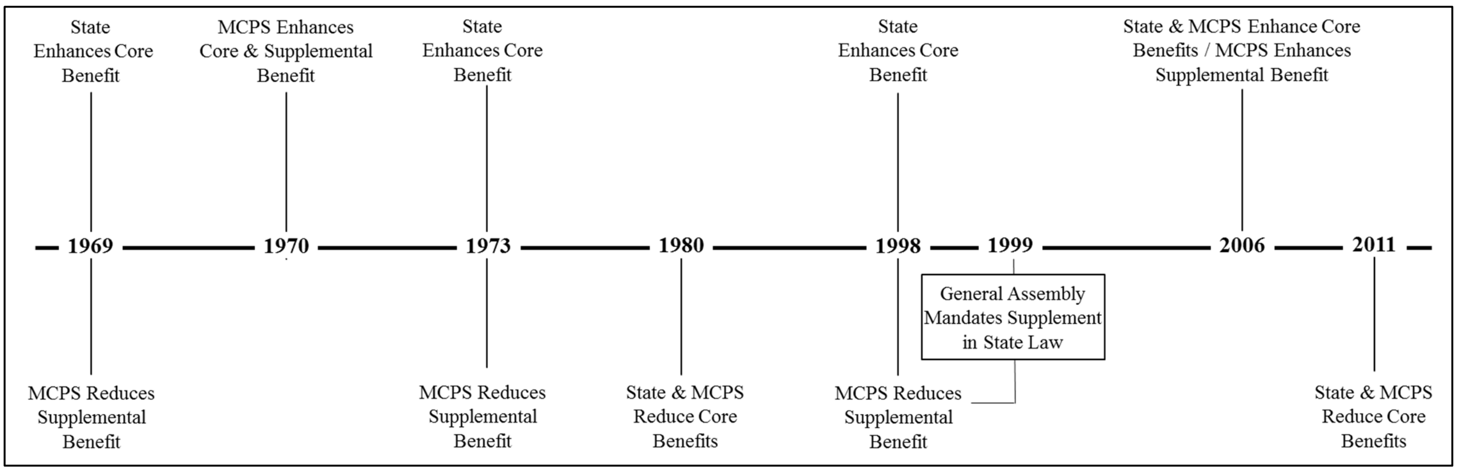
## SECTION IV. PENSION HISTORY AND TIMELINE

OLO researched the history of pension benefits provided to MCPS employees. This section details the provisions of the State Teachers' Plan and MCPS Local Plan pensions from their origins through the present.

### A. Major Pension Plan Changes

A detailed timeline showing changes to the State Teachers' Plan and MCPS Local Plan pension benefits appears below. As shown in the following exhibit, the pension plans have undergone multiple significant changes over the past four decades. These changes include both benefit enhancements and benefit reductions.

**Major Changes in State and MCPS Pension Benefits, 1969 to 2011**




In reviewing the history of the pension plans, OLO observed four recurring themes:

***Theme #1: State and MCPS decisions to enhance pension benefits occurred when economic conditions were favorable or concurrent with tax increases or budgetary surpluses.***

- In 1969, a 1% increase in the State sales tax resulted in higher pension benefits.
- In 1973, State pension benefits increased due to an accounting adjustment.
- Strong economic conditions in 1998 and 2006 increased State and MCPS pension benefits.

***Theme #2: State and MCPS decisions to reduce pension benefits occurred during times of fiscal constraints or pension fund instability.***

- In 1980 benefits decreased in order to increase the funded ratio of the State pension plan.
- As a result of the market downturn in 2009-2010, the State and MCPS decreased benefits in 2011.

***Theme #3: MCPS' long-standing policy has been to preserve parity between teachers' and non-teachers' retirement benefits.***

- In 1970, MCPS increased the pension multiplier from 1.75% to 2.0% for non-teachers. To maintain an overall multiplier of 2% for all employees, MCPS increased the supplement benefit for teachers.
- When the State increased/decreased teacher pension benefits in 1980, 2006, and 2011, MCPS adopted similar benefit changes for non-teachers.

***Theme #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.***

- As a result of State increases to teacher pension benefits in 1969, 1973, and 1998, MCPS decreased the teacher's supplement to maintain the total pension multiplier offered to non-teachers.

## B. Pension History Timeline

The core and supplemental pension benefits offered to MCPS employees have a long and eventful history. On the following pages, OLO presents a historical timeline that traces major pension plan benefit changes that occurred over the past 60 years. The timeline focuses on the State Teachers' and MCPS Local Plans (core and supplement), but also includes major structural changes in the County Government Employee's plan. To provide context, OLO has included quotations from individuals involved in some of the timeline events.

## MCPS Pension Plan Timeline

### 1927

**Teachers' Core Benefit (State Plan)**

- General Assembly enacts legislation creating the State Teachers' Retirement System.

### 1951

**Teachers' Core Benefit (State Plan)**

- State sets teachers' pension multiplier at 1.43%.

### 1965

**MCG General Employees' Retirement Benefit**

- County Government leaves State Employees' Retirement Plan and creates own pension plan.

### 1968

**Non-Teachers' Total Pension Benefit (MCPS Plan)**

- MCPS creates local pension plan for non-teachers with plan design similar to County Government general (non-public safety) employee's pension plan.
- MCPS sets non-teachers' pension multiplier at 1.75%.

**MCPS Supplement – Teachers**

- MCPS creates pension supplement; sets multiplier at 0.32%, the difference between State Teachers' Plan and Local MCPS Plan.

**<u>1969</u>**

**Teachers' Core Benefit (State Plan)**

- State increases pension multiplier from 1.43% to 1.67%.

> *"The new spending programs would be financed largely by increasing the State sales tax from 3 per cent to 4 per cent."*
>
> *Washington Post*, February 28, 1969
>
> *"Unless there is a tax increase this year, the types of services the people demand and are entitled to cannot be achieved."*
>
> Governor Marvin Mandel, *The Baltimore Sun*, February 26, 1969.

**Non-Teachers' Total Pension Benefit (MCPS Plan)**

- MCPS initially decides to maintain pension multiplier at 1.75% for non-teachers and then subsequently raises the multiplier to 2.00% for non-teachers.

**MCPS Supplement – Teachers**

- MCPS initially decreases pension supplement multiplier for teachers from 0.32% to 0.08% to maintain a total combined multiplier of 1.75%; subsequently, MCPS raises the teachers' supplemental pension multiplier to 0.33% to establish a total multiplier of 2.0% for all employees.

## 1973

### Teachers' Core Benefit (State Plan)

- State increases pension multiplier from 1.67% to 1.82%.

> *"Gov. Marvin Mandel yesterday announced a multi-million dollar program of increased retirement benefits for teachers and state employees…Mandel said the…benefit package…will be funded by raising the official rate of return which Maryland demands on the investment of moneys in the state retirement fund."*
>
> *Washington Evening Star*, January 19, 1973

### MCPS Supplement – Teachers

- MCPS decreases supplement from 0.33% to 0.18% to maintain a total combined multiplier of 2.0%.

> *"MCPS plan requires that a retiree receiving an increase in state benefits... should receive a corresponding decrease in benefits under the County Plan"*
>
> Board of Education Resolution No. 545-73

## 1976

### MCPS Supplement – Teachers

- Maryland Court of Appeals rules that the pension supplement is not permanently fixed or frozen at a certain level; rather rights are vested in the aggregate multiplier percentage of 2%.

> *"The Board funded liability is 'not anywhere near caught up.' In such circumstance the Board refusing to increase the base pension...cannot be said to be arbitrary.... On the contrary, it tends to preserve the integrity of the Plan."*
>
> The Honorable J. Orth, Court of Appeals of Maryland, Benson v. Board of Education of Montgomery County, 1976

## 1980

**Teachers' Core Benefit (State Plan)**

- State replaces the State Teachers' Retirement System with a new Teachers' Pension System.
- State modifies pension plan design including:
  - Increasing the retirement age from 60 years of age to 62 years of age and five years of service;
  - Reducing employee contributions from 5.0% of pay to noncontributory for annual compensation less than the Social Security Wage Base;
  - Reducing the benefit multiplier from 1.8% to 0.8%; and
  - Changing cost-of-living adjustments from unlimited compounded adjustments to simple adjustments capped at 3.0%.

> *"In response to concerns about the retirement systems' deteriorating financial status, the General Assembly established the Joint Committee on Pensions.... The Committee's most significant finding was that unless major changes were made to the funding and benefit structures of the plans, the State would face a future of ever increasing pension costs both in terms of total dollars and as a percentage of payroll."*
>
> Department of Legislative Services, Legislative Handbook Volume V, page 107.

**Non-Teachers' Total Pension Benefit (MCPS Plan)**

- MCPS modifies non-teachers' pension plan parallel to changes made to Teachers' Pension System.

## 1994

**MCG General Employees' Retirement Benefit**

- County Government replaces pension benefit with defined contribution retirement benefit for newly hired general (non-public safety) employees.

## 1998

| Teachers' Core Benefit (State Plan) |
|---|
| • State discontinues integration of pension plan benefits with Social Security.<br>• State modifies the pension plan design by:<br>– Increasing the pension multiplier from 0.8% to 1.4%;<br>– Amending the cost-of-living adjustments for retirees from a 3.0% simple cost-of-living adjustment to a 3.0% compounded adjustment;<br>– Increasing member contributions from noncontributory to 2% of all earnable compensation; and<br>– Eliminating the 5% contribution on compensation above the Social Security Wage Base. |
| **Non-Teachers' Core Benefit (MCPS Plan)** |
| • MCPS modifies non-teachers' plan parallel to changes made by the State for teachers. |

**MCPS Supplement – All Employees**

- County Board of Education votes in June 1988 to eliminate the pension supplement for teachers in order to establish a uniform pension multiplier of 1.4% for both teachers and non-teachers.

