Achieving a Structurally Balanced Budget in Montgomery County

Part II:
Options for Long-Term Fiscal Balance

OFFICE OF LEGISLATIVE OVERSIGHT
REPORT NUMBER 2011-2

December 7, 2010

EXECUTIVE SUMMARY

This report is the second part of the Office of Legislative Oversight's two-part assignment on achieving a structurally balanced budget in Montgomery County.

As requested by the County Council, the purpose of Part II is to inform a discussion of options to help the County navigate toward long-term fiscal sustainability. As with the many other jurisdictions that face similar budget pressures, the County's fiscal picture for the foreseeable future requires decisions that will inevitably require some to pay more and others to receive less. Marginal, short-term, and one-time fixes will not produce a sustainable solution for the County.

The options outlined in OLO's Part II report offer an array of potential budget savings and revenue raising choices. Some would yield substantial savings in the short term, and others would yield even greater savings but only in the longer term. Many of the options are not mutually exclusive and could be combined to achieve some savings in the short term and more over time.

The cost containment and/or revenue raising options that the Council decides to consider will be influenced by some key information that is not yet in hand. This includes updated revenue projections, updated estimates of the County's pension and OPEB (retiree health trust) liabilities, and the agencies' and County Executive's future budget requests, which will reflect the collective bargaining agreements reached between the County Executive and the County Government unions and the Board of Education and the school unions.

The rest of this executive summary provides a general background and roadmap to the contents of OLO's Part II report, which consists of eight issue papers and an appendix of related information. This executive summary concludes with some recommended next steps for the Council's consideration of the report's contents.

BACKGROUND

OLO's Part I analysis concluded that Montgomery County faces a structural budget problem.[1] By FY16, the combined cost of the County's legal and policy commitments (i.e., employee pensions, health insurance for active and retired employees, debt service, and current revenue contributions to the capital budget, retiree health trust fund, and County's fund reserves) is projected to total $1.6 billion, or roughly one-third of all available tax revenue.

In the current climate, revenue growth for the foreseeable future is unlikely to keep pace with the steadily rising costs of our public sector's spending commitments. Consequently, the approach of previous years - where projected revenue for the upcoming fiscal year was sufficient to fully fund the current year's budget, absorb the increased cost of commitments, and support new initiatives (e.g., program expansions, salary increases) - no longer works.

As a result, Montgomery County, like many other state and local governments across the nation, faces the extraordinary challenge of making decisions that will result in long-term fiscal sustainability, a task that can only be accomplished by permanently raising more revenue or making reforms that reduce future government costs.

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[1] OLO's Part I findings, presented to the Montgomery County Council on 11/23/10, are available at: http://www.montgomerycountymd.gov/content/council/olo/reports/pdf/2011-2.pdf

What Guided OLO's Selection of Options to Include?

The options that OLO selected to examine flow directly from our Part I analysis, which identified the major cost drivers of the tax supported budgets for the four agencies: County Government, Montgomery County Public Schools, Montgomery College, and M-NCPPC.

In order to deliver a useful product to the Council, OLO selected a finite number of cost savings and revenue raising options to assess and present. The Appendix (©4) contains a list of additional options worthy of mention, any of which are potential candidates for further development.

OLO's selection of specific cost containment and budget reduction options is based on the following factors:

1. **The experience of other jurisdictions**. The cost pressures and difficult trade-offs facing Montgomery County are by no means unique. OLO was guided by research into how other state and local governments are addressing their own structural revenue and expenditure imbalances. The Appendix (©119) contains examples of cost containment strategies for retirement benefits and health insurance costs undertaken in other places.

2. **The advice of subject matter experts**. Throughout the study period, OLO's work was guided by the advice of subject matter experts, particularly on the technically complex issues of public sector finance and employee benefits. OLO consulted extensively with the many knowledgeable professionals in the agencies' respective budget, finance, and human resources offices. OLO also reviewed a plethora of articles, reports, and research briefs written in recent years about balancing public sector budgets and ongoing fiscal sustainability.

3. **The potential for substantial and recurring agency savings.** OLO placed priority on options that, if implemented, could result in substantial and recurring reductions in tax supported agency costs. Because employee pay and benefits constitutes 82% of tax supported spending, this is where we concentrated our effort. The first five issue papers address options to reduce agency spending on the building blocks of personnel costs: employee salaries, retirement/pension benefits, health benefits for active employees, health benefits for retirees, and workforce size.

4. **The legal feasibility of structural changes to employee pay and benefits.** Shortly after being assigned this project, OLO requested an opinion from the County Attorney on the legal issues related to changing employee pay and benefits. All of the options included in OLO's issue papers adhere to the guidance outlined in the memo from the County Attorney, which is included in its entirety in the Appendix (©8).

5. **Reforms that would reduce per employee costs.** OLO's Part I analysis showed that the primary driver of agency personnel expenditure growth is not a larger workforce, but rather higher per employee costs. Based on this finding, the papers that deal with personnel cost issues focus on changes to the structure of employee salaries and benefits that either lower or reduce the growth rate of the agencies' per employee costs.

6. **The need to address the issues of workforce size, but without duplicating work of the Organizational Reform Commission and Cross-Agency Resource-Sharing Committee.** One way to lower personnel costs is to reduce the workforce. Concurrent to this OLO project, two efforts underway are expected to identify potential budget savings based on functional reorganizations or consolidations and increased efficiency of government operations. Specifically:

   - The Organizational Reform Commission was established jointly by the Council and County Executive earlier this year. The Commission was created to make recommendations for potential reorganization or consolidation of functions performed by the County-funded agencies. The Commission was tasked with submitting a final report to the Council and Executive by January 31, 2011.

   - The Cross-Agency Resource-Sharing Committee (CARS) is a major inter-agency effort launched earlier this year by the County Government's Chief Administrative Officer, for the stated purpose to provide a "forum among County agencies to share ideas/best practices, develop potential resource-sharing strategies to achieve operational efficiencies, reduce costs, and improve the quality of services offered to our residents." CARS is on schedule to submit its first round of recommendations to the CARS Executive Committee later this month.

   The Appendix (©48-67) contains more information about both groups and the status of their work to date. In order to supplement and not duplicate the efforts of these two initiatives, OLO's issue paper on workforce size provides a macro-perspective on the number of positions (measured in workyears) that would need to be abolished in each agency in order to lower personnel costs, calculated in increments of $10 million.

7. **The role of debt service in the competition for tax supported revenue.** OLO's Part I analysis highlighted the rising cost of debt service over the past ten years, and its projected growth going forward. Because dollars spent on paying back debt are not available to fund the annual agency operating costs, OLO includes several options that show how reducing debt issuance frees up more resources for agency operating budgets.

8. **The inclusion of options to raise more revenues.** While the bulk of OLO's Part II report provides options that would reduce spending, the final issue paper addresses options to raise more revenue. Should there be interest in seeking additional tax supported revenue to pay for existing spending commitments and emerging budget priorities, the choices are either to:

   - Adjust the rates for current revenue sources; or
   - Identify new revenue sources.

   In selecting options for raising revenue, OLO included one for each of the major sources of local revenue: property tax, income tax, excise taxes, and user fees.

OVERVIEW OF THE EIGHT ISSUE PAPERS.

The next three pages contain brief overviews of the eight issue papers. Details on the sources of data and methodology used to calculate potential costs savings are included in the Appendix (©68).

A. Employee Salaries

Salaries represent the largest component of personnel costs. Between FY02 and FY11, employee salaries across the four agencies grew by 50% in the aggregate and by higher amounts (up to 80%) for individual employees. Issue Paper A includes one approach that would actually reduce the total cost of salaries and a series of options to slow the rate of salary growth:

- The first option presents cost savings associated with three different levels of an across-the-board salary rollback (1%, 3%, and 5%) for all agency employees. A salary rollback is a permanent reduction in an employee's base salary. A 1% salary rollback implemented in FY12 across the four agencies would save about $23 million.
- The other salary-related options explore a range of alternatives for modifying the current structure of general wage adjustments and step increases. Modifying the structure of pay increases could substantially lower the growth rate of personnel costs going forward, compared to their growth rates over the past decade.

B. Retirement/Pension Benefits

From FY02 to FY11, tax supported costs of pension and retirement benefits for employees across the four agencies increased by 226%, from $59 million to $193 million. By FY16, annual agency retirement costs are projected to cost more than $264 million. (This estimated amount does not include any costs related to a potential shift of pension liability from the State to the County for MCPS, Montgomery College, and library employees.)

Issue Paper B presents options to lower the projected increases in locally paid annual pension and retirement benefit costs for County Government and MCPS, including approaches to:

- Replace defined benefit retirement plans with lower cost defined contribution or hybrid plans;
- Increase the share of retirement costs paid by employees; and
- Reduce benefit levels.

Changes to retirement/pension plans hold the potential for saving hundreds of millions of dollars in the long-term. However, if changes are restricted to new hires, the savings will not be large in the immediate term. Actuarial analysis is necessary to determine the specific dollar savings that is achievable for any options related to retirement benefit changes.

C. Health Benefits for Active Employees

Over the past decade, total tax supported agency spending on group insurance (primarily health insurance and prescription drug coverage) for active employees increased 134%, from $134 million to $315 million. The costs of group insurance (assuming no change to the current structure) are estimated to increase another 55% to $487 million by FY16.

Issue Paper C presents options to reduce the cost of health benefits through restructuring how the premium is split between the employer and the employee. Specific options included are to:

- Set a uniform employer cost share of 70% for all plans;
- Charge employees who enroll dependents a higher cost share; and
- Set a uniform employer cost share of 60% for part-time employees.

Implementing the options outlined in this paper (as of January 2012) could produce savings for the four agencies that range from $7 million to $46 million in FY12, and from $19 million to $123 million by FY16. Phasing in changes over several years also provides cost savings, but at a slower rate.

D. Health Benefits for Retirees

Over the past ten years, total pay-as-you-go agency spending on group insurance for retired employees more than doubled from $31 million to $79 million. Absent changes to the current structure, these costs are estimated to increase another 57% to nearly $124 million by FY16. According to the latest actuarial estimates, the County's total future liability for retiree group insurance costs is estimated at $2.7 billion.

Issue Paper D presents options to lower the projected increases in agency retiree health insurance by:

- Eliminating retiree group insurance benefits for new employees;
- Reducing the employer's share of premium costs; or
- Changing current eligibility criteria and/or benefit levels for retiree health insurance.

Actuarial analysis is necessary to determine the potential savings that could be achieved by implementing any of these options. Changing the structure of retiree health benefits holds the potential to save tens of millions of dollars every year; however, if the changes are only applied to new hires, then the savings in the near term will be relatively modest.

E. Workforce Size

OLO's Part I analysis found that the primary cost driver behind increased personnel costs over the past decade has been higher costs per employee as opposed to substantial growth in the workforce. Nonetheless, reducing positions, measured in workyears, represents one way to reduce personnel costs.

The content of the issue paper on workforce size was designed to supplement and not duplicate the work of the Organizational Reform Commission and Cross-Agency Resource-Sharing Committee. Both of these groups have been tasked with recommending potential budget savings that would result from functional reorganizations/consolidations and increased efficiency of government operations.

Issue Paper E provides an overview of the allocation of workyears across the agencies, and calculates the number of workyears (for each agency) that must be eliminated in order to yield increments of $10 million in savings. To provide some additional perspective, Issue Paper E also includes illustrative examples of what $10 million in workyears "buys" in each agency.

F. Operating Expenses

"Operating expenses" consist of everything in an agency's operating budget other than personnel costs. Examples include spending for contractual support, utility payments, facility and vehicle maintenance, office and program supplies, and technology. In FY11, budgeted operating expenses represent about 9% of MCPS' tax supported spending and 32% of County Government's tax supported spending.

Issue Paper F summarizes the major components of tax supported operating expenses for County Government and Montgomery County Public Schools, and discusses two approaches to reduce FY12 operating costs in order to achieve increments of $10 million in savings. One approach is an "across-the-board" reduction that decreases operating expenses in all departments by a uniform percent. Another approach is for targeted reductions in operating expenses using priority-based criteria.

G. Debt Service

During the past decade, debt service payments increased 47% from $177 million in FY02 to $260 million in FY11. If the County issues General Obligation bonds at the rate projected in the most recent CIP ($325 million/year), debt service will increase to $391 million in FY16, an amount that is projected to exceed the combined tax supported budgets of Montgomery College and M-NCPPC.

Issue Paper G calculates the projected savings in annual debt service that would result from reducing annual general obligation bond issuance. In addition, this paper identifies the potential consequences of reducing the amount of debt issued.

H. Revenue

Issue Paper H presents four options to generate additional revenue for tax supported expenditures. One option is presented for each of the major locally generated sources of revenue:

- Property taxes,
- Income taxes,
- Excise taxes, and
- Fees/charges.

Three of the four options would generate revenue that would be available for unrestricted use. The fourth option would raise revenue for transportation projects that add new capacity. The paper provides estimates of potential additional revenue associated with each option, which ranges from $3-$20 million in FY12 to more than $150 million by FY16.

Appendix

The Appendix contains additional background and reference materials, including:

- A primer on the State's Maintenance of Effort law;
- Memoranda from the County Attorney on the Council's authority to modify employee salaries and benefits, and the Council's role in collective bargaining;
- Regional comparative data on health and retirement benefits; and
- Case studies of changes to employee retirement and health benefits in other jurisdictions across the country.

In addition, the Appendix includes a glossary of terms, copies of Council resolutions related to fiscal and debt policies, and additional information on the charges and work to date of the Organizational Reform Commission and the Cross-Agency Resource-Sharing Committee.

Recommended Next Steps

County leaders face a large and complex challenge of bringing projected revenue and spending into long-term alignment. To assist in this effort, the Council requested the Office of Legislative Oversight to develop options that can form the basis for an informed discussion about various ways to raise revenue and/or bend the agencies' future cost curves downward.

As stated earlier, the number and choice of specific cost containment and/or revenue raising options that the Council will need to consider will depend, at least in part, on some key information that is not yet in hand. This includes: updated revenue projections, updated estimates of the County's pension and OPEB (retiree health trust) liabilities, and the agencies' and County Executive's future budget requests, which will reflect the collective bargaining agreements reached between the County Executive and the County Government unions and the Board of Education and the school unions.

Although the exact size of the FY12 and future year structural budget "gaps" that the Council needs to close is not yet known, OLO recommends that the Council prepare for the upcoming budget deliberations by adopting an explicit time line for discussion of this Part II report that includes the following steps:

1. An initial period designated for the Council to ask questions and for staff to prepare answers, with the overall purpose of enabling a common understanding of the options presented.

2. A step for seeking feedback from the general public as well as known stakeholders. The Council should consider coordinating the timing of such input with any outreach efforts that the Council holds on the recommendations of the Organizational Reform Commission and the Cross-Agency Resource-Sharing Committee.

3. A date by which the Council selects a short list of options for further research and analysis that might involve, for example, more refined estimates of cost savings, more detailed analysis of the potential impact on employees, a proposed implementation schedule, and the gathering of more specific comparative data. Included in this step would be any Council requests for additional legal advice or cost estimates related to options that require retaining actuarial services.

4. A decision and action phase, during which the Council decides which, if any, of the options to support, and then takes the legislative, policy, and/or budget actions necessary to move forward with implementation.

As the Council works its way through this next phase of gathering more information, soliciting feedback, weighing alternatives, and making decisions, OLO offers some closing observations on key facts to keep in mind:

- Government is a people-intensive business, so it is no surprise that the great majority of the County's resources is allocated to human capital. Unfortunately, the corollary to this reality is that achieving substantial budget savings requires the County to reduce spending on personnel. There are two ways to reduce personnel costs: shrink the workforce and/or lower costs per employee.

