MFP Committee #5
April 20, 2009
Briefing

MEMORANDUM

April 16, 2009

TO: Management & Fiscal Policy Committee

FROM: Karen Orlansky, Director KO
Office of Legislative Oversight

SUBJECT: **OLO Memo Report 2009-9: A Research Brief on Furloughs and Buyouts**

On April 14, 2009, the Council released OLO Memorandum Report 2009-9: A Research Brief on Furloughs and Buyouts. OLO prepared this research brief in response to the Council's request for basic facts and comparative information on furloughs and buyouts, identified as two strategies being used across the country to minimize or even avoid the use of layoffs.

- A furlough is the placement of an employee in a temporary non-duty, non-pay status to achieve budget savings through reducing personnel costs.
- A buyout is any type of financial incentive provided by an employer to encourage employees to voluntarily leave their jobs either through retirement or resignation.

The report includes a fiscal analysis of the 2008 County Government buyout and a description of the 2009 buyout proposed by the Executive. Appendix B contains a memo from Robert Drummer, Legislative Attorney, that answers a set of questions about the Council's authority to require furloughs or buyouts in the FY10 operating budget.

At the MFP Committee session on Monday, OLO staff will provide a brief presentation of the report. OLO is also working with Council staff to review the fiscal impact of the proposed 2009 buyout, as outlined in legislation introduced at the request of the Executive, Expedited Bill 10-09, Personnel – Retirement Incentive Program.

Committee members are asked to bring their copies of OLO's report to the meeting. Extra copies are available from OLO's office. The full report has also been posted online at: http://www.montgomerycountymd.gov/olo

Attachment: Executive Summary of OLO Report 2009-9

OFFICE OF LEGISLATIVE OVERSIGHT MEMORANDUM REPORT 2009-9
APRIL 14, 2009

In these difficult economic times, many state and local governments are reluctantly turning to employee layoffs in order to reduce operating expenses and balance their budgets. Furloughs and buyouts represent two alternative strategies being used by employers to reduce compensation costs, and downsize or restructure the workforce:

- A furlough is the placement of an employee in a temporary non-duty, non-pay status to achieve budget savings.
- A buyout is any type of financial incentive provided by an employer to encourage employees to voluntary leave their jobs either through retirement or resignation.

Montgomery County has historically worked very hard to minimize the use of layoffs. To further the Council's understanding of how furloughs and buyouts work in practice, the Council requested the Office of Legislative Oversight to prepare a research brief about these two strategies, including the reported experiences of other jurisdictions.

FURLOUGHS – REPORTED ADVANTAGES AND DOWNSIDES

The use of furloughs has expanded during the past year as a relatively common employer response to the current economic downturn. The most commonly cited advantages and downsides to using furloughs as a budget savings strategy are listed in the table below.

Commonly Cited Advantages
• A furlough provides immediate and predictable savings. • A furlough may serve to minimize or even avoid the use of layoffs. • A furlough is a temporary adjustment that does not require changes to the current size or structure of the workforce. • Employees tend to prefer furloughs vs. other forms of compensation reductions that pay employees less for the same amount of work. • A furlough can be structured to provide some additional savings in operating costs by closing facilities on certain days.
Commonly Cited Downsides
• Furloughs do not deliver long-term savings from a structural change in the workforce. • Furloughs can result in grievances and/or lawsuits from employee organizations. • Furloughs can result in increased overtime expenses to maintain services or to "make up" the work missed during a furlough. • Furloughs typically result in some amount of less work being performed.

COMMON DESIGN QUESTIONS

Furloughs are not all structured identically. However, while each furlough plan has its unique characteristics, there are common design questions to address if/when a furlough plan for County Government employees is before the Council for consideration. The key questions are:

1. How much budget savings does the furlough need to achieve?
2. Is the furlough going to be voluntary or mandatory?
3. How many furlough hours or days are there going to be? Should the number of furlough hours or days be the same for all employees?
4. Should furlough days be designated or subject to employee choice (i.e., rolling)? Should there by any incentives or options as to when furloughs are taken?
5. Should certain employees be exempt from the furlough, e.g. certain job types or classes, employees earning less than a certain amount?
6. How should the compensation adjustment be taken out of employees' paychecks?
7. How should the calculation of employee benefits be treated as a result of a furlough?

In deciding how to answer these questions, the Council must weigh three potentially-competing factors: budget savings; adverse impacts on employees (both in terms of wages and morale); and changes in productivity and levels of service delivery.

LESSONS LEARNED

Based on information compiled about furlough plans being implemented by other public sector employers, OLO identified the following recurring themes or "lessons learned":

Furloughs provide immediate budget savings without reducing the size of the workforce. Jurisdictions that are implementing furloughs report they are achieving their targeted reduction in compensation costs, either immediately or in the near future. By design, a furlough does not require an employer to reduce the size or change the structure of the workforce.

Employers can design a furlough in ways that mitigate some of the negative effects on employees, especially the financial loss for those earning lower salaries. Typical strategies used to mitigate the adverse impacts of furloughs on employees include protecting employee benefits and spreading out the salary loss over multiple pay periods. Other strategies include exempting employees who earn less than a certain amount and/or requiring higher-paid employees to take more furlough days than lower-paid employees.

Not much is documented about the impact of furloughs on productivity. The use of rolling furloughs and exempting certain employees are design approaches intended to minimize service disruptions. Some jurisdictions strive to maintain service levels to the public by providing incentives for employees to take their furlough days on pre-existing holidays.