> *"Over the years, that supplement cost us millions of dollars, but because it helped provide a more competitive plan for our teachers, it was money well spent. The situation changed this year, however, when the state finally revised the State Pension Plan to make it more competitive."*
>
> Letter to the Editor written by the Board of Education Audit Committee, *The Gazette*, July 30, 1998.
>
> *"It baffles me why we would start to withdraw local funds. It undercuts our efforts. From a purely political point of view there is no reason to rush to judgement. Certainly there is no fiscal need. We are flush with funds."*
>
> Del. John A. Hurson (D – Bethesda), *The Gazette*, June 24, 1998

- County Board of Education votes in October 1998 to halve the pension supplement multiplier.

> *"The perception among employees was that the Board had taken something from them."*
>
> Board of Education Member Nancy J. King, Board of Education Minutes, October 26, 1998.
>
> *"The volatility in the investment market could mean that the school system, and therefore the taxpayers, might someday have to foot the bill for pension benefits. How is the taxpayer going to pay for it?"*
>
> Board of Education Member Mona M. Signer, *The Gazette*, October 28, 1998.

## 1999

### MCPS Supplement – All Employees

- Maryland General Assembly enacts legislation requiring the County Board of Education to provide a supplemental pension benefit of 0.08%.

> *"MCPS added a supplement to the state's retirement benefit for our teachers so that they, too, would have benefits comparable to our county government employees."*
>
> Board of Education Position Opposing House Bill 406, 1999
>
> "*It is important to understand the construct of the MCPS supplemental plan. Although it has provided a 10 percent greater benefit than did the State Teachers' Pension System, it did not promise a 10 percent greater benefit if the state plan were improved."*
>
> Board of Education Position Opposing House Bill 406, 1999
>
> *"Del. Heller said he is really torn: He really does not want the state legislature so deeply involved with the local school system's operations, but he does not want to see the school board 'compromise a state action.'"*
>
> *The Gazette*, January 6, 1999.

**2006**

**Teachers' Core Benefit (State Plan)**

- State increases the pension multiplier from 1.4% to 1.8% retroactively for all service from 1998.
- State increases the mandatory employee contribution from 2.0% to 5.0% of salary.

> *"The state's current retirement system ceased to be competitive some time ago. Ranked 50th in the nation, based on the benefit calculation, the state system also produced among the worst monetary benefits nationally because of lower employee contributions."*
>
> MCPS Superintendent Jerry Weast, Memo to the Board of Education, May 9, 2006

**Non-Teachers' Core Benefit (MCPS Plan)**

- MCPS modifies non-teachers' plan to parallel changes made by the State for teachers.

> *"A self-renewing organization is enhanced when employees feel secure in knowing that appropriate pension benefits are provided upon their retirement – benefits that encourage career commitment, professional development, and service to our community."*
>
> MCPS Superintendent Jerry Weast, Memo to the Board of Education, May 9, 2006

**MCPS Supplement – All Employees**

- MCPS increases the pension supplement for both teachers and non-teachers from 0.08% to 0.20% retroactive to 1998.
- MCPS increases the mandatory employee pension supplement contribution from 0.2% to 0.5% of salary (phased in over three years).

> *"The provision of a supplemental pension benefit for MCPS employees continues to be a key factor in maintaining a competitive advantage in the recruitment and retention of teachers and other employees."*
>
> MCPS Superintendent Jerry Weast, Memo to the Board of Education, May 9, 2006

## 2011

### Teachers' Core Benefit (State Plan)

- State modifies the pension plan design by:
  - increasing the mandatory employee contribution from 5.0% to 7.0% of salary and
  - lowering the cap on cost-of-living adjustments for all employees.

- For employees hired on or after July 1, 2011, State modifies the pension plan design by:
  - Decreasing the pension multiplier from 1.8% to 1.5%;
  - Changing the average final salary calculation from highest three to highest five years;
  - Adjusting the age and years of service requirements for regular and early retirement; and
  - Increasing the vesting period from five to ten years.

> *"We would have liked to have kept the multiplier at 1.8 for everybody, but it just wasn't feasible to do that and reach the 80 percent liability by 2023."*
>
> House of Delegates Speaker Michael Busch to Associated Press, April 4, 2011

### Non-Teachers' Core Benefit (MCPS Plan)

- MCPS modifies non-teachers' plan to parallel changes made by the State for teachers.

### MCPS Supplement – All Employees

- MCPS maintains 0.2% multiplier but adjusts eligibility, vesting, and other provisions to align with changes made to the State pension plan.

### MCG General Employees' Retirement Benefit

- For employees hired before July 1, 1994, County Government:
  - lowers the cap cost-of-living adjustments and
  - increases the mandatory employee contribution from 4.0% to 6.0% of salary (and to 8.0% for earnings above the Social Security wage base).
- For employees hired on or after July 1, 2011, County Government reduces the employer contribution to employee's defined contribution retirement accounts by 2.0% for one year.

> *"My recommended changes to the County's benefits structure is the beginning of a continued effort to better structure our benefits to provide savings for both the County and its employees."*
>
> County Executive Isiah Leggett's FY12 Budget Message, March 15, 2011

## SECTION V. COMPARISON OF PUBLIC SECTOR RETIREMENT BENEFITS

In presentations to the Board of Education and the Council, MCPS superintendents historically 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.

This section compares the retirement benefits of an MCPS employee with those in the three employee groups listed above. This comparison focuses primarily on the value of the retirement to employees who work sufficient years to earn a full retirement benefit. The reader should note that a full comparison of retirement benefits necessarily involves multiple factors such as the pension multiplier, calculation of final earnings, credits for years of service, employee contribution rates, cost of living adjustments, Social Security integration, vesting periods, portability.

In addition, retirement benefits are only one aspect of employee compensation. Comparison of compensation among different groups of employees is a complex undertaking that must take into account salary, health insurance, retirement, and other benefits. The intent of this section is to compare the value of retirement benefits; this report does not attempt to draw any conclusions regarding the relative value of total compensation packages offered to different employee groups.

Note: The calculations shown below represent the average value of a pension received by a retired MCPS teacher. The benefit received by any particular retiree will vary depending on several factors, most notably, life expectancy. A retiree who outlives average life expectancy would receive a higher cumulative lifetime benefit; a retiree with a shorter life would receive less.

### A. Montgomery County Government Employees

MCPS provided OLO with demographic information about its retirees. For the purpose of this comparison, OLO focused on the largest employee group in MCPS, namely teachers. MCPS actuarial data indicate that the median age of full retirement for teachers is 64 years after a career of 35 years. 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 (in current year dollars). In addition, the retired MCPS teacher would receive an annual Social Security benefit of about $23,000 over and above the MCPS pension benefit for a total annual retirement payment of about $91,400. A similar teacher hired on or after July 1, 2011 would receive an annual pension of about $56,600 (in current year dollars) or about $79,600 per year including Social Security.

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.[14] OLO found the present value of the pension benefit to equal about $1.4

[14] For this present value calculation, OLO assumed an annual inflation rate of 2.75% and an annual pension cost of living adjustments of 1.75%.

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.

OLO sought to compare the MCPS pension benefit with the retirement benefit offered to current County Government general employees. The County Government discontinued providing a pension benefit for new general government (non-public safety) employees hired since October 1, 1994. Since that date, new County Government employees receive a defined contribution retirement or cash balance benefit.

At present, about 80% of the general government workforce participates in a defined contribution or cash balance retirement plan. In both non-pension plans, the employee contributes 4.0% of salary into a personal retirement account and the County Government contributes an additional 8.0% of salary to the account. In the defined contribution plan (called the Retirement Savings Plan), the employee manages account investments; in the cash balance plan (called the Guaranteed Retirement Income Plan), the County Government guarantees a 7.25% annual return.

OLO calculated how much an MCPS ten-month teacher with a Master's Degree and 35 years of service would have accumulated in a retirement account had he/she received a County Government retirement benefit instead of the MCPS pension. For the purpose of this comparison, OLO assumed that the employee participated in the GRIP. OLO found that the employee would have retired with an account balance of about $800,000 (in current year dollars). Participation in the GRIP would not change the retiree's Social Security benefit of about $23,000 per year.

OLO acknowledges that it is difficult to compare the value of post-retirement lifetime pension payments benefits with accumulation of a lump-sum retirement account balance. Alternative methodologies and assumptions will produce varying results. Nonetheless, OLO's calculations found that, in the case of the teacher described above, the MCPS pension benefit had a present value that exceeds the GRIP benefit by about 50% to 75% (or $400,000 to $600,000 in current year dollars). In return for this additional benefit, an employee participating in the MCPS pension would have contributed about $100,000 (in current year dollars) more over the course of his/her career than an employee participating in the County Government GRIP.[15]

### B. Public School Employees in Other Maryland Counties

Teachers: Public school teachers throughout the State of Maryland participate in the same pension plan. Therefore, no difference exists between the core retirement benefit received by MCPS teachers and by teachers in other counties. Teachers statewide receive the identical pension multiplier (1.8% for employees hired before July 1, 2011 and 1.5% for employees hired after that date) of final average salary per year of service. However, as MCPS teachers earn top of grade salaries that are higher than those in other Maryland counties, the dollar value of the core pension earned by MCPS teachers retiring after 30 or more years will exceed the dollar value earned by a teacher with similar credentials and years of service elsewhere in the State.