- The County Government and Montgomery County Public Schools (MCPS) together account for 91% of all tax supported spending. MCPS accounts for two-thirds of all tax supported workyears. In order to yield substantial savings, any cost containment option that involves reducing personnel costs must extend to both County Government and MCPS.

- Structural changes to pay or benefits that reduce per employee costs but only apply to newly hired employees will not yield large savings in the near term. There are some options, however, such as changing the structure of pension benefits and retiree health benefits, that hold the potential for substantial dollar savings in the longer term even if only applied to new hires.

For the many governments currently struggling to align revenues and desired expenditures, it certainly would be desirable if some options existed that magically provided win-win solutions. However, as with so many other jurisdictions, the reality of the County's fiscal picture, at least for the foreseeable future, requires decisions that involve asking some to pay more and/or others to make do with less. In other words, the reality is that none of the options promise an outcome where everyone wins.

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The Office of Legislative Oversight appreciates the cooperation received from the leadership and staff of the County Government, Montgomery County Public Schools, Montgomery College, and Maryland-National Capital Park and Planning Commission. This assignment was a major undertaking during a compressed time period. OLO's work was greatly facilitated by the reliable and constructive assistance of the four agencies involved. Special thanks are also owed to the Council Staff Director and the many other Council staff members with whom we consulted regularly.

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Appendix

Issue Paper A

Employee Salaries

EMPLOYEE SALARIES

OVERVIEW: This paper presents options to reduce agency expenditures on employee salaries and/or slow the growth rate of future salary expenditures without reducing workforce size.

FY02-FY11 Agency Salary Expenditures

The table below shows tax supported salary expenditures by agency for FY02 and FY11. During this 10-year period, the rate of inflation was 29% and tax supported agency spending on employee salaries (in aggregate) increased by 50%. This percent change in agency salary expenditures reflects multiple factors such as salary increases, change in workforce size, turn-over, job promotions, position reclassifications, special pay, and overtime.

Table 1. Tax Supported Salary Expenditures by Agency

Agency	FY02	FY11	FY02-FY11 Increase	
			$	%
Montgomery County Government	$364 million	$518 million	$154 million	42%
MCPS	$878 million	$1.3 billion	$422 million	53%
Montgomery College	$79 million	$141 million	$62 million	79%
M-NCPPC	$40 million	$53 million	$13 million	33%
Total	**$1.4 billion**	**$2.1 billion**	**$651 million**	**50%**

General Wage Adjustments and Step Increases

In most years during the past decade, the two drivers of salary increases were general wage adjustments and step increases (also referred to as service increments):

- A **general wage adjustment** is an increase in pay granted to all employees on a specific date, usually the beginning of a new fiscal year. Historically, the practice of County agencies has been to grant general wage adjustments as increases to base salary. The general wage adjustment is often referred to as a cost-of-living adjustment (COLA).

- A **step increase (or service increment)** is an increase to base salary granted to employees who are below the maximum for their pay grade and who meet minimum job performance requirements. An employee typically receives a step increase on the anniversary of his/her original hire date.

Providing step increases and general wage adjustments, which are included in agency personnel regulations and/or in collectively bargained agreements between agencies and their respective employee unions, has significantly increased salary expenditures over the past decade.

Table 2 shows, for the most recent five fiscal years, the annual cost (by agency) of the average general wage adjustment (GWA) and average annual step increases received by eligible employees.[1] As noted in Table 2, no employees received step increases in FY11 and no employees received general wage adjustments in FY10 or FY11.

Table 2. Average Percent and Annual Cost of Step Increases and General Wage Adjustments

Agency	FY07		FY08		FY09		FY10		FY11	
	Step	GWA	Step	GWA	Step	GWA	Step	GWA	Step	GWA
County Government	3.5%	3.7%	3.5%	4.8%	3.5%	4.1%	3.5%	None	None	None
MCPS[2]	3.5%	3.5%	3.5%	4.6%	3.5%	5.0%	3.5%	None	None	None
M-NCPPC	3.5%	3.3%	3.5%	3.3%	3.5%	3.3%	3.5%	None	None	None
Montgomery College	2.8%	3.8%	3.0%	5.0%	3.0%	5.2%	2.7%	None	None	None
Estimated Annual Costs (in millions)	**$32.8**	**$71.3**	**$35.9**	**$102.9**	**$38.2**	**$107.0**	**$38.1**	**--**	**--**	**--**
	$104.1		**$138.8**		**$145.2**		**$38.1**		**--**	

The cost of step increases shown above represents the full annualized costs of these salary adjustments. As a result, the numbers are higher than the amount shown in annual agency budget requests for steps because eligible employees receive step increases at various points throughout the fiscal year (based on the anniversary of their hiring dates).

Annual Salary Increases as Cost Drivers

To illustrate the cumulative cost effect of annual pay increases, Table 3 shows the salary growth between FY02 and FY11 for four different sample employees. The calculations assume that each employee was hired at the minimum salary for the position in FY02, remained at the same grade (with no promotion, reclassification, or any type of special pay), and received the applicable service increment and general wage adjustment each year.

Table 3. Salary/Wage Change from Salary Increases for Selected Positions

Agency	Position	FY02	FY11	FY02-FY11 Increase	
				$	%
County Government	Social Worker I	$36,900	$61,900	$25,000	68%
County Government	Firefighter III	$35,400	$62,500	$27,100	77%
MCPS	Teacher (MA)	$39,000	$70,000	$31,000	79%
MCPS	Bus Operator	$18,900	$35,700	$16,800	89%

[1] The table here shows the average step and GWA across all bargaining units for each agency, and as a result does not necessarily reflect the specific step increase or GWA percent received by a given employee. Appendix (©72) provides details on the annual step and GWA percent increases granted in each agency between FY01 and FY11.
[2] MCPS' annual increment cost data are derived by a salary simulation that assumes all positions are filled and moving along the salary schedule. As a result, the data do not account for factors such as turnover or lapse.

Overview of Options

The rest of this issue paper presents one strategy for reducing agency expenditures on salaries (a salary rollback) and several additional strategies for slowing the rate of salary growth by modifying the structure of granting general wage adjustments and step increases. The options on the structure of general wage adjustments and step increases, unlike the majority of options within this report, show the <u>projected costs</u> associated with each structure as opposed to the projected savings. In sum:

- Option #1 outlines the personnel cost savings associated with three different levels of an across-the board salary rollback (1%, 3%, and 5%) for all agency employees. A salary rollback is a permanent reduction in an employee's base salary. The estimated savings from a salary rollback range from $23 million to $115 million in FY12, depending on the rollback level.

- Option #2 outlines three alternatives for providing general wage adjustments (GWA) in ways that would slow the rate of salary growth compared to the cost of the agencies' general practice over the years. The three scenarios are to: (2A) Provide smaller general wage adjustments; (2B) Provide biennial general wage adjustments; and (2C) Provide general wage adjustments as lump-sum payments, not as increases to base pay.

- Option #3 outlines three alternatives for providing step increases in ways that would slow the rate of salary growth compared to the cost of the agencies' general practice over the years. The three scenarios are to: (3A) Provide smaller annual step increases; (3B) Provide biennial step increases; and (3C) Provide step increases as lump-sum payments, not as increases to base pay.

For the general wage adjustment and step increase options, the estimates of agency expenditures through FY16 reflect the additional costs associated with each alternative compared to a continued freeze on salaries (i.e., no general wage adjustment or step increase provided).

Implementation Issues

Changes to the salary structure within the agencies fall under the authority of the governing body for each agency, and do not require changes to State or County law. Salary and wage levels are included in all the collectively bargained agreements between agencies and employee unions. For a discussion of general legal issues surrounding modification to employee pay and benefits, see the memos in the Appendix from the County Attorney on: 1) the Council's authority to modify employee pay and benefits, and 2) the Council's role in collective bargaining. The County Attorney has concluded that the Council may impose salary reductions in future fiscal years. See ©8 and ©22.

OPTION #1: Salary Rollback

As approved in the FY11 agency budgets, tax supported personnel costs (salaries and wages, social security, retirement, and group insurance) across Montgomery County Government, MCPS, Montgomery College, and M-NCPPC total $2.7 billion. Salaries and wages for employees account for $2.0 billion (74%) of this total, with the balance of $0.7 billion (26%) for employee benefits.[3]

Alternative Structure

A salary rollback is a permanent reduction in an employee's base salary. A salary rollback is different from a furlough in a number of significant ways. First, a salary rollback does not reduce the number of hours worked. Second, in the year following a salary rollback, it is not assumed that an employee's salary will return to its previous level. And third, a salary rollback leads to savings related to retirement costs, which are a function of an employee's salary. (Both furloughs and salary rollbacks result in savings related to the costs of social security.)

This option calculates the potential savings compared to FY11 personnel costs for each agency at three different levels of salary rollback applied uniformly across each agency's workforce: 1%, 3%, and 5%. As evidenced by the implementation of furloughs in FY11, the agencies could implement a "progressive" salary rollback that achieves the same level of savings but differentiates the percent salary rollback by applying a smaller rollback to lower-paid employees and a larger rollback to higher-paid employees.

Projected Savings

Essentially, a salary rollback acts as a one-time "reset" of current salary levels, reducing the base of all salaries. From a budget perspective, the savings from a salary rollback occurs in the year it is implemented. However, the new salary base would remain at the lower level in future years until action is taken to increase it. The table below shows the projected savings by agency for three different percents of salary rollback: 1%, 3%, and 5%.

Table 4. Projected FY12 Tax Supported Savings in Personnel Costs from Salary Rollback Scenarios

% Salary Rollback	Estimated FY12 Tax Supported Personnel Cost Savings[4]				
	County Government	MCPS	M-NCPPC	Montgomery College	Total
1%	$6.2 million	$14.7 million	$0.7 million	$1.3 million	**$22.9 million**
3%	$18.7 million	$44.0 million	$2.0 million	$4.0 million	**$68.7 million**
5%	$31.2 million	$73.4 million	$3.3 million	$6.7 million	**$114.6 million**

[3] The total expenditures for benefits do not include pension contributions for any agency employees.
[4] These calculations are based on the approved FY11 budget personnel cost data. The estimates include savings to salaries, social security, and locally paid pension/retirement costs.

Effect on Individual Employee Salary

Similar to the furloughs implemented in FY11, a salary rollback reduces the paychecks of employees. However, unlike furloughs, employee salaries would not automatically return to the prior level at the beginning of the next fiscal year. In addition, the lower salary would lead to a corresponding reduction in an employee's retirement benefits. The table below shows the salary impact on two sample employees, one with an annual salary of $40K and one with an annual salary of $70K.

Table 5. Impact of Salary Rollback on Employee Base Salary

Base Salary	Base Salary after Rollback		
	1%	3%	5%
$40,000	$39,600	$38,800	$38,000
Reduction in Salary	($400)	($1,200)	($2,000)
$70,000	$69,300	$67,900	$66,500
Reduction in Salary	($700)	($2,100)	($3,500)

OPTION #2: Changes to General Wage Adjustments

From FY07 to FY09, employees in the four agencies received, on average, annual general wage adjustments (GWA) of approximately 3.5%. For the four agencies combined, the annual personnel cost increases associated with each of these general wage adjustments ranged from $71 million to $107 million.

General wage adjustments were not funded in FY10 or FY11 for any agency. The estimated cost per 1% GWA for FY12 (if funded) is listed below for each agency.

Agency	Estimated FY12 Cost per 1% GWA
MCPS	$14.7 million
County Government	$6.2 million
Montgomery College	$1.3 million
M-NCPPC	$0.7 million
Total	**$22.9 million**

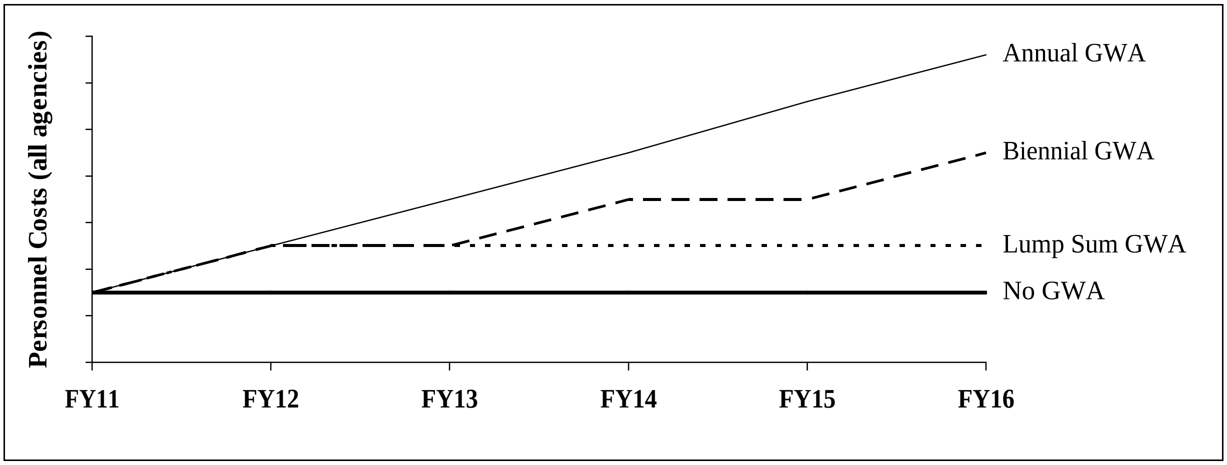
Alternative Structure

The cost of a general wage adjustment typically recurs in future years because it is usually an increase of an employee's base salary. This section outlines three different GWA scenarios, and calculates the relative costs of each scenario through FY16:

Scenario #2A: Provide "smaller" general wage adjustments.
Scenario #2B: Provide general wage adjustments only every other year.
Scenario #2C: Provide general wage adjustments as lump sum payments.

The exhibit below compares the "cost curve" associated with each of the three different scenarios, assuming the same GWA percent and assuming all other personnel cost variables remain constant. Of course, no GWA saves the most money. However, among the GWA options, the exhibit illustrates how an annual GWA that increases base salary is the most costly option over time (because it raises base budget costs every year), while an annual lump sum GWA that does not automatically increase an employee's base pay is the least costly option.

Exhibit 1. Cost Curves for Different GWA Scenarios



Projected Budget Impact

The total budget impact of a general wage adjustment depends on the size and structure of the GWA granted, the number of employees who receive it, current salaries, and the cost of benefits that are a function of those salaries. For each GWA scenario, this paper examines the difference in costs for two sizes of GWA increases: 1% and 3%. Table 6 summarizes the estimated annual and five-year tax supported costs associated with each GWA scenario across the four agencies.

Table 6. Estimated Tax Supported Personnel Costs of General Wage Adjustment Scenarios (all agencies)

GWA Scenario		Annual Increase in Personnel Costs (in millions)						Total Increase, FY11-FY16
		FY11	FY12	FY13	FY14	FY15	FY16	
Scenario 2A: Smaller Annual General Wage Adjustment	1%	--	$22.9	$23.1	$23.4	$23.6	$23.8	**$116.8 million**
	3%	--	$68.7	$70.7	$72.8	$74.9	$77.0	**$364.1 million**
Scenario 2B: Biennial General Wage Adjustment	1%	--	$22.9	--	$23.1	--	$23.4	**$69.4 million**
	3%	--	$68.7	--	$70.7	--	$72.8	**$212.2 million**
Scenario 2C: Lump Sum General Wage Adjustment	1%	--	$22.9	--	--	--	--	**$22.9 million**
	3%	--	$68.7	--	--	--	--	**$68.7 million**

Scenarios #2A-#2C (beginning on the next page) show the cumulative cost impacts associated with each GWA scenario and detail the estimated costs by agency.

Effect on Individual Employee Salary

Table 7 shows the projected base salary in FY16 under each scenario for an employee earning $50,000 in FY11 (assuming no other salary enhancements).