While employees prefer voluntary vs. mandatory furloughs, voluntary furloughs may not achieve the desired level of cost savings. The obvious downside to voluntary furloughs is that there is unlikely to be 100% participation and the resulting cost savings is smaller.

Some furloughs have resulted in legal challenges from employees unions. Three of the eight jurisdictions reviewed experienced legal challenges to their furlough plans with varied results.

OBJECTIVES OF BUYOUT PROGRAMS

A buyout program provides an employer with the opportunity to reduce compensation costs and restructure the workforce. To the extent a buyout allows an employer to minimize layoffs, buyouts also mitigate the morale problems surrounding layoffs. Buyouts have the added advantage of reducing an employer's exposure to unemployment compensation liability that can result from layoffs.

Buyouts generally result in immediate compensation cost reductions. The greatest compensation cost savings occur when an employer abolishes positions vacated by a buyout. When positions are refilled, an employer can often achieve some lesser "turnover" savings attributed to lapse and lower salaries of the new hires.

Buyouts can serve as effective tools for restructuring the workforce. Buyouts create position vacancies that allow an employer to reshape the workforce to reflect current staffing needs and resource availability. Buyouts create vacancies which afford an employer the opportunity to downsize through the elimination of positions. Alternatively, an employer may choose to refill positions with employees that have different skills.

TYPES OF BUYOUTS

The type of retirement plan offered employees affects the buyout incentives that an employer can offer. The table below shows examples of incentives that could be offered to members of any retirement plan compared to those only applicable to members in defined benefit plans.

Buyout Incentives for all Retirement Plans	Additional Incentives Limited to Defined Benefit Retirement Plans
Cash payments	Adjustments to credited years of service
Contribution to portable retirement accounts	Lowered age and years of service requirements
Enhanced post-employment health benefits	Reduction in early retirement penalty

POTENTIAL DOWNSIDE OF BUYOUTS - COSTS CAN EXCEED SAVINGS

While buyouts can offer immediate reductions in compensation costs, the research evidences that buyouts too often incur costs that offset or exceed program savings, particularly when implemented independent of a downsizing or restructuring plan. Federal and state evaluations show that much of the fiscal benefit of a buyout is lost when an employer:

- Refills vacated positions; and/or
- Pays overtime or hires contractors to perform the work of buyout-vacated positions.

Buyouts that create long-term employer liabilities (e.g., by increased pension and/or retiree health benefits) can also result in total program costs that exceed program savings.

Federal and state evaluations of buyout programs recommend implementing buyouts only in concert with a downsizing plan; targeting the buyout toward departments, programs, or job classes that are subject to reductions-in-force; and minimizing the refilling of vacated positions.

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2008 COUNTY GOVERNMENT BUYOUT

In May 2008, as recommended by the Executive, the Council approved a buyout program for non-public safety Employees' Retirement System (ERS) members, who were at normal retirement or within two years of normal retirement. The incentive consisted of a $25,000 payment and a reduction in the early retirement penalty. Buyout recipients had to retire by June 30, 2008.

Of the 838 eligible employees, 150 (or 18%) accepted the buyout. Three-fourths of the employees who accepted the 2008 buyout were eligible for normal retirement. Of the 150 positions vacated by the buyout, the County refilled 96 positions (64%) and abolished 54 positions (36%).

From FY09 - FY19, OLO's fiscal analysis shows that the 2008 County Government buyout will:

- Save $20.2 million (of which $8.5 million was saved in FY09)
- Cost $33.0 million
- Result in a net cost of $12.8 million

Almost half of the total savings of $20.2 million occurs in FY09 due to position abolishments and turnover savings. However, because the buyout program obligates the County to cover $33 million in new costs over the next decade, the net result is a cost increase of **$12.8 million.**

Beginning in FY10, and continuing for the next ten years, the County must pay back the ERS Trust Fund the $3.75 million it cost for the $25,000 per employee incentive payments. The buyout also resulted in retirees drawing pensions and health coverage for longer periods, which also increased the County's future liability.

Net Savings and Cost Increases Resulting from the 2008 County Government Buyout ($ in millions)

Fiscal Year	(A) Savings	(B) Cost Increases	(A) – (B) Net Savings or (Cost Increases)
FY09	$9.9	$1.4	$8.5
FY10-19	$10.3	$31.6	($21.3)
Total FY09-FY19	**$20.2**	**$33.0**	**($12.8)**

2009 PROPOSED COUNTY GOVERNMENT BUYOUT

As recommended by the Executive, the 2009 County Government buyout is being offered to Employees' Retirement System members who are eligible for normal retirement or within two years of normal retirement. The proposed 2009 incentive is $40,000 plus elimination of the early retirement penalty. The terms of the proposed 2009 buyout were bargained with MCGEO.

As the Council considers the proposed 2009 County Government buyout, OLO recommends the Council ask the Executive to address the following questions:

1. What are the estimated annual costs and savings of the 2009 buyout from FY10-FY20?
2. What percent of buyout-vacated positions will the Executive abolish permanently?
3. Is there a scenario whereby eligibility for the 2009 buyout could be targeted toward job classes that are subject to reductions in force?
4. What are the Executive's plans for coordinating the proposed 2009 buyout with the discontinued service retirement program?