MCPS is the sole public school district in Maryland that provides teachers with a supplemental pension benefit. The MCPS supplement adds 0.2% of final average salary per year of service to an employee's pension multiplier. For a ten-month teacher with a Master's Degree retiring at top of

[15] Based on the difference in employee contribution rates: 7.5% of salary for the MCPS pension versus 4.0% for the County Government GRIP.

grade after 35 years of service, the pension supplement would have a value of about $6,800 per year under the current salary schedule. Assuming this employee began his/her teaching career at age 29 and lived until the age of 87, the present value of the lifetime supplemental pension benefit would equal about $142,000 (in current year dollars).

Non-Teachers: MCPS provides non-teachers with a similar pension benefit offered to teachers. Elsewhere in Maryland, 19 school districts provide parity in pension benefits between teachers and non-teachers. In these counties, 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. Four school districts do not provide teachers and non-teachers similar retirement benefits. Non-teachers in three school districts (Baltimore City, Baltimore County, and Wicomico County) participate in the City/County Government's general employees' retirement plan while non-teachers in one district (Charles County) participate in a Board of Education sponsored retirement plan with a different plan design than the State Teachers' Pension Plan.

MCPS is the only school district to offer a pension supplement to non-teachers. The pension supplement is the same as that offered to teachers. For an MCPS Building Services Worker retiring at top of grade after 35 years of service, the pension supplement would have a value of about $2,700 per year under the current salary schedule. Assuming this employee began his/her career at age 29 and lived until the age of 87, the present value of the lifetime supplemental pension benefit would equal about $56,000 (in current year dollars).

### C. Fairfax County Public School Employees

As with MCPS, Fairfax County Public Schools (FCPS) employees participate in different retirement plans depending on job classification.

Teachers and Other Educational Employees: Full-time educators, administrators, support employees in the FCPS participate in two retirement plans – one Statewide and one specific to FCPS. The Virginia Retirement System (VRS) serves public school (and other public sector) employees throughout Virginia. VRS participants hired after July 1, 2010 and before January 1, 2014 receive a benefit of 1.7% of final salary for each year of service prior to July 1, 2013 and 1.65% of final salary for each year of service after January 1, 2013. This Statewide pension plan underwent a significant modification in 2014. VRS participants hired after July 1, 2014 participate in a hybrid pension/defined contribution retirement plan. For these newer hires, the VRS provides a pension benefit equal to 1.0% of salary for each year of service. In addition, under the hybrid plan, the employer matches a mandatory employee contribution of 1.0% of annual salary into a retirement account.[16]

FCPS educators receive an additional pension benefit from the Educational Employees' Supplementary Retirement System of Fairfax County (ERFC).

For FCPS educators hired before July 1, 2001, FCPS adjusts the level of ERFC benefits to supplement the benefits received from VRS. For example, an FCPS educator under this scenario would receive an ERFC pension benefit of 1.85% of final average compensation for each year of

[16] In addition, the employer contributes 0.5% of salary for every 1.0% of salary voluntarily contributed by the employee up to a total employer match of 2.5%.

ERFC credited service. This multiplier is then reduced by the VRS Adjustment (1.65% of the portion of VRS average final compensation in excess of $1,200 multiplied by years of creditable Virginia service) to calculate the appropriate supplement. For payment periods, if any, before full Social Security age, the member receives an additional temporary benefit equal to 1.0% percent of final average compensation multiplied by credited service at retirement.

For educators hired after July 1, 2001, the ERFC supplement provides the retiree with an annual benefit of 0.8% of average final salary per year of service. In total, newly hired FCPS educators receive a combined 1.8% pension multiplier as well as a minimum 1.0% of salary annual contribution to a retirement account. Newly hired MCPS teachers receive a combined 1.7% pension multiplier with no employer contribution to a retirement account. The difference in the pension multiplier is partially offset by the higher top of grade salary for MCPS teachers.

<u>Other Employees</u>: 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. This pension plan provides a pension multiplier of 1.8% of average annual salary per year of service. Alternatively, employees may opt to make a higher contribution (5.33% instead of 4.0% of salary) to receive a 2.0% pension multiplier.

## SECTION VI. MCPS PENSION PLAN MODIFICATION OPTIONS

OLO asked Bolton Partners, Inc., the County Council's actuarial advisor, to estimate the potential cost savings that would result from alternative modifications to the MCPS Local Pension Plan. This section summarizes these potential modifications and presents the results of the Bolton Partners' actuarial assessment.

### A. Overview of Plan Modification Options

As shown in the table below, OLO requested that Bolton Partners assess the potential cost savings of eight possible modifications to the MCPS Local Pension Plan.[17] Bolton Partners conducted an actuarial analysis of each option to determine the potential cost savings. Bolton Partners based its calculations on the data and assumptions included in the most recent MCPS Employees' Retirement and Pension Plan Actuarial Valuation Report presented to the Board of Education on November 16, 2015. Since cost savings resulting from pension plan modifications change over time, Bolton Partners projected future year savings over a twenty-two year time period (displayed in current year dollars).

**MCPS Pension Plan Modification Options**

| | |
|---|---|
| Option A.1 | Eliminate pension supplement for all existing employees (future service) and new hires. |
| Option A.2 | Eliminate pension supplement for new hires only. |
| Option A.3 | Eliminate pension supplement for all existing employees hired before 7/1/11 (future service). |
| Option B.1 | Reduce pension supplement multiplier to 0.08% for all existing employees (future service) and new hires. |
| Option B.2 | Reduce pension supplement multiplier to 0.08% for new hires only. |
| Option B.3 | Reduce pension supplement multiplier to 0.08% for all existing employees hired before 7/1/11 (future service). |
| Option C | Increase employee cost share for pension supplement to 0.7% of salary for all existing employees and new hires. |
| Option D | Amend the core and supplement pension for non-teachers to integrate with Social Security (future service). |

A copy of the final report from Bolton Partners, including a description of methodology and assumptions, appears in the appendix.

[17] OLO originally asked Bolton Partners to evaluate ten possible pension plan modifications. Two of the original options involved conversion of the pension supplement to a defined contribution benefit. Bolton concluded that these options would result in a net increase in costs and so, OLO excluded discussion of these options from this report.

## B. Pension Plan Modification Cost Savings

This section describes each pension plan modification option and the projected future year MCPS cost savings (in current dollars) associated with each option.

The potential cost savings presented in this section are estimates intended to inform policy makers about the approximate savings that could be achieved through the options described below. A more formal and detailed actuarial analysis would be required should the Board of Education elect to implement a pension plan modification. Moreover, as employer pension costs are a function, in part, of external factors and necessarily involve a measure of risk, the actual cost savings that would be achieved through pension plan modification could vary from actuarial estimates.

**Note: All options described below would apply to future service and would not affect benefits earned up to the effective date of the pension modification.**

*The release of this report occurs shortly before the County Council will consider the Fiscal Year 2017 (FY17) operating budget. OLO acknowledges that implementation of any pension plan modification is highly unlikely to affect FY17 expenditures. Pension plan modification necessarily involves negotiations with employee associations, detailed actuarial calculations and fiscal analysis, and revision of plan documents. This process would be difficult to complete in a short time period. As such, OLO suggests savings generated by any approved pension plan modification would likely affect the FY18 operating budget at the earliest.*

### Options A.1 – A.3 Eliminate the Pension Supplement

As discussed on page 19, the pension supplement was originally designed to be responsive to fiscal conditions and supplement core teacher pension benefits. In 1999, the pension supplement of 0.08% of salary was mandated by State law. Since then, MCPS has provided non-teachers the same core and supplemental pension benefit. In 2006, the Board of Education raised the pension supplement to 0.20% of salary, a level two-and-a-half times greater than specified by State law. The amount required to fund the pension supplement has grown over the years. For FY16, approximately $56.2 million of the Board of Education's budgeted annual contribution to its pension fund ($86.7 million) is attributable to the pension supplement. Option A would produce cost savings by eliminating the pension supplement under three different scenarios. The Board of Education previously considered this approach in 1998 prior to the State action (page 26). Of note, elimination of the pension supplement for teachers would require a change in State law.

*Option A.1 Eliminate the pension supplement for all existing employees (future service) and new hires.*

Option A.1 would eliminate the pension supplement for all MCPS employees. This option would maintain parity among existing employees and new hires.

*Option A.2 Eliminate the pension supplement for new hires only.*

Option A.2 would maintain parity among existing MCPS employees and preserves their pension benefits. Similar to the 2011 pension plan modifications, this option only would reduce pension benefits earned by new hires (teachers and non-teachers).

*Option A.3 Eliminate the pension supplement for all existing employees hired before July 1, 2011 (future service).*

Option A.3 focuses on the combined core and supplemental pension multiplier. Currently an employee hired before July 1, 2011 receives a combined multiplier of 2.0% (1.8% core multiplier plus a 0.2% supplemental multiplier) per year of credited service. In comparison, an employee hired after July 1, 2011 receives a 1.7% multiplier (1.5% core multiplier plus a 0.2% supplemental multiplier). This option would achieve greater parity among employee groups, by eliminating the supplement for employees hired before July 1, 2011. As a result, the pension multiplier disparity among employees would decrease from 0.3% to 0.1% (1.8% multiplier compared to a 1.7% multiplier).

The table on the following page produces the 22 year fiscal year savings achieved by Options A.1 – A.3 (all savings are displayed in current year dollars).