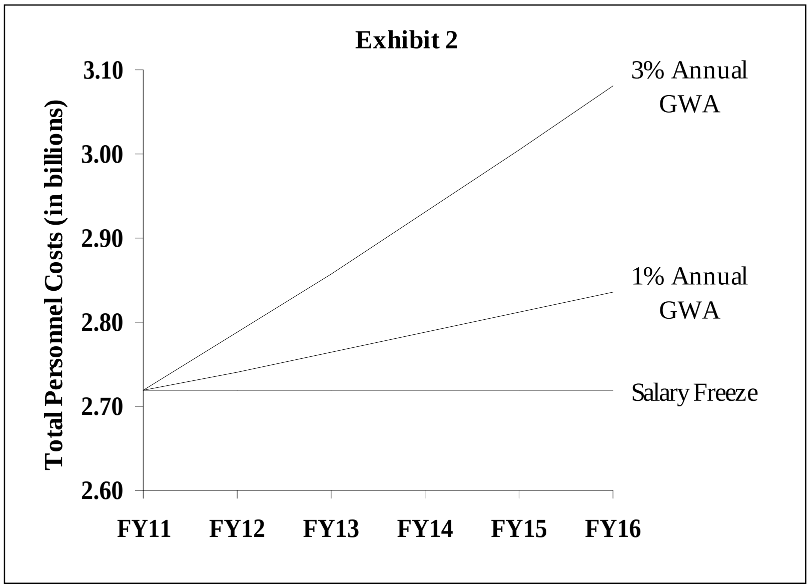
Table 7. FY11-FY16 Estimated Employee Salary Change by General Wage Adjustment Scenario

FY11 Salary of $50,000	1% General Wage Adjustment			3% General Wage Adjustment		
	Annual	Biennial	Lump Sum	Annual	Biennial	Lump Sum
FY16 Salary	$52,551	$51,515	$50,500	$57,964	$54,636	$51,500
% Salary Increase	+5%	+3%	+1%	+16%	+9%	+3%

#2A: Smaller Annual General Wage Adjustments

Scenario #2A details the cost impact of a 1% and 3% annual GWA. The calculations isolate the impact of general wage adjustments on personnel costs and assume all other personnel cost variables remain constant.

Exhibit 2 shows the cumulative impact through FY16 of a 1% and 3% GWA on total agency personnel costs compared to freezing salaries at FY11 levels.



Projected Budget Impact

Table 8 shows the projected annual budget impact for both general wage adjustment scenarios through FY16. The total estimated cost increase (FY11-FY16) is about $117 million for a 1% annual GWA and $364 million for a 3% annual GWA.

Table 8. Estimated Tax Supported Personnel Costs of Annual Service Increments

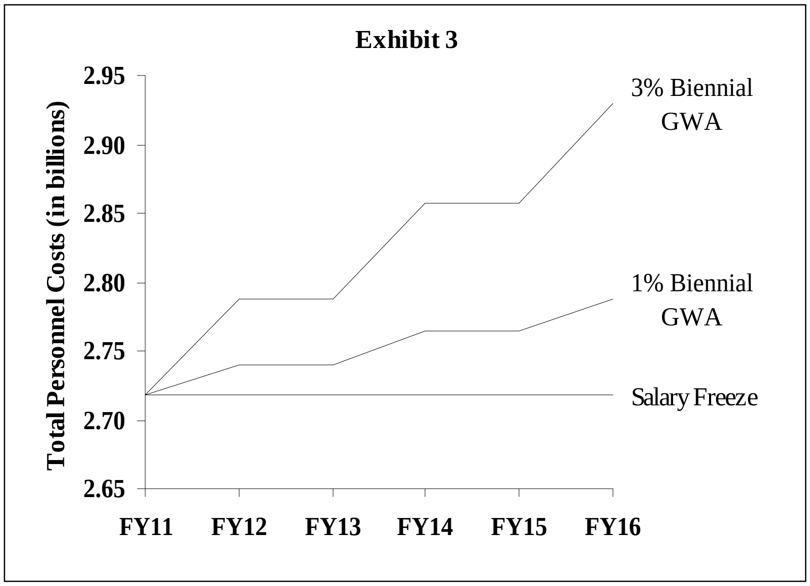
Scenario	Annual Increase in Personnel Costs (in millions)*						Total Increase, FY11-FY16
	FY11	FY12	FY13	FY14	FY15	FY16	
1% Annual General Wage Adjustment							
MCPS	--	$14.7	$14.8	$15.0	$15.1	$15.3	$74.9 million
County Government	--	$6.2	$6.3	$6.3	$6.4	$6.5	$31.7 million
Montgomery College	--	$1.3	$1.4	$1.4	$1.4	$1.4	$6.9 million
M-NCPPC	--	$0.7	$0.7	$0.7	$0.7	$0.7	$3.3 million
Total	--	**$22.9**	**$23.1**	**$23.4**	**$23.6**	**$23.8**	**$116.8 million**
3% Annual General Wage Adjustment							
MCPS	--	$44.0	$45.3	$46.7	$48.0	$49.4	$233.5 million
County Government	--	$18.7	$19.2	$19.8	$20.3	$20.9	$98.9 million
Montgomery College	--	$4.0	$4.1	$4.3	$4.4	$4.5	$21.3 million
M-NCPPC	--	$2.0	$2.0	$2.1	$2.1	$2.2	$10.4 million
Total	--	**$68.7**	**$70.7**	**$72.8**	**$74.9**	**$77.0**	**$364.1 million**

*Annual increases by agency may not add to "Total" or "Total Increase" values due to rounding.

#2B: Biennial General Wage Adjustments

Scenario #2B details the cost impact of a 1% and 3% biennial (i.e., every other year) GWA. The calculations isolate the impact of general wage adjustments on personnel costs, and assume all other personnel cost variables remain constant.

Exhibit 3 shows the cumulative impact through FY16 of a 1% and 3% biennial GWA on total agency personnel costs compared to freezing salaries at FY11 levels.



Projected Budget Impact

Table 9 shows the projected annual budget impact for both general wage adjustment scenarios through FY16. The total estimated cost increase (FY11-FY16) is about $69 million for a 1% biennial GWA and $212 million for a 3% biennial GWA.

Table 9. Estimated Tax Supported Personnel Costs of Biennial General Wage Adjustments

Scenario	Annual Increase in Personnel Costs (in millions)*						Total Increase, FY11-FY16
	FY11	FY12	FY13	FY14	FY15	FY16	
1% Biennial General Wage Adjustment							
MCPS	--	$14.7	--	$14.8	--	$15.0	$44.5 million
County Government	--	$6.2	--	$6.3	--	$6.3	$18.8 million
Montgomery College	--	$1.3	--	$1.4	--	$1.4	$4.1 million
M-NCPPC	--	$0.7	--	$0.7	--	$0.7	$2.0 million
Total	--	**$22.9**	--	**$23.1**	--	**$23.4**	**$69.4 million**
3% Biennial General Wage Adjustment							
MCPS	--	$44.0	--	$45.3	--	$46.7	$136.0 million
County Government	--	$18.7	--	$19.2	--	$19.8	$57.7 million
Montgomery College	--	$4.0	--	$4.1	--	$4.3	$12.4 million
M-NCPPC	--	$2.0	--	$2.0	--	$2.1	$6.1 million
Total	--	**$68.7**	--	**$70.7**	--	**$72.8**	**$212.2 million**

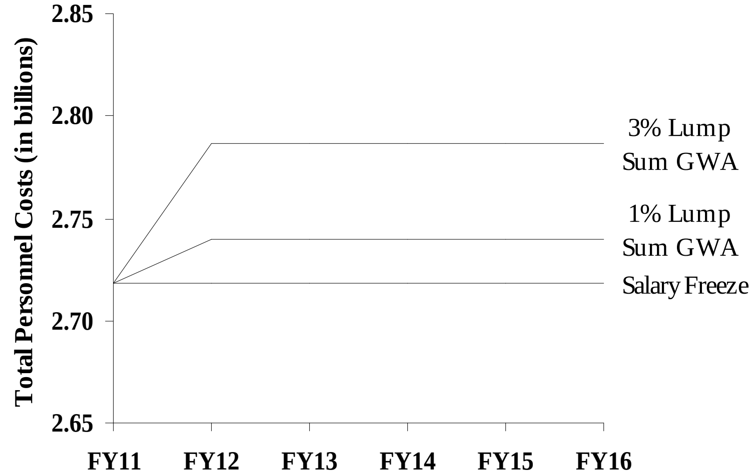
*Annual increases by agency may not add to "Total" or "Total Increase" values due to rounding.

#2C: Lump Sum General Wage Adjustments

Scenario #2C details the cost impact of a 1% and 3% annual lump sum GWA that does not increase an employee's base salary. The calculations isolate the impact of general wage adjustments on personnel costs, and assume all other personnel cost variables remain constant.

Exhibit 4 shows the cumulative impact through FY16 of a 1% and 3% annual lump sum GWA on total agency personnel costs compared to freezing salaries at FY11 levels.

Exhibit 4



Projected Budget Impact

Table 10 shows the projected annual budget impact for the annual lump sum general wage adjustment scenarios through FY16. The total estimated cost increase (FY11-FY16) is about $23 million for a 1% lump sum GWA and $69 million for a 3% lump sum GWA.

Table 10. Estimated Tax Supported Personnel Costs of Lump Sum General Wage Adjustments

Scenario	Annual Increase in Personnel Costs (in millions)						Total Increase, FY11-FY16
	FY11	FY12	FY13	FY14	FY15	FY16	
1% Annual Lump Sum General Wage Adjustment							
MCPS	--	$14.7	--	--	--	--	$14.7 million
County Government	--	$6.2	--	--	--	--	$6.2 million
Montgomery College	--	$1.3	--	--	--	--	$1.3 million
M-NCPPC	--	$0.7	--	--	--	--	$0.7 million
Total	--	**$22.9**	--	--	--	--	**$22.9 million**
3% Annual Lump Sum General Wage Adjustment							
MCPS	--	$44.0	--	--	--	--	$44.0 million
County Government	--	$18.7	--	--	--	--	$18.7 million
Montgomery College	--	$4.0	--	--	--	--	$4.0 million
M-NCPPC	--	$2.0	--	--	--	--	$2.0 million
Total	--	**$68.7**	--	--	--	--	**$68.7 million**

OPTION # 3: Changes to Step Increases

From FY07 to FY10, eligible employees received, on average, annual step increases of approximately 3.5% in County Government, MCPS, and M-NCPPC and 3% in Montgomery College. The annual tax supported costs for step increases ranged from $33 million to $38 million for the four agencies combined.

Step increases were not funded in FY11 for any agency. The estimated cost per 1% step in FY12 (if funded) is listed below for each agency.

Agency	Estimated FY12 Cost per 1% Step
MCPS	$7.1 million
County Government	$2.3 million
Montgomery College	$0.8 million
M-NCPPC	$0.2 million
Total	**$10.4 million**

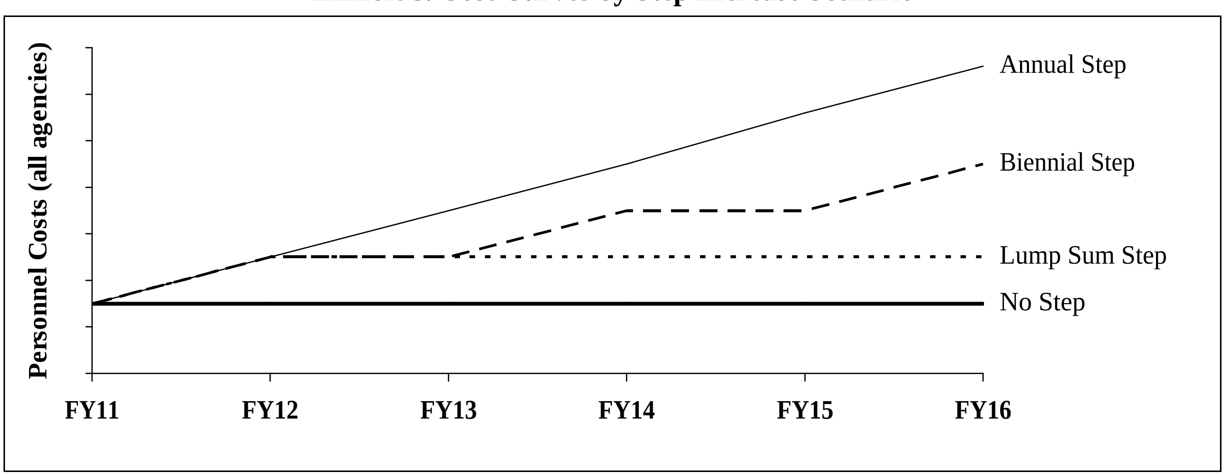
Alternative Structure

The cost of a step increase typically recurs in future years because it is usually an increase of an employee's base salary. This section outlines three different scenarios for providing step increases, and calculates the relative impact on personnel costs through FY16:

Scenario #3A: Provide "smaller" annual step increases.
Scenario #3B: Provide step increases only every other year.
Scenario #3C: Provide step increases as lump sum payments.

The exhibit below compares the "cost curve" associated with each of the three step increase scenarios, assuming the same step amount and assuming all other personnel cost variables remain constant. Of course, no step increase saves the most money. However, among the step increase options, the exhibit illustrates how an annual step increase is the most costly option over time (because it raises base budget costs every year), while an annual lump sum step that does not automatically increase an employee's base salary is the least costly option.

Exhibit 5. Cost Curves by Step Increase Scenario



Projected Budget Impact

The total budget impact of a step increase depends on the current salary and number of employees that receive it, the percent of the step increase provided, and the cost of benefits that are a function of salary increases. For each step increase scenario, this issue paper examines the difference in costs for 1% and 3% step increases. Table 11 summarizes the estimated annual and five-year tax supported costs associated with each step increase scenario across the four agencies.

Table 11. Estimated Tax Supported Personnel Costs of Step Increase Scenarios (all agencies)

Step Increase Scenario*		Annual Increase in Personnel Costs (in millions)						Total Increase, FY11-FY16
		FY11	FY12	FY13	FY14	FY15	FY16	
Scenario 3A: Smaller Annual Step Increase	1%	--	$10.4	$10.5	$10.6	$10.6	$10.6	**$52.7 million**
	3%	--	$31.3	$31.8	$32.2	$32.6	$33.1	**$161.0 million**
Scenario 3B: Biennial Step Increase	1%	--	$10.4	--	$10.5	--	$10.6	**$31.5 million**
	3%	--	$31.3	--	$31.8	--	$32.2	**$95.3 million**
Scenario 3C: Lump Sum Step Increase	1%	--	$10.4	--	--	--	--	**$10.4 million**
	3%	--	$31.3	--	--	--	--	**$31.3 million**

*Each scenario applies the percent step increase as an average across each agency's workforce.

Scenarios #3A-#3C (beginning on the next page) show the cumulative personnel cost impacts for the different step increase scenarios and detail the estimated costs by agency.

Effect on Individual Employee Salary

Table 12 shows the projected base salary in FY16 under each scenario for an employee earning $50,000 in FY11 (assuming no other salary enhancements).