**Options A.1 –A.3: Eliminate the MCPS Pension Supplement**
**Future Projected Savings ($ in millions)**
*Displayed in Current Year Dollars*

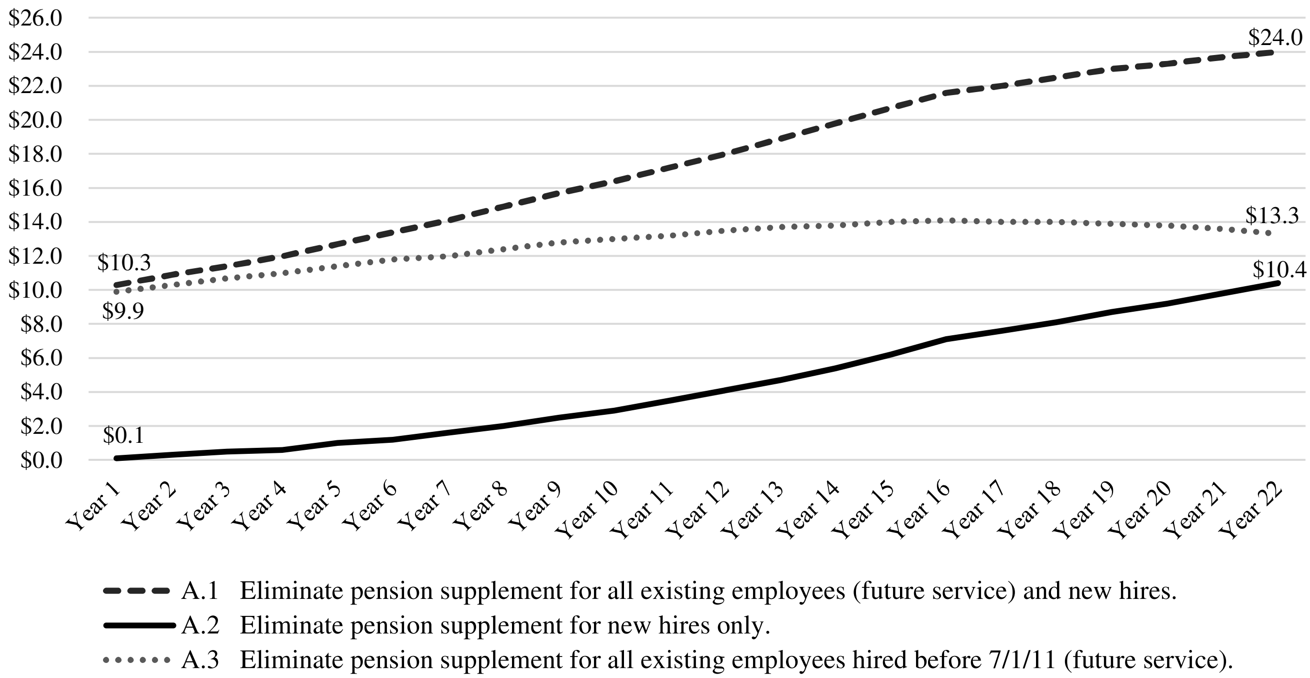
| Option | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Year 6 | Year 7 | Year 8 | Year 9 | Year 10 | Year 11 | Year 12 | Year 13 | Year 14 | Year 15 | Year 16 | Year 17 | Year 18 | Year 19 | Year 20 | Year 21 | Year 22 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| A.1 | $10.3 | $10.9 | $11.4 | $12.0 | $12.7 | $13.4 | $14.1 | $14.9 | $15.7 | $16.4 | $17.2 | $18.0 | $18.9 | $19.8 | $20.7 | $21.6 | $22.0 | $22.5 | $23.0 | $23.3 | $23.7 | $24.0 |
| A.2 | $0.1 | $0.3 | $0.5 | $0.6 | $1.0 | $1.2 | $1.6 | $2.0 | $2.5 | $2.9 | $3.5 | $4.1 | $4.7 | $5.4 | $6.2 | $7.1 | $7.6 | $8.1 | $8.7 | $9.2 | $9.8 | $10.4 |
| A.3 | $9.9 | $10.3 | $10.7 | $11.0 | $11.4 | $11.8 | $12.0 | $12.4 | $12.8 | $13.0 | $13.2 | $13.5 | $13.7 | $13.8 | $14.0 | $14.1 | $14.0 | $14.0 | $13.9 | $13.8 | $13.6 | $13.3 |

***Option A.1*** *Eliminate pension supplement for all existing employees (future service) and new hires.*

***Option A.2*** *Eliminate pension supplement for new hires only.*

***Option A.3*** *Eliminate pension supplement for all existing employees hired before July 1, 2011 (future service).*

**Options A.1 - A.3: Eliminate the Pension Supplement**
**Future Projected Savings (in millions)***




*Displayed in Current Dollars

*Option A.1* *Eliminate MCPS pension supplement for all existing employees (future service) and new hires.*

Option A.1 produces the largest initial savings of $10.3 million saved. Increasing by an annual average rate of 3.9%, over the twenty-two-year period, projected savings reach $24.0 million in Year Twenty-Two.

*Option A.2* *Eliminate MCPS pension supplement for new hires only.*

Option A.2 produces the lowest initial savings ($0.1 million in the Base Year). As the new hire population increases, future projected savings grow at an average annual rate of 23.5% to $10.4 million in Year Twenty-Two.

*Option A.3* *Eliminate MCPS pension supplement for all existing employees hired before July 1, 2011 (future service).*

Initially, Option A.3 produces a savings of $9.9 million. Savings from this option increase annually to a high point of $14.1 million in Year 16 as many current employees near retirement. Beginning in Year 17, savings begin to decline slowly.

Effect on retirees: The effect of Options A.1 – A.3 on retiree pension benefits would differ based on the employee's length of service with MCPS at the time of the plan modification.

Under the current pension system, a ten-month MCPS teacher (with a Master's Degree) hired before July 1, 2011 would receive a pension benefit of about $68,400 per year (in current year dollars) at the conclusion of a 35-year career. For a teacher with 20 years of service at the time of the pension plan modification, Options A.1 and A.3 would reduce the annual pension benefit to about $65,500. For a teacher with 10 years of service at the time of the pension plan modification, Options A.1 and A.3 would reduce the annual pension benefit to about $63,500.

The current pension system provides a different benefit for employees hired after July 1, 2011. Under the current pension system, an MCPS teacher (with a Master's Degree) hired after July 1, 2011 would receive a pension benefit of about $56,600 per year (in current year dollars) at the conclusion of a 35-year career. For these teachers, Options A.1 and A.2 would reduce the annual pension benefit to about $50,000.

Options A.1 – A.3 would have no effect on a retiree's Social Security benefit. After a 35-year career, a retired MCPS teacher would receive a Social Security benefit of about $23,600 annually in addition to his/her pension benefit.

**Options B.1 – B.3 Reduce the Pension Supplement to State Law Requirements**

Under State law, the required supplement multiplier is 0.08% per year of credited service (see page 8). MCPS currently provides a pension supplement with a 0.2% multiplier, a level two-and-a- half times greater than mandated by State law. Option B examines the savings that could be achieved if MCPS were to reduce the pension supplement to the level specified in State law.

*Option B.1 Reduce pension supplemental multiplier to the State mandated level of 0.08% for all existing employees (future service) and new hires.*

Option B.1 would return the supplemental pension benefit to the amount specified in State law and would maintain parity among existing employees and new hires.

*Option B.2 Reduce pension supplemental multiplier to the State mandated level of 0.08% for new hires only.*

Option B.2 would maintain parity between current employees and preserves their existing pension benefits. Similar to the 2011 pension benefit changes, this option only reduces the pension benefit earned by new hires (teachers and non-teachers).

*Option B.3 Reduce pension supplemental multiplier to the State mandated level of 0.08% for all existing employees hired before July 1, 2011 (future service).*

This option would reduce the combined multiplier for existing employees hired before July 1, 2011, from 2.0% to 1.88% (1.8% core multiplier plus 0.08% supplemental multiplier). This option would achieve greater parity with employees hired after July 1, 2011who currently receive a combined multiplier of 1.7%.

The table on the following page produces the 22 year fiscal year savings achieved by Options B.1 – B.3 (all savings are displayed in current year dollars).

## Options B.1 –B.3: Reduce the Pension Supplement to State Law Requirements
## Future Projected Savings ($ in millions)
*Displayed in Current Year Dollars*

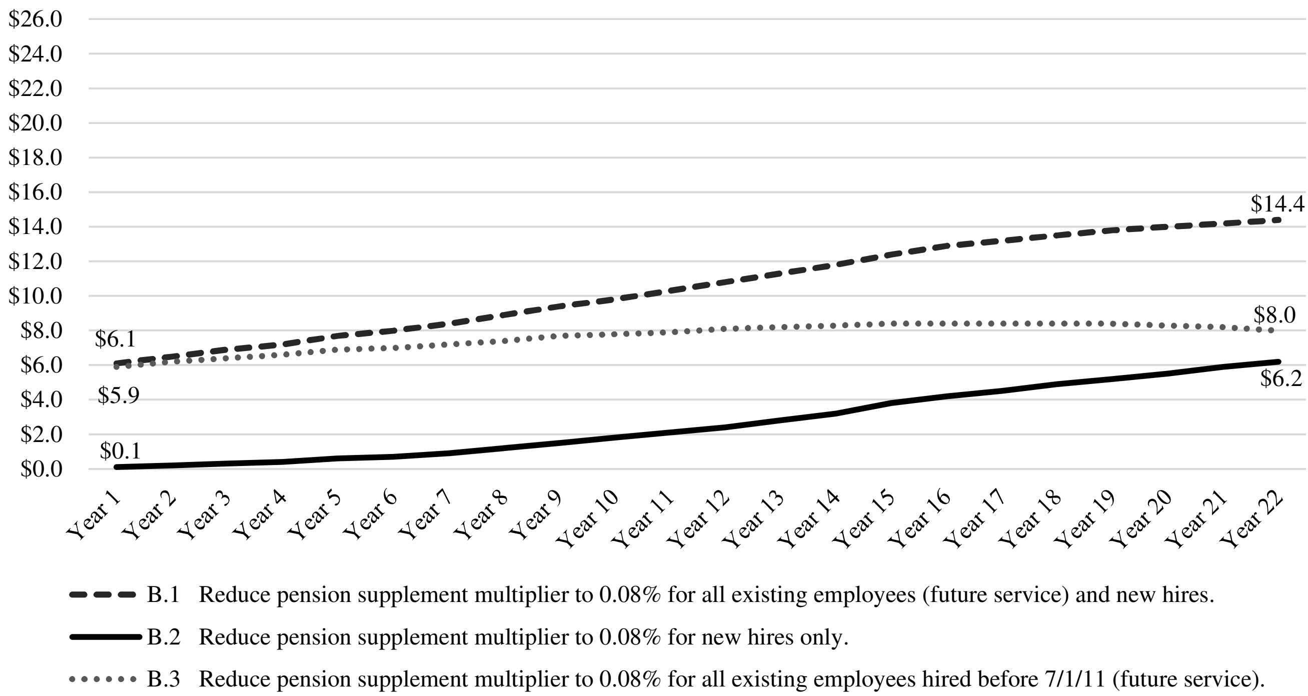
| Option | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Year 6 | Year 7 | Year 8 | Year 9 | Year 10 | Year 11 | Year 12 | Year 13 | Year 14 | Year 15 | Year 16 | Year 17 | Year 18 | Year 19 | Year 20 | Year 21 | Year 22 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| B.1 | $6.1 | $6.5 | $6.9 | $7.2 | $7.7 | $8.0 | $8.4 | $8.9 | $9.4 | $9.8 | $10.3 | $10.8 | $11.3 | $11.8 | $12.4 | $12.9 | $13.2 | $13.5 | $13.8 | $14.0 | $14.2 | $14.4 |
| B.2 | $0.1 | $0.2 | $0.3 | $0.4 | $0.6 | $0.7 | $0.9 | $1.2 | $1.5 | $1.8 | $2.1 | $2.4 | $2.8 | $3.2 | $3.8 | $4.2 | $4.5 | $4.9 | $5.2 | $5.5 | $5.9 | $6.2 |
| B.3 | $5.9 | $6.2 | $6.4 | $6.6 | $6.9 | $7.0 | $7.2 | $7.4 | $7.7 | $7.8 | $7.9 | $8.1 | $8.2 | $8.3 | $8.4 | $8.4 | $8.4 | $8.4 | $8.4 | $8.3 | $8.2 | $8.0 |

***Option B.1*** *Reduce pension supplement multiplier to 0.08% for all existing employees (future service) and new hires.*

***Option B.2*** *Reduce pension supplement multiplier to 0.08% for new hires only.*

***Option B.3*** *Reduce pension supplement multiplier to 0.08% for all existing employees hired before July 1, 2011 (future service).*

**Options B.1 -B.3: Reduce the Pension Supplement**
**Future Projected Savings (in millions)***




*Displayed in Current Dollars

*Option B.1* *Reduce pension supplement multiplier to 0.08% for all existing employees (future service) and new hires.*

Option B.1 produces the largest initial savings with $6.1 million saved. Increasing by an annual average rate of 4.0% over the twenty-two-year period, projected savings reach $14.4 million in Year Twenty-Two.

*Option B.2* *Reduce pension supplement multiplier to 0.08% for new hires only.*

Option B.2 produces the lowest initial savings ($0.1 million). As the new hire population increases, future projected savings grow at an average annual rate of 20.6%, reaching $6.2 million saved in Year Twenty-Two.

*Option B.3* *Reduce pension supplement multiplier to 0.08% for all existing employees hired before 7/1/2011 (future service).*

Initially, Option B.3 produces a savings of $5.9 million. Savings from this option increase annually to $8.4 million in Year 15 as many current employees near retirement. Savings hold constant through Year 19 and then begin to decline slightly in Year 20.

Effect on retirees: The effect of Options B.1 – B.3 on retiree pension benefits would differ based on the employee's length of service with MCPS at the time of the plan modification.

Under the current pension system, an MCPS teacher (with a Master's Degree) hired before July 1, 2011 would receive a pension benefit of about $68,400 per year (in current year dollars) at the conclusion of a 35-year career. For a teacher with 20 years of service at the time of the pension plan modification, Options B.1 and B.3 would reduce the annual pension benefit to about $66,600. For a teacher with 10 years of service at the time of the pension plan modification, Options B.1 and B.3 would reduce the annual pension benefit to about $65,600.

The current pension system provides a different benefit for employees hired after July 1, 2011. Under the current pension system, an MCPS teacher (with a Master's Degree) hired after July 1, 2011 would receive a pension benefit of about $56,600 per year (in current year dollars) at the conclusion of a 35-year career. For these teachers, Options B.1 and B.2 would reduce the annual pension benefit to about $52,600.

Options B.1 – B.3 would have no effect on a retiree's Social Security benefit. After a 35-year career, a retired MCPS teacher would receive a Social Security benefit of about $23,000 annually in addition to his/her pension benefit.

**Option C Increase Employee Cost Share for Pension Supplement**

In 2011 the State and MCPS increased employee cost share for the core pension benefit from 5.0% to 7.0% of salary for all employees (see page 29). However, MCPS did not make a corresponding increase in the employee cost share for the supplemental pension benefit. Rather, MCPS held the employee cost share for the pension supplement constant 0.5% of salary. Option C would increase the required employee contribution rate for the pension supplement from 0.5% to 0.7% of salary to align with employee cost share for the core pension benefit.

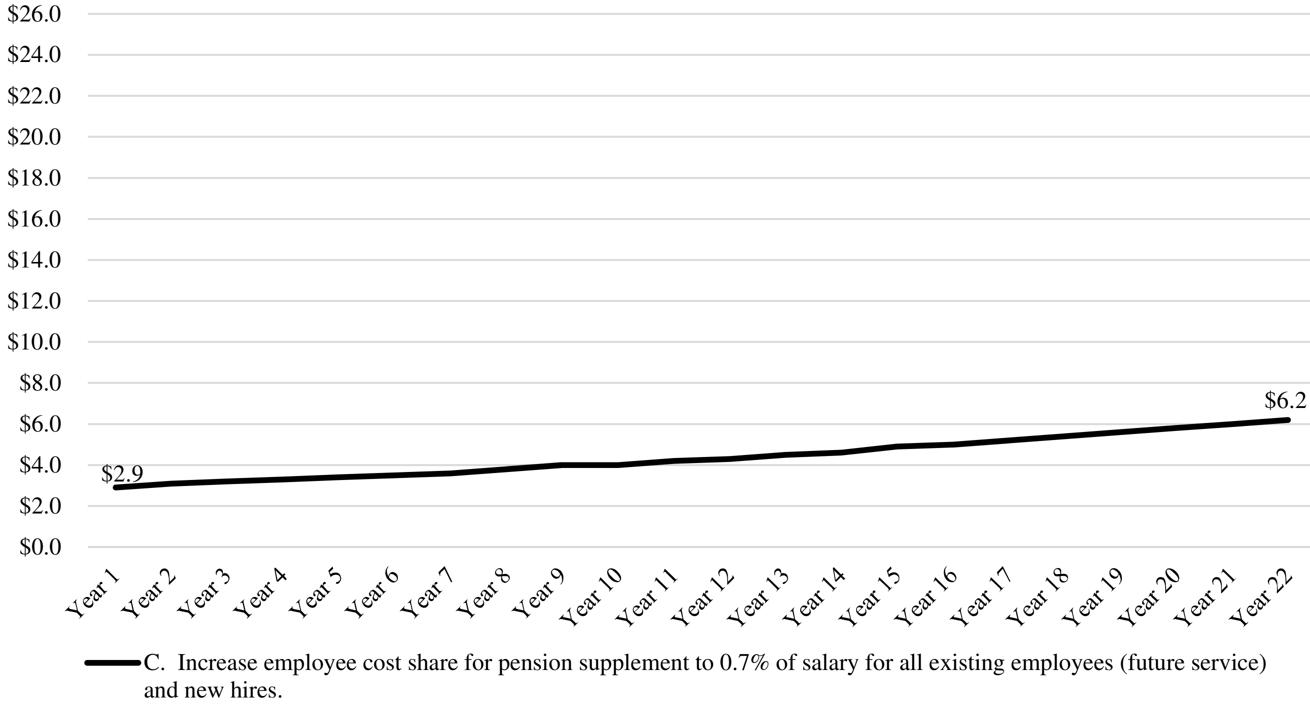
The table on the following page projects the 22 year fiscal year savings achieved by Option C (all savings are displayed in current year dollars).

## Option C: Increase Employee Cost Share for Pension Supplement
**Future Projected Savings ($ in millions)**
*Displayed in Current Year Dollars*

| *Option* | *Year 1* | *Year 2* | *Year 3* | *Year 4* | *Year 5* | *Year 6* | *Year 7* | *Year 8* | *Year 9* | *Year 10* | *Year 11* | *Year 12* | *Year 13* | *Year 14* | *Year 15* | *Year 16* | *Year 17* | *Year 18* | *Year 19* | *Year 20* | *Year 21* | *Year 22* |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *C* | $2.9 | $3.1 | $3.2 | $3.3 | $3.4 | $3.5 | $3.6 | $3.8 | $4.0 | $4.0 | $4.2 | $4.3 | $4.5 | $4.6 | $4.9 | $5.0 | $5.2 | $5.4 | $5.6 | $5.8 | $6.0 | $6.2 |

***Option C*** *Increase employee cost share to 0.7% for all existing employees (future service) and new hires.*

**Option C: Increase Employee Cost Share for Pension Supplement**
**Future Projected Savings (in millions)***




*Displayed in Current Dollars

Option C produces an initial savings of $2.9 million. Over the twenty-two-year period, savings achieved under this option increase by an average annual rate of 3.5% to a projected savings of $6.2 million in Year Twenty-Two.