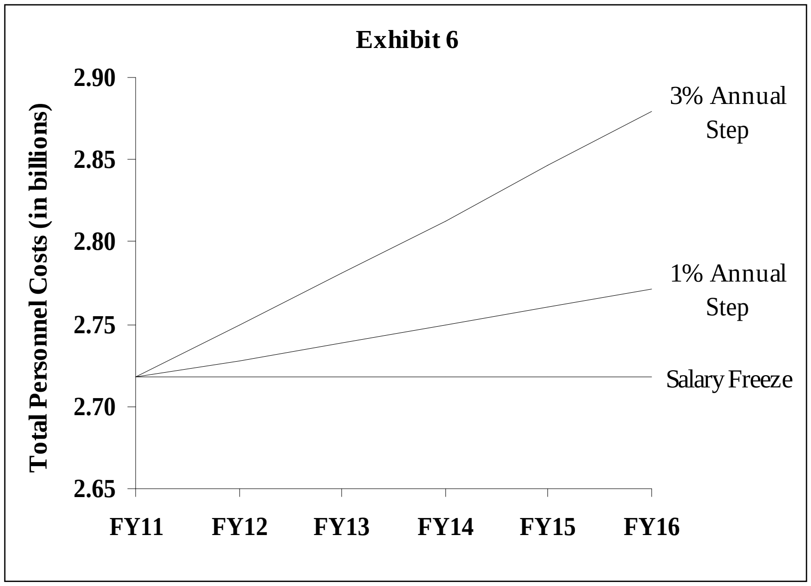
Table 12. FY11-16 Employee Salary Change by Step Increase Scenario

FY11 Salary of $50,000	1% Step Increase			3% Step Increase		
	Annual	Biennial	Lump Sum	Annual	Biennial	Lump Sum
FY16 Salary	$52,551	$51,515	$50,500	$57,964	$54,636	$51,500
% Salary Increase	+5%	+3%	+1%	+16%	+9%	+3%

3A: Smaller Annual Step Increases

Scenario #3A details the cost impact of a 1% and 3% annual step increase for eligible employees. The calculations isolate the impact of step increases on personnel costs and assume all other cost variables remain constant.

Exhibit 6 shows the cumulative impact through FY16 of a 1% and 3% step increase for eligible employees on total agency personnel costs compared to freezing salaries at FY11 levels.



Projected Budget Impact

Table 13 shows the projected annual budget impact for both annual step increase scenarios through FY16. The total estimated cost increase (FY11-FY16) is about $53 million for a 1% annual step and $161 million for a 3% annual step.

Table 13. Estimated Tax Supported Personnel Costs of Annual Step Increases

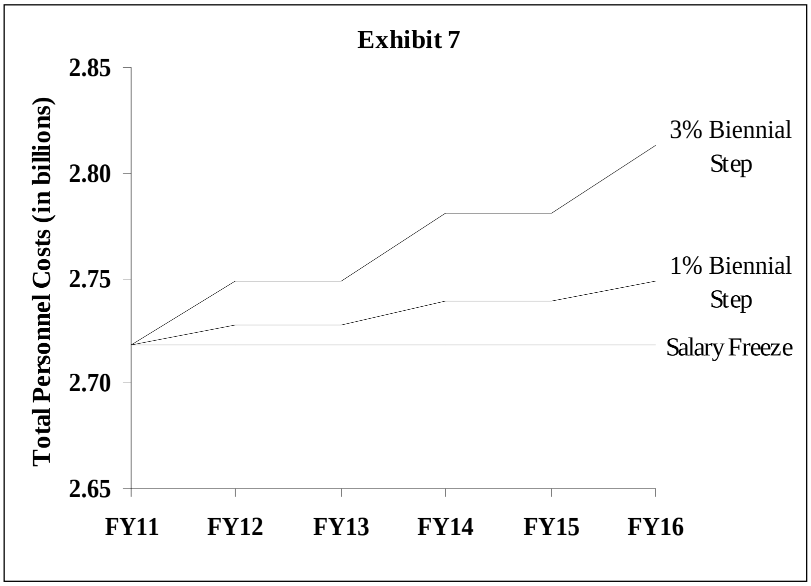
Scenario	Annual Increase in Personnel Costs (in millions)*						Total Increase, FY11-FY16
	FY11	FY12	FY13	FY14	FY15	FY16	
1% Annual Step Increase							
MCPS	--	$7.1	$7.2	$7.2	$7.2	$7.3	$36.0 million
County Government	--	$2.3	$2.3	$2.3	$2.3	$2.4	$11.6 million
Montgomery College	--	$0.8	$0.8	$0.8	$0.8	$0.8	$3.9 million
M-NCPPC	--	$0.2	$0.2	$0.2	$0.2	$0.2	$1.2 million
Total	--	**$10.4**	**$10.5**	**$10.6**	**$10.6**	**$10.6**	**$52.7 million**
3% Annual Step Increase							
MCPS	--	$21.4	$21.7	$22.0	$22.3	$22.7	$110.1 million
County Government	--	$6.9	$7.0	$7.1	$7.2	$7.2	$35.4 million
Montgomery College	--	$2.3	$2.3	$2.4	$2.4	$2.5	$11.9 million
M-NCPPC	--	$0.7	$0.7	$0.7	$0.7	$0.7	$3.6 million
Total	--	**$31.3**	**$31.8**	**$32.2**	**$32.6**	**$33.1**	**$161.0 million**

*Annual increases by agency may not add to "Total" or "Total Increase" values due to rounding.

#3B: Biennial Step Increases

Scenario #3B details the cost impact of a 1% and 3% biennial (i.e., every other year) step increase for eligible employees. The calculations isolate the impact of step increases on personnel costs, and assume all other cost variables remain constant.

Exhibit 7 shows the cumulative impact through FY16 of a 1% and 3% biennial step increase on total agency personnel costs compared to freezing salaries at FY11 levels.



Projected Budget Impact

Table 14 shows the projected annual budget impact for both step increase scenarios through FY16. The total estimated cost increase (FY11-16) is about $32 million for a 1% biennial step and $95 million for a 3% biennial step.

Table 14. Estimated Tax Supported Personnel Costs of Biennial Step Increases

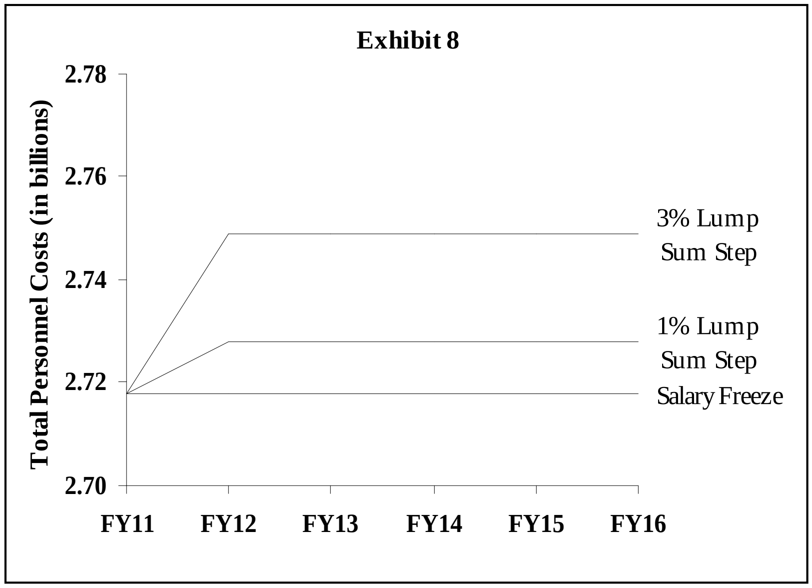
Scenario	Annual Increase in Personnel Costs (in millions)*						Total Increase, FY11-FY16
	FY11	FY12	FY13	FY14	FY15	FY16	
1% Biennial Increment							
MCPS	--	$7.1	--	$7.2	--	$7.2	$21.5 million
County Government	--	$2.3	--	$2.3	--	$2.3	$7.0 million
Montgomery College	--	$0.8	--	$0.8	--	$0.8	$2.3 million
M-NCPPC	--	$0.2	--	$0.2	--	$0.2	$0.7 million
Total	--	**$10.4**	--	**$10.5**	--	**$10.6**	**$31.5 million**
3% Biennial Increment							
MCPS	--	$21.4	--	$21.7	--	$22.0	$65.2 million
County Government	--	$6.9	--	$7.0	--	$7.1	$21.0 million
Montgomery College	--	$2.3	--	$2.3	--	$2.4	$7.0 million
M-NCPPC	--	$0.7	--	$0.7	--	$0.7	$2.1 million
Total	--	**$31.3**	--	**$31.8**	--	**$32.2**	**$95.3 million**

*Annual increases by agency may not add to "Total" or "Total Increase" values due to rounding.

3C: Lump Sum Step Increases

Scenario #3C details the cost impact of 1% and 3% annual lump sum step increase that does not increase an employee's base salary. The calculations isolate the impact of step increases on personnel costs, and assume all other cost variables remain constant.

Exhibit 8 shows the cumulative impact through FY16 of a 1% and 3% lump sum step increase on total agency personnel costs compared to freezing salaries at FY11 levels.



Projected Budget Impact

Table 15 shows the projected annual budget impact for annual lump sum step increase scenarios through FY16. The total estimated cost increase (FY11-16) is about $10 million for a 1% lump sum step and $31 million for a 3% lump sum step.

Table 15. Estimated Tax Supported Personnel Costs of Lump Sum Step Increases

Scenario	Annual Increase in Personnel Costs (in millions)						Total Increase, FY11-FY16
	FY11	FY12	FY13	FY14	FY15	FY16	
1% Annual Lump Sum Step Increase							
MCPS	--	$7.1	--	--	--	--	$7.1 million
County Government	--	$2.3	--	--	--	--	$2.3 million
Montgomery College	--	$0.8	--	--	--	--	$0.8 million
M-NCPPC	--	$0.2	--	--	--	--	$0.2 million
Total	--	**$10.4**	--	--	--	--	**$10.4 million**
3% Annual Lump Sum Step Increase							
MCPS	--	$21.4	--	--	--	--	$21.4 million
County Government	--	$6.9	--	--	--	--	$6.9 million
Montgomery College	--	$2.3	--	--	--	--	$2.3 million
M-NCPPC	--	$0.7	--	--	--	--	$0.7 million
Total	--	**$31.3**	--	--	--	--	**$31.3 million**

Issue Paper B

Retirement/Pension Benefits

RETIREMENT/PENSION BENEFITS

OVERVIEW: This paper presents options to lower the projected increases in annual pension and retirement expenditures across the four tax supported agencies. The options outline different ways to reduce agency expenditures by phasing out the use of defined benefit plans, reducing benefit levels, or increasing employee contributions to their retirement benefit.

Current and Projected Costs for Retirement/Pension

From FY02 to FY11, tax supported costs of pension and retirement benefits for employees across the four agencies increased by 226%, from $59.3 million to $193.4 million. Four primary factors explain the increases in retirement costs over the past decade:

- Salary and wage increases for employees;
- The percent of County agency employees in defined benefit plans;
- Enhancements to pension and retirement plan benefits; and
- Market losses on pension plan investments.

Based on data from agency actuaries and the Fiscal Plan s assumption of no salary growth or change in workforce size over the next five years, annual agency retirement expenditures are projected to increase by $70 million (37%) from FY11-FY16. (See Table 1 below.)

Table 1. Approved FY11 and Projected FY16 Tax Supported Retirement Expenditures, by Agency

Agency	FY11 Approved	FY16 Projected	FY11-FY16 Projected Increase	
			$	%
County Government	$117.1 million	$154.5 million	$37.4 million	32%
MCPS	$62.4 million	$90.8 million	$28.4 million	46%
M-NCPPC	$12.0 million	$16.2 million	$4.2 million	35%
Montgomery College	$1.9 million	$2.6 million	$0.7 million	37%
Total	**$193.4 million**	**$264.1 million**	**$70.7 million**	**37%**

Because County Government and MCPS account for the majority (93% in FY11) of agency tax supported retirement costs, the options to reduce future costs presented in this paper focus on those two agencies. In general, the types of structural change to retirement benefits discussed in the options could be applied to M-NCPPC and Montgomery College as well.

Introduction to Retirement/Pension Benefits

State and local governments typically provide one or more of the following three types of retirement plans for their employees: a defined benefit plan (also referred to as a pension plan), a defined contribution plan, or a hybrid plan. At the present time, approximately 88% of employees in the four agencies participate in a defined benefit plan. The next page begins a general overview of each type of plan; a summary of the plans offered by the agencies begins on page B-3.

Defined Benefit Plans. Defined benefit plans, or pension plans, pay a retiree a set monthly amount from retirement until death. As illustrated in the example below, a retiree s annual pension is determined by a formula that typically takes into account the employee s final earnings, years of service,[1] and a pension multiplier [2] set by the employer. In addition, defined benefit plans often include a provision to annually increase the pension (post-retirement) with a cost-of-living adjustment (COLA).

Annual Pension	=	Average Final Earnings	x	Multiplier	x	Years of Service
$42,000	=	$70,000	x	2%	x	30

To fund defined benefit pensions, employers pay a contribution every year into a retirement trust fund. This annual contribution is determined by an actuary based on the projected funding needed to pay promised pensions to the current workforce upon retirement.[3] Most plans also require employees to contribute a set percent of salary each year to help pay for their future retirement benefits. The money in the retirement fund is invested, and employee and employer contributions combined with investment earnings pay for employees pensions.

In defined benefit plans, employees are required to work a minimum number of years before they become eligible to receive a pension (called vesting). If an employee leaves an employer before vesting, the employer typically refunds the employee s contributions to the plan. If an employee vests but leaves before qualifying for retirement, typically the employee can request a refund of the employee s contributions or the employee can receive a pension at a later date.

Depending upon their structure, retirement plans distribute a certain degree of financial risk between the employer and the employee. Defined benefit plans place the financial risk on the employer because the employer is responsible for paying the entire annual pension upon retirement, even if the retirement trust does not have sufficient funds to pay for promised pensions.

Social Security Integration in Defined Benefit Plans. In a defined benefit plan, once retirees reach Social Security retirement age they receive both a monthly pension payment and a monthly Social Security payment (unless their employer did not participate in the federal Social Security program). Many employers structure defined benefit plans to integrate with Social Security, meaning that the amount a retiree will receive in a pension is lowered by some amount to account for the retiree s additional income from Social Security.[4] Generally, defined benefit plans integrate with Social Security by changing the formula used to calculate the annual pension amount. Integrating defined benefit plans with Social Security lowers the long-term cost of pensions for employers.

[1] Defined benefit plans often allow members to count earned sick leave toward their years of service for retirement purposes.
[2] A pension multiplier is a percent of wages used to calculate an annual pension.
[3] Actuaries use numerous assumptions and projections to calculate an employer s annual defined benefit plan contribution. Assumptions include projected mortality rates, employee hiring and terminations, age of retirement, investment returns, salary increases, and rate of inflation.
[4] Federal law governs social security integration in defined benefit plans. The structure of defined benefit plans integration with social security is subject to any relevant changes to federal law.

Defined Contribution Plans. In a defined contribution plan, an employee contributes a set percent of salary to a retirement account, which changes its value over time as a result of investment returns (or losses). Often an employer will also make contributions to the employee s retirement account either contributing a set percent of employee salary or matching a percent of the employee contribution. Upon retirement, the employee s benefit is the total of the employee and employer contributions and any investment income earned on the joint contributions.

Unlike defined benefit plans, defined contribution plans are portable. Employees can take retirement funds in a defined contribution plan with them if they leave an employer, often transferring the funds to a new retirement account. Defined contribution plans may also have vesting periods requiring employees to stay with an employer a certain amount of time before an employee can take an employer s contributions. If the employee leaves an employer before vesting, the employee can only take his or her own contributions.

In contrast to defined benefit plans, it is the employee who bears the risk in defined contribution plans. The employee guides investment of the funds in the retirement account, and the employer s financial responsibility ends after the employer contributes any required funds to employees accounts.

Hybrid Plans. Hybrid plans have characteristics of both defined benefit and defined contribution plans. Some hybrid plans have a defined benefit component and a defined contribution component, while others have different structures entirely. The risk related to a hybrid retirement plan falls in between that of a defined benefit and a defined contribution plan, and typically the employer and the employee more equally share the risk based on the design of the plan.