Effect on retirees: The effect of Option C on employee cost share would differ based on the employee's current salary. For an employee earning $52,900 (the current entry level pay for a ten-month teacher with a Master's Degree), Option C would increase the annual cost share by $106. For an employee earning $100,400 (the current top of grade pay for a teacher with a Master's Degree), Option C would increase the annual cost share by $201.

**Option D Amend the Core and Supplement Pension for Non-Teachers to Integrate with Social Security.**

In 1998, the State and MCPS eliminated integration of the core and supplement pension with Social Security (see page 8 for an explanation of Social Security integration). The pension benefit offered to County Government public safety employees integrates with Social Security. Option D examines the savings to the MCPS Local Pension Plan that could be achieved by re-integrating non-teacher pension benefits with Social Security.

Option D would create a disparity between teacher and non-teacher pension benefits as the State Teachers' Pension plan does not integrate benefits with Social Security. Integrating teacher pension benefits with Social Security would require a change in State law and would apply to teachers throughout the State. (As a result of the recent shift of teacher pension normal costs to the counties, integrating the State Teachers' Pension Plan with Social Security would produce cost savings to the County.)

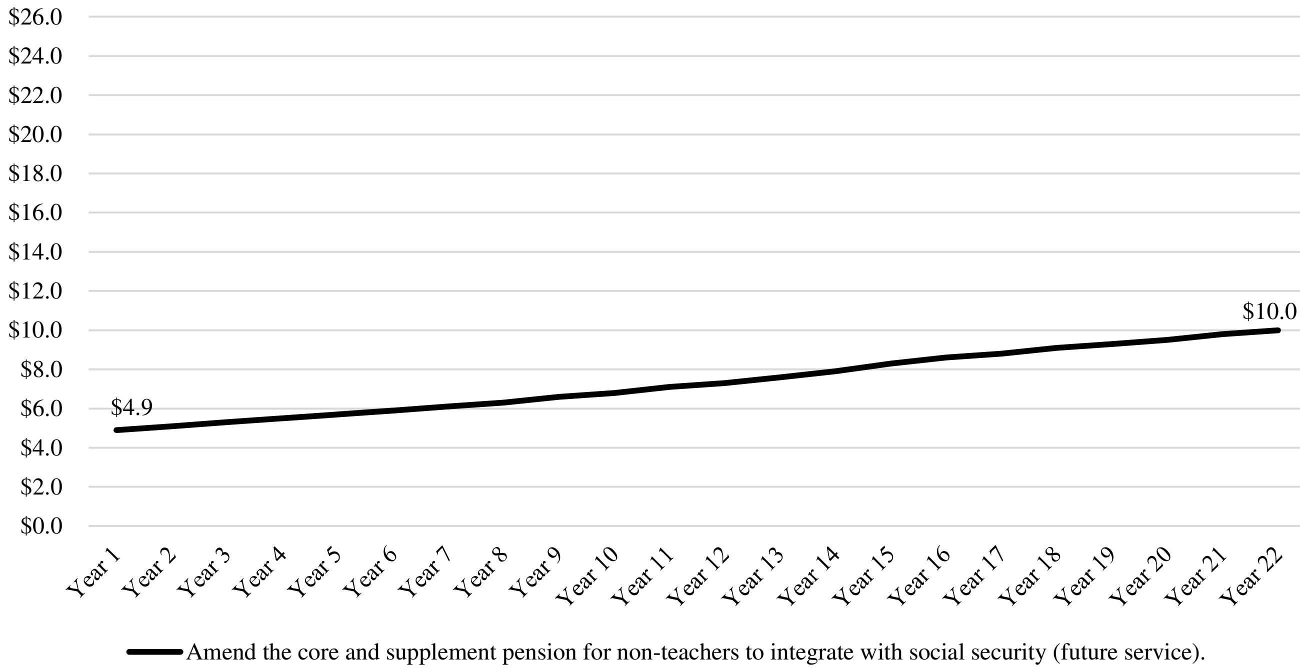
The table on the following page produces the 22 year fiscal year savings achieved by Option D (all savings are displayed in current year dollars).

**Option D: Amend Core and Supplement Pension for Non-Teachers to Integrate with Social Security Future Projected Savings ($ in millions)**
*Displayed in Current Year Dollars*

| *Option* | *Year 1* | *Year 2* | *Year 3* | *Year 4* | *Year 5* | *Year 6* | *Year 7* | *Year 8* | *Year 9* | *Year 10* | *Year 11* | *Year 12* | *Year 13* | *Year 14* | *Year 15* | *Year 16* | *Year 17* | *Year 18* | *Year 19* | *Year 20* | *Year 21* | *Year 22* |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *D* | $4.9 | $5.1 | $5.3 | $5.5 | $5.7 | $5.9 | $6.1 | $6.3 | $6.6 | $6.8 | $7.1 | $7.3 | $7.6 | $7.9 | $8.3 | $8.6 | $8.8 | $9.1 | $9.3 | $9.5 | $9.8 | $10.0 |

***Option D*** *Amend Core and Supplement Pension for Non-Teachers to Integrate with Social Security (future service).*

**Option D: Amend the Core and Supplement Pension for Non-Teachers to Integrate with Social Security Future Projected Savings (in millions)***




*Displayed in Current Dollars

Option D produces an initial savings of $4.9 million. Over the twenty-two-year period, savings achieved under this option increase by an average annual rate of 3.3% to a projected savings in Year Twenty-Two of $10.0 million.

Effect on retirees: Option D would reduce a retiree's pension benefit by an amount approximately equal to his/her annual Social Security benefit.

The options detailed above represent a range of potential pension plan changes that project future cost savings. However, they do not represent the universe of potential plan modifications available to the Council. OLO is available to assist the Council with developing further pensions plan modification options and cost estimates.

## SECTION VII. MCPS COMMENTS

The Office of Legislative Oversight circulated a final draft of this report to the Chief Operating Officer of the Montgomery County Public Schools. OLO appreciates the time taken by MCPS staff to review the draft report and provide comments. The final report incorporates technical corrections provided by the MCPS.

The written comments received from Chief Operating Officer appear on the next two pages.

MCPS MONTGOMERY COUNTY PUBLIC SCHOOLS
www.montgomeryschoolsmd.org
MARYLAND



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

# APPENDIX

**Bolton Partners, Inc.**

**Final Report**

# Memorandum

**To:** Aron Trombka

**From:** Tom Lowman & Kris Seets

**Date:** February 4, 2016

**Re:** MCPS Pension design study

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This memo has been prepared for the Montgomery County Council to address questions about the impact of certain potential changes to the Montgomery County Public Schools (MCPS) Pension system. We were asked to study 8 potential changes. These potential changes are listed in Attachment 1 to this memo. Some changes only apply to new hires and some to all existing employees (potentially both teachers and non teachers). The results are shown in terms of future contribution projections since changes for new hires will only emerge slowly over time.

This memo has been revised from earlier versions to reflect comments and additional information provided by the MCPS retirement plan actuary. One key bit of new information was the impact of benefit changes on the Normal Cost rate for members hired after 6/30/2011. The Employer Normal Cost for the Supplement for Teachers is 0.64% of payroll (0.97% for non teachers). However, for those hired after 6/30/2011 it is only 0.07% (0.30% for non Teachers) and might rise gradually to 0.36% (0.62% for non Teachers). This is largely because of the changes in the retirement ages made in 2011.

We would like to note two items not directly related to this study:

- Earlier this year MCPS had plans to contribute a minimum contribution rate of 5.73% of covered payroll but we understand that is no longer applicable. The FY17 rate is 4.18%.

- MCPS noted that there has been a gradual decrease in contribution rates as more members are covered by the post-2011 provisions (later retirement ages and for non Teachers lower accrual rates on core benefits).

## Charts showing cost impact

We included three contribution projection charts. All three cover the fiscal year contributions from FY2018 through FY2038. We select FY18 as the year to start by assuming the changes would be effective 7/1/2016 and not sooner. Since the FY17 contribution is based on the

7/1/2015 actuarial valuation (which has already been completed), we assumed that the 2015 Actuarial Valuation would not be revised for the FY17 contribution rates. The parties could agree to revise the FY17 contribution rates to reflect any changes.

The three sets of charts (attachments 2-4) show:

1. Dollar amount of contribution by Fiscal Year and by design change
2. Change in contribution as a percentage of payroll by Fiscal Year and by design change
3. Dollar amount of change in contribution (savings) by Fiscal Year and by design change

The first line of results on each chart contains the base line projection with no changes.

For changes involving new hires we used the simplifying assumption that all new hires are hired on July 1st so that those hire on July 1, 2016 would be impacted by the change. This is probably a reasonable assumption for new Teacher but non-Teachers might leave/be-replaced any time in the fiscal year and the savings might be a little less in the early years. This is only an issue for changes just impacting new hires.

None of the changes include the few employees covered by the old Retirement System.

Option D.1. is based on a Social Security integration design. The brief descriptions of the other designs are straightforward but Option D.1. requires some additional definition of this design. This is contained in attachment 5.

## **Employee contributions**

Teachers contribute 0.5% of salary for the supplement and non-teachers contribute 7.5% for their entire benefit. As indicated in the MCPS 2015 Employee benefit summary, employees participating in the MCPS pension plan contribute 7 percent of their salary for core benefit and an additional 0.5 percent for the supplemental benefit.

Based on this allocation, Option A (elimination of the supplement for future years of service) would result in a reduction in employee contribution of 0.5% of pay to the level of 0% for teachers and 7.0% for non teachers.

For Option B (replacing the 0.2% supplement with 0.08% for future years of service) this concept would result in a reduction in employee contribution of 0.3% (0.5% x (1- 0.08%/0.2%)) to the level of 0.2% for teachers and 7.2% for non teachers.

Option C does not change the benefit but increases the employee contribution rate for teachers to 0.7%. This would change the contribution rate for non teachers to 7.7%.

Option D has no obvious adjustment and is only for non-teachers. We assumed the 7.5% employee contribution rate would not change.

## Actuarial certification

This memo has been prepared for the Montgomery County Council for the purposes of estimating the impact of various proposed changes to the MCPS pension system. It is neither intended nor necessarily suitable for other purposes. Bolton Partners is not responsible for the consequences of any other use or the reliance by any other party.

We used the assumptions, data and methods shown in the 2015 actuarial valuation and our own estimate of the new hire payroll in future years. Our model is based on the Normal Cost as a good representation of the benefits associated with future years of service. The plan actuary will have a more complete model that can more accurately measure the cost of these changes including a soft freeze in benefits. However, we believe our model is acceptable for preliminary planning purposes. Any final decision should be based on results produced by the plan's actuary.

We have also made an adjustment to the future normal cost for non-teachers due to the emerging population of post June 30, 2011 hires. We believe the assumptions, data and methods used to be sufficient. Future actuarial measurements may differ significantly from the current measurements and projections in this letter due to such factors as the following: plan experience differing from that anticipated by the economic and demographic assumptions, changes in economic or demographic assumptions, and changes in plan provisions or applicable law. Again, before any changes are adopted, the cost impact should be confirmed by the plan actuary. Tom Lowman and Kris Seets are credentialed actuaries and meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained in this letter. We are currently compliant with the Continuing Professional Development Requirement of the Society of Actuaries. We are not aware of any direct or material indirect conflict of interest that would impair the objectivity of our work. To the best of our knowledge, this letter and its contents have been prepared in accordance with generally recognized and accepted actuarial principles and practices which are consistent with the Code of Professional Conduct and applicable Actuarial Standards of Practice as set out by the Actuarial Standards Board.

## Attachment 1

**MCPS Pension Modification Options**
**(for calculation of in change to ARC schedule)**

| | |
|---|---|
| A.1 | Eliminate pension supplement for all existing employees (future service) and new hires. |
| A.2 | Eliminate pension supplement for new hires only. |
| A.3 | Eliminate pension supplement for all existing employees hired before 7/1/11 (future service). |
| B.1 | Reduce pension supplement multiplier to 0.08% for all existing employees (future service) and new hires. |
| B.2 | Reduce pension supplement multiplier to 0.08% for new hires only. |
| B.3 | Reduce pension supplement multiplier to 0.08% for all existing employees hired before 7/1/11 (future service). |
| C.1 | Increase employee cost share for pension supplement to 0.7% of salary for all existing employees and new hires. |
| | |
| D.1 | Amend the core and supplement pension for non-teachers to integrate with social security (future service). |

Attachment 2: Projected Contributions Amounts ($ in millions)

| Valuation Date: | 7/1/2016 | 7/1/2017 | 7/1/2018 | 7/1/2019 | 7/1/2020 | 7/1/2021 | 7/1/2022 | 7/1/2023 | 7/1/2024 | 7/1/2025 | 7/1/2026 | 7/1/2027 | 7/1/2028 | 7/1/2029 | 7/1/2030 | 7/1/2031 | 7/1/2032 | 7/1/2033 | 7/1/2034 | 7/1/2035 | 7/1/2036 | 7/1/2037 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Contribution for FYE: | 6/30/2018 | 6/30/2019 | 6/30/2020 | 6/30/2021 | 6/30/2022 | 6/30/2023 | 6/30/2024 | 6/30/2025 | 6/30/2026 | 6/30/2027 | 6/30/2028 | 6/30/2029 | 6/30/2030 | 6/30/2031 | 6/30/2032 | 6/30/2033 | 6/30/2034 | 6/30/2035 | 6/30/2036 | 6/30/2037 | 6/30/2038 | 6/30/2039 |
| Base Line Contribution: | $61.6 | $63.7 | $65.9 | $68.2 | $70.7 | $73.2 | $75.8 | $78.6 | $81.5 | $84.4 | $87.5 | $90.7 | $94.0 | $97.4 | $64.7 | $67.1 | $68.8 | $70.5 | $72.2 | $73.8 | $58.4 | $59.4 |
| **MCPS Pension Modification Options** | Note: Changes might not be applied to FY17 unless 2015 valuation is revised and changes adopted by 7/1/2016. | | | | | | | | | | | | | | | | | | | | | |
| A.1 Eliminate pension supplement for all existing employees (future service) and new hires. | $51.3 | $52.8 | $54.5 | $56.2 | $58.0 | $59.8 | $61.7 | $63.7 | $65.8 | $68.0 | $70.3 | $72.7 | $75.1 | $77.6 | $44.0 | $45.5 | $46.8 | $48.0 | $49.2 | $50.5 | $34.7 | $35.4 |
| A.2 Eliminate pension supplement for new hires only. | $61.5 | $63.6 | $65.8 | $68.2 | $70.6 | $73.0 | $75.4 | $77.9 | $80.4 | $83.0 | $85.7 | $88.4 | $91.1 | $93.9 | $60.4 | $62.0 | $63.1 | $64.1 | $65.2 | $66.1 | $50.0 | $50.4 |
| A.3 Eliminate pension supplement for all existing employees hired before 7/1/11 (future service). | $51.7 | $53.4 | $55.2 | $57.2 | $59.3 | $61.4 | $63.8 | $66.2 | $68.7 | $71.4 | $74.3 | $77.2 | $80.3 | $83.6 | $50.7 | $53.0 | $54.8 | $56.5 | $58.3 | $60.0 | $44.8 | $46.1 |
| B.1 Reduce pension supplement multiplier to 0.08% for all existing employees (future service) and new hires. | $57.0 | $59.2 | $61.5 | $63.9 | $66.4 | $68.9 | $71.5 | $74.2 | $76.9 | $79.7 | $82.6 | $85.6 | $88.6 | $91.8 | $58.7 | $60.7 | $62.1 | $63.4 | $64.7 | $66.0 | $50.2 | $50.9 |
| B.2 Reduce pension supplement multiplier to 0.08% for new hires only. | $61.5 | $63.5 | $65.6 | $67.9 | $70.2 | $72.5 | $75.0 | $77.5 | $80.1 | $82.8 | $85.6 | $88.5 | $91.5 | $94.6 | $61.4 | $63.4 | $64.8 | $66.2 | $67.6 | $69.0 | $53.2 | $53.9 |
| B.3 Reduce pension supplement multiplier to 0.08% for all existing employees hired before 7/1/11 (future service). | $54.0 | $56.0 | $58.1 | $60.3 | $62.6 | $65.0 | $67.6 | $70.3 | $73.0 | $75.9 | $79.0 | $82.1 | $85.4 | $88.8 | $56.0 | $58.5 | $60.3 | $62.1 | $63.9 | $65.7 | $50.4 | $51.6 |
| C.1 Increase employee cost share for pension supplement to 0.7% of salary for all existing employees and new hires. | $58.7 | $60.6 | $62.7 | $64.9 | $67.3 | $69.7 | $72.2 | $74.8 | $77.5 | $80.4 | $83.3 | $86.4 | $89.5 | $92.8 | $59.8 | $62.1 | $63.6 | $65.1 | $66.6 | $68.0 | $52.4 | $53.2 |
| D.1 Amend the core and supplement pension for non-teachers to integrate with social security (future service). | $56.7 | $58.6 | $60.6 | $62.7 | $65.0 | $67.3 | $69.7 | $72.3 | $74.9 | $77.6 | $80.4 | $83.4 | $86.4 | $89.5 | $56.4 | $58.5 | $60.0 | $61.4 | $62.9 | $64.3 | $48.6 | $49.4 |