County Government Retirement Plans

The County Government provides all three types of retirement plans, and County law outlines which employees are covered by which plans. The table below summarizes each plan and the employees covered. Participation is required for full-time employees, and optional for part-time employees.

Table 2. Summary of County Government Retirement Plans

Retirement Plan	Plan Type	Covered Employees
Employees' Retirement System (ERS)	Defined Benefit	• Employees hired before October 1, 1994 • Represented public safety employees regardless of date of hire
Employees' Retirement Savings Plan (RSP)	Defined Contribution	• Non-public safety employees hired on or after October 1, 1994 • Non-represented public safety employees hired on or after October 1, 1994
Guaranteed Retirement Income Plan (GRIP)	Hybrid	

Table 3 (on the next page) shows the FY11 total tax supported retirement expenditures for each County Government plan. In FY11, the County Government s total tax supported contributions were $117 million. The County s defined benefit plan includes about one-half of active employees in FY11 but accounts for 88% ($103 million) of the total tax supported retirement expenditures.

Table 3. Total FY11 County Government Tax Supported Retirement Expenditures

Plan	Active Members (as of October 2010)	FY11 Tax Supported Expenditures	Per Employee Contribution (as % of salary)
ERS	4,635	$103.3 million	25-38%*
RSP	3,272	$11.2 million	8-10%
GRIP	942	$2.6 million	8-10%
Total	**8,849**	**$117.1 million**	**--**

*For employees hired on or after July 1, 1978. See the Appendix (©96) for a summary of ERS per employee contributions rates from 2000 to 2009.

Employees Retirement System (ERS). In 1994, the ERS was closed to new members **except for new public safety employees represented by an employee bargaining unit.** As outlined in County law (Chapter 33), employees in the ERS are divided into seven different groups determined by their bargaining unit and date of hire.[5] Each group has a separate set of variables used to calculate pensions (e.g., multiplier, average final salary, etc.) and different requirements for retirement eligibility (combination of age and/or years of service).

The ERS is integrated with Social Security and retirees receive a smaller pension (determined by a formula that varies by group) once they reach Social Security retirement age. The County Government s Board of Investment Trustees manages and invests ERS funds. See the Appendix (©79) for a summary of the plan s provisions for each group (e.g., group eligibility, member contributions, multipliers, retirement eligibility, etc.).

Table 4. County Government ERS Employee Groups with Active Members

Groups	Open to New Employees
Employees hired before October 1, 1994	No
Deputy sheriffs and correctional staff	**Yes**
Police	**Yes**
Firefighters	**Yes**

In the last decade, the percent of total pension liability funded by the current balance in the ERS has declined. Specifically, in FY00, the ERS had sufficient funds to pay for 98.9% of future pension liabilities; in FY09 that percent had declined to 78.4% due to investment losses and increased liabilities due to benefit enhancements.[6]

Employees Retirement Savings Plan (RSP). The RSP was opened in 1994 and includes: non-public safety employees hired after October 1, 1994, and non-represented public safety employees. Both the County and the employee contribute a percent of the employee s salary to the employee s retirement account. For each non-public safety employee, the County contributes 8% of salary and the employee contributes 4% of salary annually. For each non-represented public safety employee, the County contributes 10% of the employee s salary and the employee contributes 3%.

[5] Employees of several other agencies and political subdivisions participate in the ERS at their own cost, including employees from the Montgomery County Revenue Authority, the Housing Opportunities Commission, and the Town of Chevy Chase.
[6] 2009 Annual Report of the Board of Investment Trustees.

Guaranteed Retirement Income Plan (GRIP). The GRIP, a hybrid retirement plan, was opened in 2009. Employees eligible for the RSP are also eligible for the GRIP, and new hires must choose between the two plans. When the GRIP opened, existing RSP members were given a one-time option to transfer to the GRIP. Like a defined contribution plan, both the County and the employee contribute to the GRIP account at the same percent of employee salary as in the RSP. Like a defined benefit plan, the County guarantees a fixed rate of return on the funds in an employee s GRIP account (currently 7.25%), shifting the investment risk to the employer. If GRIP investments earn less than the guaranteed return annually, the County is responsible for making up the difference. The County Government s Board of Investment Trustees manages and invests funds from the GRIP.

Montgomery County Public Schools Retirement Plans

All MCPS employees participate in a defined benefit retirement plan. Approximately 77% of MCPS employees participate in a defined benefit plan funded and administered by the State of Maryland. The remaining 23% of MCPS employees participate in a locally-funded defined benefit plan that is identical to the State plan. MCPS refers to these plans (whether state-funded or MCPS-funded) as the employees Core Pension.

In addition to the Core Pension, all MCPS employees also receive a locally-funded Pension Supplement. State law requires MCPS to provide a Pension Supplement to employees in the State pension plan.[7] The Pension Supplement that MCPS provides   a multiplier of 0.2%   is 150% higher than the Pension Supplement required by State law. The Core Pension multiplier of 1.8% combined with the 0.2% Pension Supplement provides MCPS employees with an overall 2.0% pension multiplier. See the Appendix (©79) for a summary of the plan provisions (e.g., group eligibility, multipliers, retirement eligibility, etc.).

Table 5 summarizes MCPS plan participation and FY11 tax supported expenditures, which total about $62 million. For employees in the State pension plan, MCPS pays 1.92% of salary for retirement. In contrast, MCPS pays 20.49% of salary for employees in the locally-funded plan.

Table 5. MCPS FY11 Retirement Expenditures

MCPS Employees in…	# of Employees (as of Sep. 2010)	Funded by MCPS		FY11 Tax Supported Expenditures	Per Employee Contribution (as % of salary)
		Core Pension	Supplement		
State Pension Plan	16,923		✓	$21.8 million	1.92%
Local Pension Plan	4,956	✓	✓	$40.6 million	20.49%
Total	**21,879**	--	--	**$62.4 million**	--

In FY11, the State of Maryland contributed $170 million to fund MCPS employees State pension benefits. In 2010, the Maryland Senate passed a bill requiring local jurisdictions to fund 50% of local education employees retirement costs. While the bill did not become law, the State may, in the near future, require local jurisdictions to fund a portion of the employees retirement benefits currently paid for by the State.

[7] State law requires MCPS to provide a Pension Supplement of a 0.08% multiplier. MCPS adds an additional 0.12%, for a total multiplier of 0.2%. Montgomery County is the only Maryland county required to supplement State teacher pensions.

Social Security Integration. In 1998, MCPS matched a State pension system change and discontinued Social Security integration for all locally-funded pensions. As a result, for service after July 1, 1998, MCPS employees pensions are not adjusted when they began collecting Social Security benefits.

M-NCPPC and Montgomery College Retirement Plans

Nearly all M-NCPPC employees participate in a defined benefit retirement plan. M-NCPPC has four different defined benefit plans, two open to new members and two closed, with separate plans for Park Police and non-Park Police employees. M-NCPPC s retirement plan expenditures totaled $12 million in FY11.

All Montgomery College employees participate in State of Maryland-administered retirement plans. The State funds the retirement of faculty, administrators, and professional staff, who may choose between a defined benefit plan and a defined contribution plan. Montgomery College fully funds the cost for support, paraprofessional, and technical staff to participate in a State defined benefit plan. The College funds the retirement benefits for 287 of its employees at a cost of $1.9 million in FY11.

Overview of Options

The rest of this issue paper outlines nine options to reduce projected cost increases in annual pension and retirement expenditures for County Government and MCPS. The options fall into three categories:

- Replacing defined benefit plans with lower cost defined contribution or hybrid plans;
- Increasing employees share of defined benefit plan costs; and
- Reducing defined benefit levels.

There are five options presented for County Government pension plans, and four options for MCPS locally-financed pensions. The options are developed independently of one another, although certain options could be done in combination. The table below summarizes the options and indicates the cohort(s) of individuals the options could apply to: new hires, current employees, or current retirees.

Option	Description	Option Could Apply to:		
		New Hires	Current Employees	Current Retirees
County Government Options				
1	Close the County Government defined benefit plan and enroll all new County Government employees in a defined contribution plan	✓		
2	Close the County Government defined benefit plan and enroll all new represented public safety employees in a new hybrid plan	✓		
3	Increase County Government employee contributions in defined benefit plans	✓	✓	
4	Increase the minimum retirement age and years of service for new County Government public safety employees	✓		
5	Lower the cap on annual cost of living adjustments applied to County Government retiree pensions	✓	✓	✓
MCPS Options				
1	Close MCPS' locally-funded defined benefit plans and enroll all new employees in a defined contribution plan	✓		
2	Eliminate MCPS' local pension supplement for new hires	✓		
3	Increase MCPS employee contributions for the local Pension Supplement	✓	✓	
4	Integrate MCPS' locally-funded pension with Social Security	✓		

For each option, estimating the agency savings requires calculations by the agencies actuaries. Because of the fees associated with obtaining these estimates, the options described in this issue paper explain in general how making each change would reduce agency costs. When possible, the options also give examples of potential cost savings. If the Council wants to further consider any of the options outlined in the paper, then detailed cost estimates can be requested from the agencies actuaries.

OLO chose these options, in part, based on research into strategies that other state and local governments have adopted to reduce their pension plan costs. The Appendix (©119) contains a summary of comparative examples related to pension plan changes made by other jurisdictions. The Appendix also contains a list of additional options that could achieve savings in retirement costs (©4). The additional options are either variations of those described above or different options that could produce short-term and/or long-term savings.

Implementation Issues

Changes to the structure of the County Government s retirement plans would require changes to County law. Details relating to retirement plan benefits are included in the collectively bargained agreements between the County Government and employee bargaining units. For a discussion of general legal issues surrounding modification to retirement benefits, see the memos in the Appendix (©8) from the County Attorney on: 1) Council authority to modify employee pay and benefits, and 2) the Council s role in collective bargaining.

The County Attorney has concluded that, in general, the Council may make changes to retirement benefits prospectively i.e., changes that take effect at some point in the future. The Council can make changes to retirement benefits already earned only if the changes are reasonable and necessary to serve a legitimate government purpose. See Appendix (©11).

The Council has authority to change the structure of retirement benefits for County Government employees. Likewise, the same authority lies with the governing body for each agency. Changing or eliminating the State-required portion of MCPS local Pension Supplement for MCPS employees in the State system would require a change in State law. For employees only in the MCPS-funded system, the authority to structure employees retirement plans lies with the Board of Education.

COUNTY GOVERNMENT OPTION #1: Enroll All New County Government Employees in a Defined Contribution Retirement Plan

Current Structure

All new County Government public safety employees represented by an employee bargaining unit join the County s defined benefit plan, the Employees Retirement System (ERS). All other new County Government employees join either the County s: defined contribution plan, the Employees Retirement Savings Plan (RSP); or hybrid plan, the Guaranteed Retirement Income Plan (GRIP). In FY11, the County Government s retirement benefit cost for a public safety employee enrolled in the ERS (32%-38% of an employee s salary)[8] is over three times higher than the cost for a new employee enrolled in the RSP (8-10% of an employee s salary).

Alternative Structure

Close the ERS plans to new hires and enroll *all* new County Government employees (including new public safety hires) hired after a certain date in the County Government s defined contribution plan (the RSP). The plan could maintain the current 8-10% contribution by the County Government for all employees or, as an alternative, the County Government could continue the current practice of providing a greater retirement benefit to public safety employees by establishing an even higher County contribution for those employees.

Alternatively, the County could give employees a choice between joining the RSP or the GRIP, the County Government s hybrid retirement plan that guarantees employees a fixed annual rate of return on contributions.

Projected Savings

Closing the County Government s defined benefit plan to new hires would lead to substantial long-term savings. Estimates of the specific amount and timeframe for cost savings for this option would require actuarial analysis; however, the effect of the County Government s 1994 change establishing a defined contribution plan for a part of its workforce exemplifies how this option achieves savings.

Comparing the FY11 cost of both plans can illustrate the potential magnitude of long-term savings. Although there are about the same numbers of employees enrolled in each plan, the County Government will contribute $11 million in FY11 to fund defined contributions in the RSP, compared to $103 million for the defined benefit plan.

In fact, if all County Government employees were enrolled in the RSP defined contribution retirement plan with an 8% employer contribution rate, the County Government would contribute approximately $40 million[9] toward retirement this year. This compares to the $117 million that the County Government will contribute for retiree benefits this year, a difference of $77 million.

[8] For employees hired after July 1, 1978.
[9] Calculated based on the County Government s FY11 tax supported salary cost of approximately $500 million.

Effect on Employees

Current employees would see no change to their retirement plans or future retirement benefit levels. New public safety employees would join the RSP, a defined contribution plan, instead of a defined benefit pension plan. The value of a pension compared to a defined contribution plan cannot be easily quantified because the final value of each type of plan is dependent on different factors such as salary, years of service, mortality rates, return on investments, and contribution rates. However, for employees with a similar salary history and years of service, the final value of a defined benefit plan is typically higher than the final value of a defined contribution plan.

Currently, employee contribution rates for public safety members in the ERS[10] range from 4.75-5.5% of salary.[11] Current contribution rates for members of the RSP range from 3-4% of salary. Assuming no change to the current structure of the RSP, new employees would have a lower retirement contribution and a corresponding increase in take-home pay.

Defined contribution plans have the advantage of easy portability from employer to employer for employees who leave County service before reaching normal retirement. If employees in defined benefit plans leave employment before retiring, they either: receive a refund of their contributions (often with interest), but have no remaining retirement benefit; or leave their contributions with an employer, but cannot receive a pension until they would have been eligible to retire.

[10] Hired after July 1, 1978.
[11] Employees with salaries greater than the Social Security wage base ($106,800 in 2010) contribute a higher percent of salary to the ERS, ranging from 6% to 9.25%, for the portion of salary above $106,800.

COUNTY GOVERNMENT OPTION #2: New Hybrid Plan for New Public Safety Employees

Current Structure

All new County Government public safety employees represented by an employee bargaining unit join the County s defined benefit plan, the Employees Retirement System (ERS). All other new County Government employees join either the County s: defined contribution plan, the Employees Retirement Savings Plan (RSP); or hybrid plan, the Guaranteed Retirement Income Plan (GRIP).

In FY11, the County Government s retirement benefit cost for a public safety employee enrolled in the ERS (32%-38% of an employee s salary) is over three times higher than the cost for a new employee enrolled in the RSP (8%-10% of an employee s salary). The employer s cost for defined benefit plans is impacted by many variables in a pension formula. The table below summarizes the key variables that determine pensions for the public safety employees in the ERS.

Table 6. Summary of Pension Formula Variables for ERS Public Safety Members*

Employee Contribution	Avg. Final Earnings	Minimum		Multiplier	Max. # of Years Credited in Pension Calculation
		Service	Age		
4.75 - 5.5%**	Highest 36 months	20-25 years	Any age	2.4 – 2.5%	31 - 36
		15 years	55		

*Employees hired on or after July 1, 1978.
**Employee contributions increase for any portion of salary than that is greater than the Social Security wage base ($106,800 in 2010).

Alternative Structure

Close the ERS defined benefit plans to new hires and create a new hybrid retirement plan (different from the GRIP) for represented public safety employees hired after a certain date.[12] The new hybrid plan would include both a defined benefit and a defined contribution portion.

Defined benefit component. The new defined benefit portion of the plan would change the pension formula variables to create a significantly smaller annual pension. Changes could include:

- Raising employee contribution rates;
- Increasing the minimum number of years required for full benefits;
- Increasing the minimum age for retirement with full benefits; and/or
- Decreasing the multiplier.

Defined contribution component. The defined contribution portion of this hybrid plan option would supplement the defined benefit portion and could be structured in a number of ways. A defined contribution option could be structured like the RSP (mandatory, set employer and employee contributions) or the employee could choose a contribution level within a range (e.g., 1-5% of salary) with the County Government matching a portion of that contribution.