Attachment 3: Projected Contributions as a Percentage of Payroll

| Valuation Date: | 7/1/2016 | 7/1/2017 | 7/1/2018 | 7/1/2019 | 7/1/2020 | 7/1/2021 | 7/1/2022 | 7/1/2023 | 7/1/2024 | 7/1/2025 | 7/1/2026 | 7/1/2027 | 7/1/2028 | 7/1/2029 | 7/1/2030 | 7/1/2031 | 7/1/2032 | 7/1/2033 | 7/1/2034 | 7/1/2035 | 7/1/2036 | 7/1/2037 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Contribution for FYE: | 6/30/2018 | 6/30/2019 | 6/30/2020 | 6/30/2021 | 6/30/2022 | 6/30/2023 | 6/30/2024 | 6/30/2025 | 6/30/2026 | 6/30/2027 | 6/30/2028 | 6/30/2029 | 6/30/2030 | 6/30/2031 | 6/30/2032 | 6/30/2033 | 6/30/2034 | 6/30/2035 | 6/30/2036 | 6/30/2037 | 6/30/2038 | 6/30/2039 |
| Base Line Contribution: | 4.16% | 4.15% | 4.15% | 4.15% | 4.15% | 4.15% | 4.15% | 4.15% | 4.15% | 4.16% | 4.16% | 4.17% | 4.17% | 4.17% | 2.67% | 2.68% | 2.65% | 2.62% | 2.59% | 2.56% | 1.95% | 1.92% |
| **MCPS Pension Modification Options** | Note: Changes might not be applied to FY17 unless 2015 valuation is revised and changes adopted by 7/1/2016. | | | | | | | | | | | | | | | | | | | | | |
| A.1 Eliminate pension supplement for all existing employees (future service) and new hires. | 0.70% | 0.71% | 0.72% | 0.73% | 0.75% | 0.76% | 0.77% | 0.79% | 0.80% | 0.81% | 0.82% | 0.83% | 0.84% | 0.85% | 0.86% | 0.86% | 0.85% | 0.84% | 0.83% | 0.81% | 0.79% | 0.78% |
| A.2 Eliminate pension supplement for new hires only. | 0.01% | 0.01% | 0.01% | 0.00% | 0.01% | 0.01% | 0.02% | 0.04% | 0.06% | 0.07% | 0.09% | 0.11% | 0.13% | 0.15% | 0.18% | 0.20% | 0.22% | 0.24% | 0.25% | 0.27% | 0.28% | 0.29% |
| A.3 Eliminate pension supplement for all existing employees hired before 7/1/11 (future service). | 0.67% | 0.67% | 0.67% | 0.67% | 0.67% | 0.67% | 0.66% | 0.66% | 0.65% | 0.64% | 0.63% | 0.62% | 0.61% | 0.59% | 0.58% | 0.56% | 0.54% | 0.52% | 0.50% | 0.48% | 0.46% | 0.43% |
| B.1 Reduce pension supplement multiplier to 0.08% for all existing employees (future service) and new hires. | 0.31% | 0.29% | 0.28% | 0.26% | 0.25% | 0.24% | 0.24% | 0.23% | 0.23% | 0.23% | 0.23% | 0.23% | 0.24% | 0.24% | 0.25% | 0.26% | 0.26% | 0.26% | 0.27% | 0.27% | 0.27% | 0.27% |
| B.2 Reduce pension supplement multiplier to 0.08% for new hires only. | 0.01% | 0.01% | 0.02% | 0.02% | 0.03% | 0.04% | 0.04% | 0.06% | 0.07% | 0.08% | 0.09% | 0.10% | 0.11% | 0.12% | 0.14% | 0.15% | 0.15% | 0.16% | 0.17% | 0.17% | 0.17% | 0.18% |
| B.3 Reduce pension supplement multiplier to 0.08% for all existing employees hired before 7/1/11 (future service). | 0.51% | 0.50% | 0.49% | 0.48% | 0.48% | 0.46% | 0.45% | 0.44% | 0.43% | 0.42% | 0.40% | 0.39% | 0.38% | 0.37% | 0.36% | 0.34% | 0.33% | 0.31% | 0.30% | 0.28% | 0.27% | 0.25% |
| C.1 Increase employee cost share for pension supplement to 0.7% of salary for all existing employees and new hires. | 0.20% | 0.20% | 0.20% | 0.20% | 0.20% | 0.20% | 0.20% | 0.20% | 0.20% | 0.20% | 0.20% | 0.20% | 0.20% | 0.20% | 0.20% | 0.20% | 0.20% | 0.20% | 0.20% | 0.20% | 0.20% | 0.20% |
| D.1 Amend the core and supplement pension for non-teachers to integrate with social security (future service). | 0.33% | 0.33% | 0.33% | 0.33% | 0.33% | 0.33% | 0.33% | 0.33% | 0.34% | 0.33% | 0.34% | 0.34% | 0.34% | 0.34% | 0.34% | 0.34% | 0.34% | 0.34% | 0.33% | 0.33% | 0.33% | 0.32% |

Attachment 4: Projected Estimated Savings ($ in millions)

| Valuation Date: | 7/1/2016 | 7/1/2017 | 7/1/2018 | 7/1/2019 | 7/1/2020 | 7/1/2021 | 7/1/2022 | 7/1/2023 | 7/1/2024 | 7/1/2025 | 7/1/2026 | 7/1/2027 | 7/1/2028 | 7/1/2029 | 7/1/2030 | 7/1/2031 | 7/1/2032 | 7/1/2033 | 7/1/2034 | 7/1/2035 | 7/1/2036 | 7/1/2037 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Contribution for FYE: | 6/30/2018 | 6/30/2019 | 6/30/2020 | 6/30/2021 | 6/30/2022 | 6/30/2023 | 6/30/2024 | 6/30/2025 | 6/30/2026 | 6/30/2027 | 6/30/2028 | 6/30/2029 | 6/30/2030 | 6/30/2031 | 6/30/2032 | 6/30/2033 | 6/30/2034 | 6/30/2035 | 6/30/2036 | 6/30/2037 | 6/30/2038 | 6/30/2039 |
| Base Line Contribution: | $61.6 | $63.7 | $65.9 | $68.2 | $70.7 | $73.2 | $75.8 | $78.6 | $81.5 | $84.4 | $87.5 | $90.7 | $94.0 | $97.4 | $64.7 | $67.1 | $68.8 | $70.5 | $72.2 | $73.8 | $58.4 | $59.4 |
| **MCPS Pension Modification Options** | Note: Changes might not be applied to FY17 unless 2015 valuation is revised and changes adopted by 7/1/2016. | | | | | | | | | | | | | | | | | | | | | |
| A.1 Eliminate pension supplement for all existing employees (future service) and new hires. | $10.3 | $10.9 | $11.4 | $12.0 | $12.7 | $13.4 | $14.1 | $14.9 | $15.7 | $16.4 | $17.2 | $18.0 | $18.9 | $19.8 | $20.7 | $21.6 | $22.0 | $22.5 | $23.0 | $23.3 | $23.7 | $24.0 |
| A.2 Eliminate pension supplement for new hires only. | $0.1 | $0.1 | $0.1 | $0.0 | $0.1 | $0.2 | $0.4 | $0.7 | $1.1 | $1.4 | $1.8 | $2.3 | $2.9 | $3.5 | $4.3 | $5.1 | $5.7 | $6.4 | $7.0 | $7.7 | $8.4 | $9.0 |
| A.3 Eliminate pension supplement for all existing employees hired before 7/1/11 (future service). | $9.9 | $10.3 | $10.7 | $11.0 | $11.4 | $11.8 | $12.0 | $12.4 | $12.8 | $13.0 | $13.2 | $13.5 | $13.7 | $13.8 | $14.0 | $14.1 | $14.0 | $14.0 | $13.9 | $13.8 | $13.6 | $13.3 |
| B.1 Reduce pension supplement multiplier to 0.08% for all existing employees (future service) and new hires. | $4.6 | $4.5 | $4.4 | $4.3 | $4.3 | $4.3 | $4.3 | $4.4 | $4.6 | $4.7 | $4.9 | $5.1 | $5.4 | $5.6 | $6.0 | $6.4 | $6.7 | $7.1 | $7.5 | $7.8 | $8.2 | $8.5 |
| B.2 Reduce pension supplement multiplier to 0.08% for new hires only. | $0.1 | $0.2 | $0.3 | $0.3 | $0.5 | $0.7 | $0.8 | $1.1 | $1.4 | $1.6 | $1.9 | $2.2 | $2.5 | $2.8 | $3.3 | $3.7 | $4.0 | $4.3 | $4.6 | $4.8 | $5.2 | $5.5 |
| B.3 Reduce pension supplement multiplier to 0.08% for all existing employees hired before 7/1/11 (future service). | $7.6 | $7.7 | $7.8 | $7.9 | $8.1 | $8.2 | $8.2 | $8.3 | $8.5 | $8.5 | $8.5 | $8.6 | $8.6 | $8.6 | $8.7 | $8.6 | $8.5 | $8.4 | $8.3 | $8.1 | $8.0 | $7.8 |
| C.1 Increase employee cost share for pension supplement to 0.7% of salary for all existing employees and new hires. | $2.9 | $3.1 | $3.2 | $3.3 | $3.4 | $3.5 | $3.6 | $3.8 | $4.0 | $4.0 | $4.2 | $4.3 | $4.5 | $4.6 | $4.9 | $5.0 | $5.2 | $5.4 | $5.6 | $5.8 | $6.0 | $6.2 |
| D.1 Amend the core and supplement pension for non-teachers to integrate with social security (future service). | $4.9 | $5.1 | $5.3 | $5.5 | $5.7 | $5.9 | $6.1 | $6.3 | $6.6 | $6.8 | $7.1 | $7.3 | $7.6 | $7.9 | $8.3 | $8.6 | $8.8 | $9.1 | $9.3 | $9.5 | $9.8 | $10.0 |

## Attachment 5

The following is background and a proposal to design an integrated formula.

State pension systems:

State general employees and teachers hired before July 1, 2011 get 1.8% of AFS for every year of service after 7/1/1988. State general employees hired on or after July 1, 2011 get 1.5% of AFS for every year of service.

MCPS pension system

MCPS teachers get an extra 0.2% of AFS for every year of service after 7/1/1988.

What non Teachers get depends on whether they were hired before or after July 1, 2011. Those hired before 7/1/2011 get 1.8% plus 0.2% for every year of service after 7/1/1998 (i.e. 2.0%). Those hired on or after 7/1/2011 get 1.5% plus 0.2% for every year of service (i.e. 1.7%).

The MCG Integrated formula is:

The benefit multiplier is 2.0% of final average salary for every year of service and payable until Social Security Normal Retirement Age (SSNRA, which ranges from age 65 to 67). After Social Security Normal Retirement Age the benefit multiplier for every year of service payable is 1.25% of final average salary up "Social Security Covered Compensation" plus 2.0% of final average salary in excess of "Social Security Covered Compensation."

**Proposal:** To "integrate" the non teachers MCPS benefit like MCG we would continue the 2.0% (for those hired before 7/1/2011) or 1.7% (for those hired on or after 7/1/2011) benefit until SSNRA. After SSNRA we could provide for years of service earned in the future:

For those hired before 7/1/2011:

1.25% of final average salary up "Social Security Covered Compensation" plus 2.0% of final average salary in excess of "Social Security Covered Compensation."

For those hired on or after 7/1/2011:

1.25% of final average salary up "Social Security Covered Compensation" plus 1.7% of final average salary in excess of "Social Security Covered Compensation."

We could lower the 1.25%/1.7% to 0.95%/1.7% to keep the spread the same for the two groups (i.e. use the same approximation of the Social Security benefit) but we have not for this study.