[12] This option is similar to the Federal Employees Retirement System, which has both a defined benefit and a defined contribution component.

Projected Savings

While this option offers the opportunity for long-term savings compared to the current plans, the actual amount would depend upon how the hybrid plan was structured. As indicated earlier, estimates of the specific amount and timeframe for cost savings would require actuarial analysis.

Effect on Employees

Current employees would see no change to their retirement plans or future retirement benefit levels. New public safety employees would join a hybrid plan with both defined contribution and defined benefit components.

This type of plan would marry the benefits and drawbacks of defined benefit and defined contribution plans and more evenly distribute future financial risk between the County Government and employees. For example, employees would be able to rely upon a stream of income from a pension, but could not take the benefit with them to another employer. Similarly, employees would have a portable retirement plan with the defined contribution component, but the total value would depend upon the rate of investment returns.

COUNTY GOVERNMENT OPTION #3: Increase Employee Contributions in Defined Benefit Plans

Current Structure

All County Government employees in the defined benefit plan (Employees Retirement System) contribute a portion of their salaries to help fund their pensions. In a defined benefit plan, employee contributions affect the annual contribution required from employers. Specifically, increased employee contributions result in decreased contributions for the County Government. The table below summarizes the current employee contribution rates set forth in County law.

Table 7. Current ERS Employee Contribution Rates as Percent of Salary (hired on or after July 1, 1978)

Group	Current Rate*
Non-Public Safety Employees hired before Oct. 1, 1994	4.0%
Deputy Sheriff and Corrections	4.75%
Police	4.75%
Fire	5.5%

*Employees contribute a higher percent of salary, ranging from 6% to 9.25%, for any portion of salary than that is greater than the Social Security wage base ($106,800 in 2010).

Alternative Structure

Increase the required employee contribution for all current and future employees in all ERS groups. For example, the County could increase the current rate for all groups by a set percent (e.g., a 50% increase) or establish a uniform but higher contribution rate for all groups (e.g., 7% for all members).

Projected Savings

Estimates of the specific amount and timeframe for cost savings would require actuarial analysis; however, a general description of how this option achieves savings follows.

If employees contribute a higher percent of salary to the ERS, the County s required contribution would decrease. While the decrease would not be dollar-for-dollar, the County s savings would reflect the magnitude of increased employee contributions. Table 8 shows that if employee contribution rates had been increased by 50% for all groups, employees would have contributed an additional $8.6 million to the ERS in FY11.

Table 8. Example of Potential County Government Savings from Increased Employee ERS Contributions

Employee Contribution		Difference
Current Structure	50% Increase	
$17.4 million	$26.0 million	+$8.6 million

Effect on Employees

Increasing employee ERS contributions would decrease the amount of money that employees take home in paychecks. For example, raising the employee contribution by 50% for an ERS public safety employee earning $50,000 annually and contributing 4.75% of salary would increase the employee s contribution by $1,188 annually.

COUNTY GOVERNMENT OPTION #4: Increase Minimum Retirement Age and Years of Service for New Public Safety Employees in the Defined Benefit Plan

Current Structure

Since 2001, pension benefit enhancements (such as lowering retirement age or increasing multipliers) have added to the ERS existing liabilities in amounts ranging from $27.5 million to $121.9 million. See Appendix (©93). County law establishes the minimum age and/or years of service requirements for an ERS member to retire with full benefits. Increasing or decreasing these requirements impacts defined benefit plan costs because it affects how long the plan will pay employee pensions.

Public safety members in the ERS retire at a much younger age than non-public safety members. The County s actuaries estimate that by age 54, 30% of public safety members of the ERS will retire compared to 5% of non-public safety members.[13] Earlier retirement for public safety employees is one factor that contributes to the higher cost of public safety members in the ERS compared to non-public safety members. The table below summarizes minimum age and years of service requirements for public safety members in the ERS.

Table 9. Current Minimum Age and Service Requirements for Public Safety Members of the ERS

Group	Deputy Sheriff and Corrections	Police	Fire
Minimum Age/ Years of Service	55/15	55/15	55/15
	Any/25	Any/25	Any/20

Alternative Structure

Increase the minimum age for retirement and minimum required years of services to qualify for full retirement benefits for public safety employees hired after a certain date. Possibilities include:

- Establish a minimum retirement age regardless of years of service;
- Raise the minimum retirement age by five years for members with 15 years of service; and/or
- Require at least 25 years of service for members retiring before age 55.

Projected Savings

While this option would offer the opportunity for long-term savings compared to the current plans, estimates of the specific amount and timeframe for cost savings would require actuarial analysis.

Effect on Employees

Current employees would see no change to their retirement plans. Higher minimum age and/or years of service requirements would result in new hires working longer than current active members in order to receive full retirement benefits.

[13] 2009 Actuarial Valuation for ERS Contribution in FY11.

COUNTY GOVERNMENT OPTION #5:
Lower the Pension COLA Cap

Current System

Under current County law, retirees in the ERS receive an annual cost-of-living adjustment (COLA) to their pensions based on the rate of the Consumer Price Index (CPI). Retirees can receive a negative COLA if the CPI is negative for a given year. ERS members hired by the County Government before October 1, 1978 receive an annual COLA equal to 100% of the CPI. All members hired on or after October 1, 1978 receive a COLA based on the following formula:

- 100% of the CPI up to 3%;
- 60% of the CPI greater than 3%, not to exceed 7.5%; and
- 100% of the CPI for retirees age 65 or over.

ERS retirees hired after June 30, 1978 have received a COLA of, on average, 2.5% annually between FY01 and FY10.

Alternative Structure

Lower the annual COLA applied to retiree pensions for all current and future ERS retirees through structural changes to the retiree COLA formula. There are many different ways to accomplish this. For example, the County could provide all retirees with a set annual COLA of 1%, regardless of the CPI. Another example would be for the County to provide an annual COLA based on the CPI, but with a maximum of 2%. For a discussion of the legal issues related to implementing a change to pension cost of living adjustments for current and future retirees, see the County Attorney s memos in the Appendix (©8 and ©22).

Projected Savings

Estimates of the specific amount and timeframe for cost savings would require actuarial analysis; however, a general description of how this option achieves savings follows.

As noted above, the average COLA for retirees between FY01 and FY10 was 2.5%. If a structure had been in place that capped COLA s at a maximum of 2%, retiree s would have had smaller pension increases in eight of the past ten years. As a result, the overall County required contributions to the Employees Retirement System would have been lower.

Effect on Retirees

Under this option, retirees would likely receive smaller annual pension increases, at least in some years. The magnitude of the difference depends upon the specific structure adopted.

MCPS OPTION #1: Create a Defined Contribution Plan for Locally-Funded MCPS Retirement Benefits

Current Structure

All MCPS employees participate in identical defined benefit retirement plans that include a Core Pension and a Pension Supplement. Approximately 77% of MCPS employees participate in the State Plan, where the State administers and funds the Core Pension and MCPS administers and funds the Pension Supplement. The remaining 23% of MCPS employees participate in the Local Plan where MCPS administers and funds both the Core Pension and the Pension Supplement.

In FY11, MCPS retirement benefit cost for an employee in the Local Plan is 20.49% of that employee s salary. MCPS cost for an employee in the State Plan is 1.92% of that employee s salary.

Alternative Structure

Close the locally-funded defined benefit plans (both the local Core Pension and the Pension Supplement) to new hires and create a defined contribution plan for MCPS employees hired after a certain date. Specifically:

- For employees in the Local Plan, MCPS could create a defined contribution plan to replace both the Core Pension and Pension Supplement; and
- For employees in the State Plan, MCPS could create a defined contribution plan to replace the Pension Supplement.

A variation on this option would be to create a hybrid retirement plan (similar to the GRIP in County Government). The primary difference between a defined contribution plan and a GRIP-like plan is that the GRIP plan would guarantee an annual rate of return on each employee s retirement account.

Projected Savings

Closing MCPS locally-funded defined benefit plans to new hires would lead to substantial long-term savings, similar to the savings the County Government is now realizing from establishing a defined contribution plan for a segment of its workforce in 1994. (See explanation provided earlier, page B-4)

Estimates of the specific amount and timeframe for cost savings would require actuarial analysis; however, a general description of how this option achieves savings follows.

In FY11, MCPS contribution for the nearly 5,000 employees in the Local Plan was about $41 million and equated to a contribution of 20.49% of each employee s salary. If those same employees were instead part of a defined contribution plan with an employer contribution of 8% of salary, MCPS contribution would have been around $16 million, a difference of $25 million.

For employees in the State plan, replacing the defined benefit Pension Supplement with a defined contribution plan would achieve savings as long as the employer contribution percent was set at a lower rate than required for the current plan (1.92% of salary in FY11).

Effect on Employees' Retirement

Current employees would see no change to their retirement plans or future retirement benefit levels. New MCPS employees eligible for the Local Plan would join a defined contribution plan instead of a defined benefit plan. At retirement, these new employees would receive the accumulated balance in their individual retirement account rather than a monthly pension. The value of a pension compared to a defined contribution plan cannot be easily quantified because the final value of each plan depends on factors such as salary, years of service, return on investments, and contribution rate. However, for employees with a similar salary history and years of service, the final value of a defined benefit plan is typically higher than the final value of a defined contribution plan.

Similarly, new employees in the State Plan would receive their Pension Supplement as an accumulated balance in their individual retirement account rather than as a monthly pension. Defined contribution plans have the advantage of portability from employer to employer for employees who leave County service before reaching normal retirement. Defined benefit employees who leave employment before retiring receive a refund of their contributions (often with interest), but have no remaining retirement benefit. Alternatively, defined benefit employees can leave their contributions with an employer, but cannot receive a pension until they would have been eligible to retire.

Currently, the employee contribution rate for MCPS employees in the Local Plan is 5.5% of salary.[14] If a defined contribution plan were established with lower employee contribution rates (the County Government s defined contribution plan has a 4% employee contribution rate), a new employee would pay less in annual retirement contributions than under the current structure.

[14] Employees in the State plan contribute 0.5% of salary to MCPS for the local Pension Supplement.

MCPS OPTION # 2: Eliminate MCPS' Local Pension Supplement

Current Structure

All MCPS employees participate in a locally-funded Pension Supplement, regardless of whether they participate in the State retirement plan or the Local retirement plan. A portion of the local Pension Supplement provided to employees in the State-funded plan is mandated by State law.[15]

In FY11, the Pension Supplement accounted for $25.9 million (41%) of MCPS $63.3 million in retirement plan contributions.

Table 10. FY11 Cost of MCPS Pension Supplement

Group	FY11 MCPS Contribution	FY11 Contribution Rate (% of salary)
Employees in State Plan	$22.1 million	1.92%
Employees in Local Plan	$3.8 million	1.90%
Total	**$25.9 million**	**--**

Alternative Structure

Eliminate the Pension Supplement for all MCPS employees hired after a certain date. This option would require a change to State law.

Alternatively, MCPS could eliminate the portion of the Pension Supplement ***not required*** by State law. MCPS could implement this change with no amendment to State law.

Projected Savings

Although this option would not yield significant agency savings in the short run, it would lead to substantial savings in the long run. Estimates of the specific amount and timeframe for cost savings would require actuarial analysis.

Because this option would only apply to employees hired after a specified future date, MCPS would continue to pay the pension supplement for current employees. Over the course of many years, MCPS costs for the Supplement ($26 million in FY11) would be vastly reduced and eventually eliminated.

Effect on Employees' Retirement

Current employees would see no change to their retirement plans or future retirement benefit levels. Employees hired on the effective date of the change would still receive a defined benefit pension; however, the pension would be based on a multiplier of 1.8% instead of 2%.

MCPS employees currently contribute 0.5% of salary annually toward their Pension Supplement. Employees hired after the effective date of the change would no longer be required to contribute that portion of their salary toward retirement.

[15] MCPS is required by State law to provide a 0.08% supplement to the pension multiplier; however, MCPS provides a 0.2% supplement. Montgomery County is the only Maryland County required to supplement State teacher pensions.

MCPS OPTION # 3: Increase MCPS Employee Contributions to Pension Supplement

Current Structure

All MCPS employees participate in a locally-funded Pension Supplement, regardless of whether their Core retirement plan is funded by the State or by MCPS. A portion of the local Pension Supplement given to employees in the State-funded plan is established in State law.[16]

MCPS employees contribute 0.5% of their salary for the Pension Supplement (on top of the 5% they contribute toward their Core Pension). In a defined benefit plan, employee contributions affect the annual contribution required from employers. Specifically, increased employee contributions result in decreased contributions for MCPS. MCPS total required contribution in FY11 to fund the Pension Supplement is $25.9 million.

Alternative Structure

Increase required employee contributions for the local Pension Supplement. For example, MCPS could increase the required employee contribution from 0.5% to 0.75% of salary (a 50% increase).

Projected Savings

Estimates of the specific amount and timeframe for cost savings would require actuarial analysis; however, a general estimate of savings follows.

If employees contributed a higher percent of salary toward the Pension Supplement, MCPS required contribution would decrease. While the decrease would not be dollar-for-dollar, the MCPS savings would reflect the magnitude of increased employee contributions. Table 11 shows that if employee contribution rates to the Pension Supplement had been increased by 50%, employees would have contributed an additional $3.4 million in FY11.

Table 11. Example of Potential County Government Savings from Increased Employee ERS Contributions

Pension Supplement Employee Contribution[17]		Difference
Current Structure	50% Increase	
$6.7 million	$10.1 million	+ $3.4 million

Effect on Employees’ Retirement

Changing employee contributions in a defined benefit plan does not change an employee s retirement plan or the future retirement benefit levels. An employee would have to contribute a higher portion of their salary toward their Pension Supplement benefit. In the example used above, an increase in the employee s contribution from 0.5% to 0.75% would mean that an employee earning $50,000 per year would contribute an additional $125 annually.

[16] Montgomery County is the only Maryland County required to supplement State teacher pensions.
[17] Calculated based on the MCPS approved FY11 tax supported salary costs of approximately $1.34 billion.

MCPS OPTION #4: Integrate Locally-Funded MCPS Pensions with Social Security

Current Structure

In 1979, the State of Maryland created the Teachers Pension System (and closed an existing defined benefit plan). The new System was integrated with Social Security meaning that the pension formula took into account that retirees would collect Social Security benefits in addition to pensions. Similarly, the County Government integrated its defined benefit plan with Social Security in 1978.

In 1998, the State of Maryland discontinued the Teachers Pension System s integration with Social Security for service after July 1, 1998.[18] MCPS matched the State s change and, for service after July 1, 1998, discontinued Social Security integration for the locally-funded pension plans.

Alternative Structure

For all new employees hired after a certain date, integrate locally-funded pension plans with Social Security. There are several different ways to integrate defined benefit plans with Social Security. Following the County Government s practice, MCPS could reduce the pension formula multiplier once an employee reaches Social Security normal retirement age. For example, MCPS could lower the overall multiplier for employees in the Local Plan from 2% (1.8% for Core Pension and 0.2% for Pension Supplement) to 1.25%[19] when a retiree reaches Social Security normal retirement age.

Projected Savings

While a long-term cost savings to MCPS would occur under this option, estimates of the specific amount and timeframe for cost savings would require actuarial analysis, and would depend upon how the integration with Social Security was structured.

For example, if MCPS set lower multipliers for when retirees reach Social Security retirement age, retirees pensions would decrease when they reach that age. Alternatively, MCPS could set one single lower multiplier that accounts for retirees Social Security benefits, so retirees pensions would not decrease at Social Security retirement age, but the lifetime amount paid to retirees would be lower due to the lower multiplier.

Effect on Employees' Retirement

Current employees would see no change to their retirement plans. Employees hired after the specified implementation date would receive lower overall pension benefits. For example, if an employee worked for 30 years and had a final salary of $75,000, their pension would be calculated as shown below if MCPS established two separate multipliers.

	Multiplier	x	Final Salary	x	Years of Service	=	Annual Pension
Before Social Security Retirement Age	**2%**	x	$75,000	x	30	=	**$45,000**
At Social Security Retirement Age	**1.25%**	x	$75,000	x	30	=	**$28,125**

[18] HB 1737 Fiscal and Policy Note, Maryland General Assembly 2006 Session, Department of Legislative Service, at p. 4.
[19] County Government ERS multiplier for non-public safety employees hired before October 1, 1994.

Issue Paper C

Health Benefits for Active Employees

HEALTH BENEFITS FOR ACTIVE EMPLOYEES

OVERVIEW: This paper presents options to lower the projected increases in the agencies' costs for group insurance for active employees. The options outline various ways to reduce agency costs by increasing the employee's share of the insurance premium.

Current and Projected Cost of Group Insurance

The four tax supported agencies offer four types of group insurance benefits to their employees: medical, prescription drug, dental, and vision. Over 29,000 active employees are currently enrolled in the agencies' medical plans. Over the past ten years (FY02-FY11), total agency spending on group insurance for active employees increased 134%, from $134.4 million to $314.6 million. The total costs of group insurance (assuming no change to the current structure) are estimated to increase another 55% to $486.6 million by FY16.

Table 1. Projected Agency Expenditures on Group Insurance for Active Employees ($ in millions)[1]

Agency	FY11 Approved	FY16 Projected	FY11-FY16 Increase	
			$	%
County Government	$79.5	$127.9	$48.4	61%
MCPS	$216.2	$333.2	$117.0	54%
Montgomery College	$11.6	$14.5	$2.9	25%
M-NCPPC	$7.3	$11.0	$3.7	50%
Total	**$314.6**	**$486.6**	**$172.0**	**55%**

This paper focuses on options to lower the projected increases in the agencies' cost for medical and prescription drug benefits, which account for over 90% of each agency's annual group insurance expenditures.

Overview of Agency Health Plans

Each agency structures employee health benefits to manage agency costs and provide employee choice through multiple plan offerings. The key components that influence each agency's health benefit costs include:

- **Plan Design and Administration.** Each agency offers multiple health plans and contracts out plan administration to multiple insurance carriers. Each plan structures variables such as co-pays, deductibles, out-of-pocket maximums, and the network of doctors an employee can use for care differently based on the plan design and administrator.

- **Employee Eligibility.** Each agency establishes eligibility criteria for access to health insurance benefits based on factors such as the number of hours worked (e.g., full-time, part-time) and/or whether the employee is hired on a permanent or temporary basis.

[1] Group insurance includes health benefits (medical, dental, prescription drug, and vision) plus other benefits such as life and long-term disability.

- **Level of Coverage.** Each agency generally allows employees to choose among three different levels of insurance coverage: self (covers only the employee); self+1 (covers the employee and one eligible dependent); and family (covers the employee and all eligible dependents). Montgomery College does not offer self+1 coverage.

The tables on page C-4 summarize the agencies' 2011 (calendar year) medical and prescription drug insurance plan options and eligibility guidelines for employees and their dependents.

Premium "Cost Share" for Health Benefits

Each year, agencies determine the next year's health care costs for each plan and calculate a set of per person charges, or premiums, that cover these costs. The set of annual premiums calculated for each agency vary by plan and level of coverage.

Each agency allocates its premium costs between the agency and the employee, and identifies specific cost shares for different employee groups. For example, an "80/20" cost share ratio assigns 80% of the premium cost to the agency and 20% to the employee. Expressed in dollars, a $10,000 premium with an 80/20 cost share means an agency cost of $8,000 and an employee cost of $2,000.

Table 2 displays each agency's premium cost share ratios for medical and prescription drug coverage. Three agencies, County Government, the College, and M-NCPPC, establish groups based on employee status (e.g., full-time or part-time, when hired). MCPS' groups are based on plan types (i.e., HMO or POS), hiring date, and benefit type.

Table 2. 2011 Premium Cost Share for Medical and Prescription Drug Benefits by Agency

Employee Status or Plan Type	Enrollees (July/Aug. 2010)	Health Premium Cost Share	
		Agency Pays	Employee Pays
Montgomery County Government*			
Choice Group Full- and Part-time	7,104	80%	20%
Select Group Full-time	816	76%	24%
Select Group Part-time	33	19%-57%	43%-81%
MCPS			
HMO Medical Plans	12,172	95%	5%
POS Medical Plans	6,286	90%	10%
Closed POS Medical Plan	768	80%-85%	15%-20%
Prescription Drug Plans	19,183	90%	10%
Montgomery College			
Full-time Staff and Faculty	1,356	75%	25%
Part-time Staff hired after 1993	21	37.5%	62.5%
M-NCPPC			
Merit Employees and Appointed Officials	672	85%	15%
Term Contract Employees	8	30%	70%

**For County Government, the "Choice" group consists of employees represented by a bargaining unit and unrepresented employees hired before October 1, 1994. The "Select" group consists of unrepresented employees hired on or after October 1, 1994. County Government has one prescription plan (Caremark High Option plan) where enrollees pay a higher percent of the cost share than shown in the table.

Overview of Options

The rest of this issue paper presents estimated savings for the four agencies' active employee health benefit costs, based on four options that modify one or more of the agencies' premium cost share ratios. Each option presents estimated costs for the next six years against cost projections that assume the current cost share arrangements. The estimated savings are the difference between these two cost projections. Since the options assume the changes would be effective in January 2012, all of the estimates reflect six months of savings in FY12 and a full year of savings in FY13–FY16.

- Option #1 replaces the four agencies' multiple cost share arrangements with a uniform cost share of 70/30. If implemented all at once, the estimated savings are $35 million in FY12 and $94 million by FY16. If phased in at 5% per year, the estimated savings are $10 million in FY12 and $90 million by FY16.

- Option #2 defines each agency's contributions to employee health care premiums as a fixed dollar amount calculated at 75% of each plan's lowest cost premium. This approach establishes a 75/25 cost share for the lowest cost plan and progressively higher cost shares for more expensive plans. The estimated savings are $46 million in FY12 and $123 million by FY16.

- Option #3 charges employees who enroll dependents ("self + 1" or an entire family) higher shares of a plan's total premium than individual employees since these coverage levels have higher costs. For each current cost share, this option increases the self +1 and family coverage share by 2.5% and 5% respectively. The estimated savings are $7 million in FY12 and $19 million by FY16.

- Option #4 replaces the agencies' cost share arrangements for their part-time employees with a uniform cost share ratio of 60/40. The estimated savings are $12 million in FY12 and $33 million by FY16.

The Appendix (©119) contains a summary of comparative examples related to health benefit changes made by other jurisdictions. The Appendix also contains a list of additional options that could achieve savings in health benefit costs (©4). The additional options are either variations of those described above or different options that could produce short-term and/or long-term savings.

Implementation Issues

The structure of employee health benefits is not established in County or State law. For County Government, MCPS, and M-NCPPC health benefits are part of the collectively bargained agreements between the agencies and their respective employee unions (Montgomery College does not bargain group insurance benefits). The final authority for establishing the health care cost structure for each agency lies with its respective governing body. For a discussion of legal issues surrounding modification to health benefits, see the memos in the Appendix (©8) from the County Attorney on: 1) the Council's authority to modify employee pay and benefits, and 2) the Council's role in collective bargaining.

Under the recently enacted federal health care reform legislation, health plans that existed on March 23, 2010 are "grandfathered," meaning they do not have to implement certain reforms for several years. Plans can lose grandfather status if they reduce benefits or increase beneficiaries' out of pocket expenditures by a certain amount, such as increasing an employee's premium cost share by more than 5%. As of this writing, the only local agency that has already lost its grandfather status is MCPS.

Table 3. Health Plan Options by Agency, Calendar Year 2011

Plan Type	County Government	MCPS	Montgomery College	M-NCPPC
Medical Plans	• Carefirst BlueChoice POS (High and Standard Option) • Kaiser Permanente HMO* • United Healthcare HMO	• Carefirst BlueChoice HMO • Kaiser Permanente HMO* • United Healthcare Select HMO • Carefirst BlueChoice POS • United Healthcare Select Plus POS • United Healthcare Select Plus Closed POS**	• CIGNA PPO • CIGNA POS • Kaiser Permanente HMO	• United Healthcare Choice Plus POS • CIGNA Open Access Plus In Network EPO • United Healthcare Select EPO
Prescription Drug Plans	• Caremark High Option • Caremark Standard Option • Kaiser Permanente*	• Caremark • Kaiser Permanente*	Included as part of each medical plan	• Caremark

*Kaiser prescription plans are included within Kaiser medical plans, and only available to enrollees of the medical plan. MCPS allows Kaiser medical enrollees to opt out of the Kaiser prescription coverage.
**Not open to new members, and only contains employees hired before 1994.

Table 4. Health Plan Eligibility by Agency, Calendar Year 2011

Type	County Government	MCPS	Montgomery College	M-NCPPC
Eligible Employees	Permanent full-time or part-time employees, circuit court judges, elected officials*	Permanent employees who work 20 hours or more per week	All full-time and part-time regular and temporary with benefits employees	Career employees working at least 20 hours per week, appointed officials, commissioners, merit board members, credit union employees, and Employee Retirement System employees. Term contract employees are eligible for limited benefits.
Eligible Dependents	• Spouse • Same-sex Domestic Partner** • Children	• Spouse • Same-sex Domestic Partner • Children	• Spouse • Same-sex Domestic Partner • Children	• Spouse • Domestic Partner (Same-sex or opposite-sex) • Children

*Several agencies and municipalities participate in County Government group health benefits. These entities pay 100% of the cost of premiums for their enrolled employees. The participating agencies and municipalities are listed in Appendix (©98). Full scope temporary or substitute employees in the MCGEO bargaining unit are generally eligible for benefits but pay 100% of the cost of the premium. Former employees enrolled through COBRA continuation coverage also pay the full cost.
**Members of the FOP and IAFF bargaining units also receive coverage for opposite-sex domestic partners.

OPTION #1: Change Premium Cost Share to a 70/ 30 Split

Current Structure

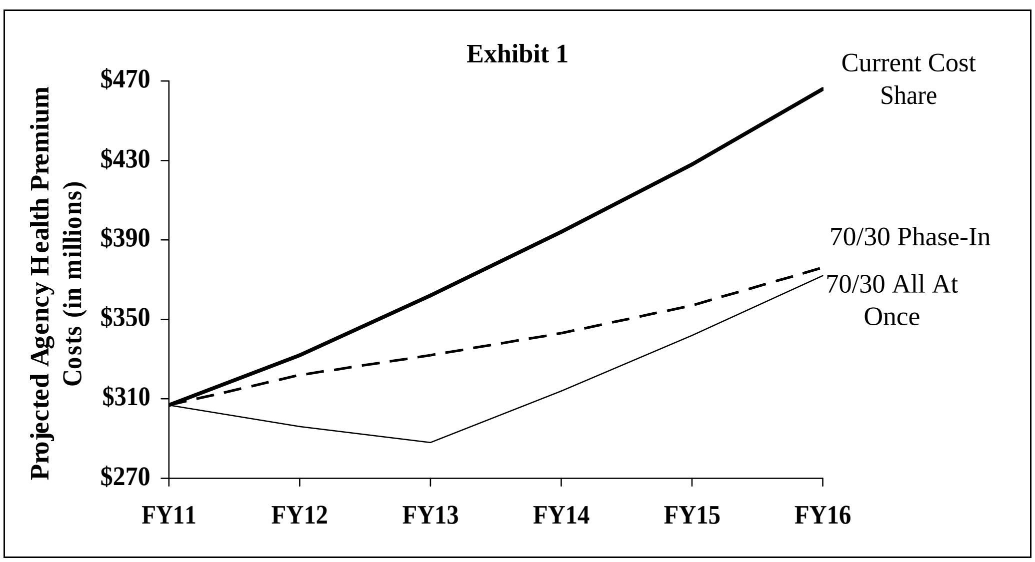
As reviewed earlier, each agency determines the structure of health benefits offered to its employees. The current cost shares arrangements vary by agency, with agency contributions for full-time employees ranging from 75% to 95% of the total premium. (See Table 2 page C-2)

Alternative Structure

This option would change the agency/employee premium cost share for medical and prescription drug coverage to 70/30 as of January 1, 2012. A 70/30 cost share assigns 70% of the annual premium to the agency and 30% to the employee. Expressed in dollars, an annual premium of $10,000 with a 70/30 cost share means an agency cost of $7,000 and an employee cost of $3,000. This option would apply to all agency employees who currently pay less than 30% of their annual premium.[2] All cost projections in this option include tax supported and non-tax supported positions.

Exhibit 1 shows potential savings from changing to a 70/30 cost share all at once compared to a phase-in approach that limits cost share increases for employees to 5% each year. The three lines in the graph are explained below:

- The top line, **Current Cost Share**, shows the projected agency cost increases for health insurance based on the current cost share arrangements.
- The middle line, **70/30 Phase-In**, shows the projected agency cost increases for health insurance based on implementing the 70/30 option across all agencies with a 5% annual phase-in that would begin in January 2012.
- The bottom line, **70/30 All At Once**, shows the projected agency cost increases for health insurance based on implementing the 70/30 option across all agencies as of January 2012.



[2] The cost share for employees who currently pay 30% or more would not change.

Projected Cost Savings

Table 5 compares projected annual agency health care costs under the current cost share arrangements with projected agency costs under the 70/30 option implemented across all four agencies as of January 1, 2012. In sum:

- In FY12, the four agencies would save $35 million in health care costs for active employees under the "all at once" option and $10 million under the "5% phase-in" option.
- By FY16, the annual savings in health care costs for active employees would be $94 million under the "all at once" option and $90 million under the "5% phase-in" option.

Increasing or decreasing the targeted cost share would adjust the savings accordingly.

Table 5. Projected Annual Health Insurance Premium Costs for All Agencies ($ in millions)

Cost Share Model	FY11 Budget	Projected Agency Health Insurance Premium Costs				
		FY12	**FY13**	**FY14**	**FY15**	**FY16**
Current Cost Share	$306.9	$331.7	$361.9	$393.8	$428.4	$466.1
70/30 Cost Share: "all at once"	--	$296.5	$288.5	$313.9	$341.6	$371.7
Difference	--	**($35.2)**	**($73.4)**	**($79.8)**	**($86.8)**	**($94.4)**
70/30 Cost Share: "5% phase-in"	--	$322.0	$331.5	$342.6	$356.8	$375.7
Difference	--	**($9.7)**	**($30.4)**	**($51.2)**	**($71.7)**	**($90.4)**

For each of the 70/30 cost share scenarios, the table below shows estimated annual savings by agency. Under either option, the largest savings would accrue to MCPS because it has the largest workforce and because MCPS employees currently pay the lowest cost share of premiums compared to the other agencies.

Table 6. Difference in Agency Health Insurance Premium Costs with 70/30 Cost Share Options ($ in millions)

Cost Share Model	FY11 Budget	Difference in Agency Health Insurance Premium Costs				
		FY12	**FY13**	**FY14**	**FY15**	**FY16**
70/ 30 Cost Share: "all at once"						
MCPS	--	($28.7)	($59.9)	($65.0)	($70.6)	($76.5)
County Government	--	($5.5)	($11.6)	($12.8)	($14.1)	($15.5)
M-NCPPC	--	($0.5)	($1.1)	($1.2)	($1.3)	($1.4)
Montgomery College	--	($0.4)	($0.8)	($0.8)	($0.8)	($0.9)
70/ 30 Cost Share: "5% phase-in"						
MCPS	--	($6.4)	($20.3)	($36.6)	(55.4)	($72.6)
County Government	--	($2.7)	($8.8)	($12.8)	($14.1)	($15.5)
M-NCPPC	--	($0.2)	($0.6)	($1.0)	($1.3)	($1.4)
Montgomery College	--	($0.4)	($0.8)	($0.8)	($0.8)	($0.9)

*The calculations for the projected costs under each model assume current plan designs and no enrollment changes.

Effect on Individual Employees

The agencies' projected savings shown above are not the result of a reduction in the annual premium amounts; instead, they reflect a shift of some of the increasing annual premium costs from the agencies to their employees. For the County Government and MCPS plans with the highest enrollments, Table 7 illustrates how a 70/30 cost share would affect the annual premiums for medical coverage paid by individual employees.

Table 7. Annual Employee Health Premium Projected Cost Increases: Current Cost Share vs. 70/30 Cost Share

	2011	2012	2013	2014	2015	2016
County Government - Carefirst High Option POS Plan (Family coverage, Choice group)						
80/20 Cost Share (Current)	$3,204	$3,500	$3,857	$4,247	$4,674	$5,140
70/30 Cost Share: "all at once"	--	$5,250	$5,786	$6,371	$7,011	$7,710
Difference	--	**+$1,750**	**+$1,929**	**+$2,124**	**+$2,337**	**+$2,570**
70/ 30 Cost Share: "5% phase-in"	--	$4,375	$5,786	$6,371	$7,011	$7,710
Difference	--	**+$875**	**+$1,929**	**+$2,124**	**+$2,337**	**+$2,570**
MCPS - United Healthcare Select HMO (Family coverage)						
95/5 Cost Share (Current)	$711	$781	$847	$919	$997	$1,082
70/30 Cost Share: "all at once"	--	$4,685	$5,084	$5,516	$5,985	$6,493
Difference	--	**+$3,905**	**+$4,236**	**+$4,597**	**+$4,987**	**+$5,411**
70/30 Cost Share: "5% phase-in"	--	$1,562	$2,542	$3,677	$4,987	$6,493
Difference	--	**+$781**	**+$1,695**	**+$2,758**	**+$3,990**	**+$5,411**

OPTION # 2: Change to a Fixed Employer Contribution

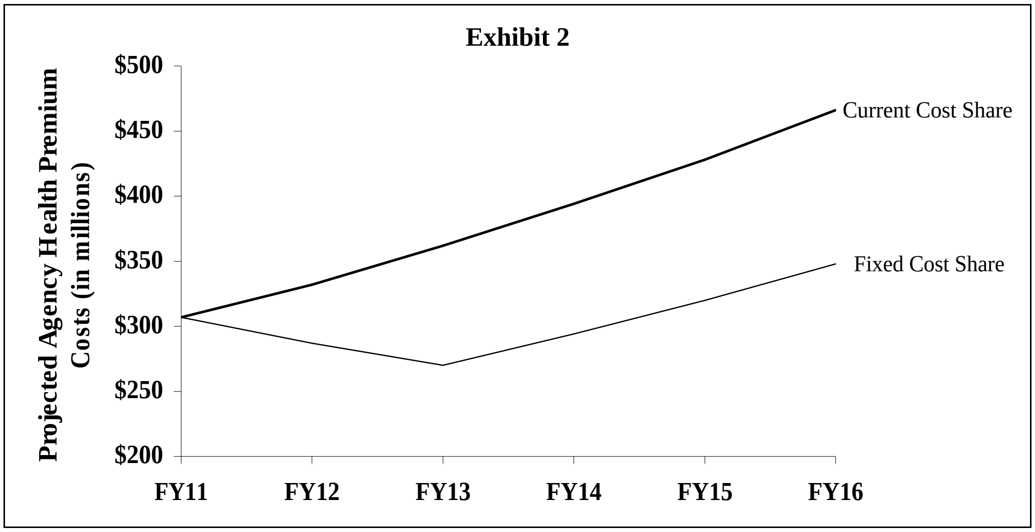
Current Structure

As reviewed earlier, each agency determines the structure of health benefits offered to its employees. The current cost share arrangements vary by agency, and agency contributions for full-time employees range from 75% to 95% of the total premium. (See Table 2, page C-2)

Alternative Structure

Under this option, an agency's contribution to an employee's insurance premium would be a fixed dollar amount and the employee would pay the difference. This option would set the fixed dollar contribution at 75% of the premium for each agency's lowest cost plan. In effect, this option would establish a 75/25 cost share for the cheapest plan and progressively higher cost shares for the other plans. All cost projections in this option include tax supported and non-tax supported positions.

Exhibit 2 shows total projected employer costs across all agencies through FY16 under the current cost share structure compared to the fixed cost option beginning in calendar year 2012.



Projected Cost Savings

Table 8 (on the next page) compares the projected annual agency health premium expenditures under the current cost share arrangements and under this fixed employer contribution option implemented across all four agencies as of in January 1, 2012. Under the fixed contribution set at 75% of the premium for the lowest cost plan:

- In FY12, the four agencies would save $46 million in health care costs for active employees.
- By FY16, the annual savings in health care costs for active employees would be $123 million.
- The largest savings would occur in MCPS because it has the largest workforce and because MCPS employees currently pay the lowest premium cost share compared to other agencies.
- Increasing or decreasing the fixed employer contribution would adjust the savings accordingly.

Table 8. Annual Agency Health Premium Costs for All Agencies ($ in millions)

Cost Share Model	FY11 Budget	Projected Agency Health Premium Costs				
		FY12	FY13	FY14	FY15	FY16
All Agencies						
Current Cost Share	$306.9	$331.7	$361.9	$393.8	$428.4	$466.1
Fixed Contribution: 75% of low plan	--	$285.6	$266.0	$289.6	$315.3	$343.2
Difference	--	**($46.0)**	**($96.0)**	**($104.2)**	**($113.2)**	**($122.9)**
Difference by Agency						
MCPS	--	($38.9)	($81.1)	($88.0)	($95.5)	($103.6)
County Government	--	($5.5)	($11.5)	($12.7)	($14.0)	($15.4)
M-NCPPC	--	($0.4)	($0.8)	($0.9)	($1.0)	($1.1)
Montgomery College	--	($1.2)	($2.5)	($2.6)	($2.7)	($2.8)

*The calculations for the projected costs under each model assume current plan designs, no enrollment changes, and that each agency's FY11 lowest cost plan remains the lowest cost plan in future years.

Effect on Individual Employees

The projected savings shown above do not reflect lower annual premium amounts; instead, they shift some of the annual premium cost increases from the agencies to their employees. For the County Government and MCPS plans with the highest enrollments, Table 9 illustrates how this option would change annual premium costs for medical coverage paid by individual employees.

Table 9. Annual Employee Health Premium Cost Projections

	2011	2012	2013	2014	2015	2016
County Government - Carefirst High Option POS Plan (Family coverage, Choice group)						
80/20 Cost Share (Current)	$3,204	$3,500	$3,857	$4,247	$4,674	$5,140
Fixed Employer Contribution Scenario	--	$5,753	$6,339	$6,980	$7,682	$8,448
Difference	--	**+$2,252**	**+$2,482**	**+$2,733**	**+$3,008**	**+$3,308**
MCPS - United Healthcare Select HMO (Family coverage)						
95/5 Cost Share (Current)	$711	$781	$847	$919	$997	$1,082
Fixed Employer Contribution Scenario	--	$6,696	$7,265	$7,883	$8,553	$9,280
Difference	--	**+$5,915**	**+$6,418**	**+$6,963**	**+$7,555**	**+$8,198**

OPTION # 3: Higher Cost Share for Self+1 and Family Coverage

Current Structure

As reviewed earlier, each agency determines the structure of health benefits offered to its employees. Current cost share arrangements vary by agency, and agency contributions for full-time employees range from 75% to 95% of the total premium. (See Table 2, C-2).

Agency cost shares are the same for all levels of coverage even though annual plan premium prices differ by level of coverage (self, self+1, or family). Since cost shares are not adjusted to account for this higher pricing, the result is higher agency costs for employees enrolled in "self+1" or "family" coverage than for employees enrolled in "self" coverage.

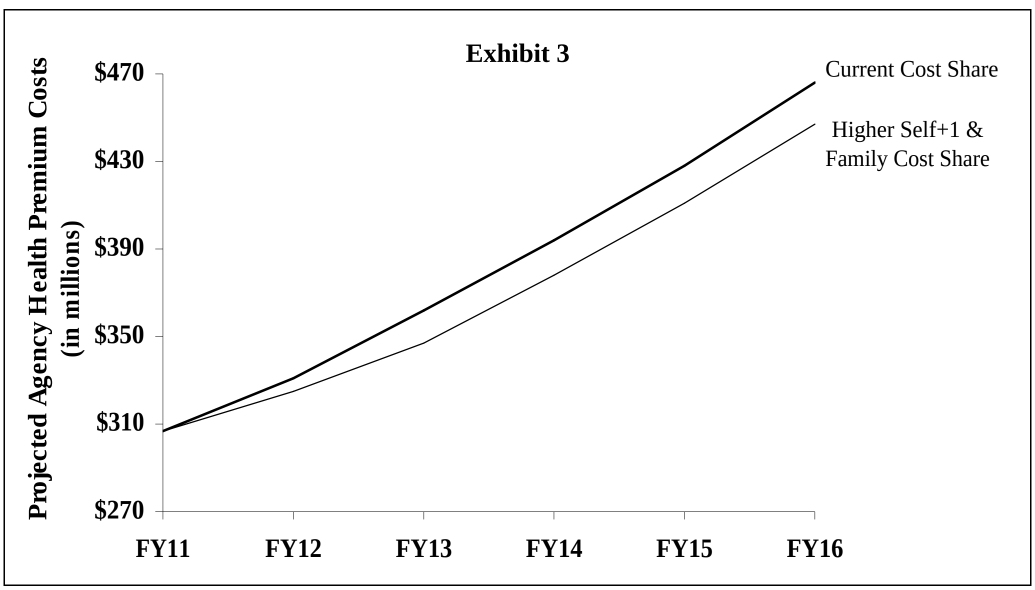
Alternative Structure

This option would increase cost shares for employees who would enroll in "self+1" or "family" coverage by 2.5% and 5% respectively. This option would apply across the agencies, regardless of plan type or employee status. Under this option, a plan with a current 80/20 cost share would have the new cost shares below:

- 80/20 cost share for a "self" enrollee;
- 77.5/22.5 cost share for a "self+1" enrollee; and
- 75/25 cost share for a "family" enrollee.

All other current cost share arrangements would not change. All cost projections in this option include tax supported and non-tax supported positions.

Exhibit 3 shows total projected employer costs across all agencies through FY16 under the current cost share structure compared to the higher cost share for "self+1" and "family" coverage option beginning in calendar year 2012.



Projected Cost Savings

Table 10 compares the projected annual agency health premium expenditures under the current cost share arrangements and under this higher cost share for "self+1" and "family" coverage option implemented across all four agencies as of January 1, 2012. Under this option:

- In FY12, the four agencies would save $7 million in health care costs for active employees.
- By FY16, the annual savings in health care costs for active employees would be $19 million.
- The largest savings would occur in MCPS because it has the largest workforce.

Increasing or decreasing the additional percent paid for "self+1" and "family" coverage would adjust the savings accordingly.

Table 10. Annual Agency Health Premium Costs for All Agencies ($ in millions)

Cost Share Model	FY11 Budget	Projected Agency Premium Costs				
		FY12	FY13	FY14	FY15	FY16
All Agencies						
Current Premium Cost Share	$306.9	$331.7	$361.9	$393.8	$428.4	$466.1
Higher Self+1 & Family Cost Share	--	$324.5	$347.1	$377.5	$410.7	$446.8
Difference	--	**($7.2)**	**($14.9)**	**($16.3)**	**($17.7)**	**($19.2)**
Difference by Agency						
MCPS	--	($4.6)	($9.7)	($10.5)	($11.4)	($12.3)
County Government	--	($2.1)	($4.4)	($4.9)	($5.4)	($5.9)
M-NCPPC	--	($0.1)	($0.3)	($0.3)	($0.3)	($0.3)
Montgomery College	--	($0.3)	($0.6)	($0.6)	($0.6)	($0.7)

*The calculations for the projected costs assume current plan designs and no enrollment changes.

Effect on Individual Employees

The projected savings shown above do not reflect lower annual premium amounts; instead, they shift some of the annual premium cost increases from the agencies to their employees. Table 11 illustrates how this option would change annual premium costs for medical coverage paid by individual employees using a County Government employee enrolled in family coverage and an MCPS employee enrolled in Self+1 coverage.

Table 11. Annual Employee Health Premium Cost Projections

	2011	2012	2013	2014	2015	2016
County Government - Carefirst High Option POS Plan (Family coverage, Choice group)						
80/20 Cost Share (Current)	$3,204	$3,500	$3,857	$4,247	$4,674	$5,140
Higher Cost Share for Family	--	$4,375	$4,822	$5,309	$5,842	$6,425
Difference	--	**+$875**	**+$964**	**+$1,062**	**+$1,168**	**+$1,285**
MCPS - United Healthcare Select HMO (Self + 1 coverage)						
95/5 Cost Share (Current)	$434	$477	$517	$561	$609	$661
Higher Cost Share for Self +1	--	$715	$776	$842	$913	$991
Difference	--	**+$238**	**+$259**	**+$281**	**+$304**	**+$330**

OPTION #4: Higher Cost Share for Part-Time Employees

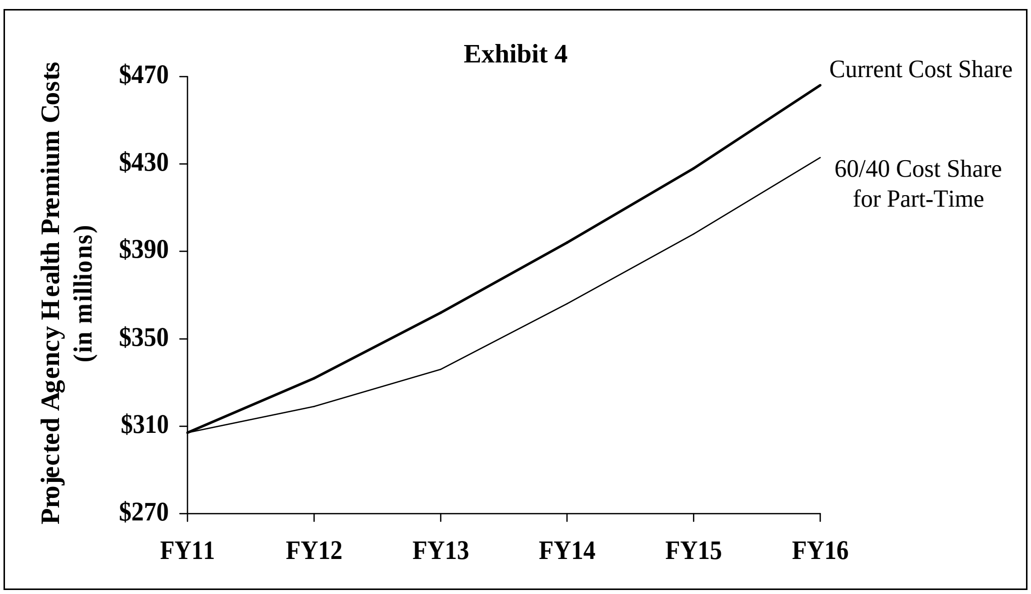
Current Structure

As reviewed earlier, each agency determines the structure of health benefits offered to its employees. Current cost share arrangements vary by agency, and agency contributions for full-time employees range from 75% to 95% of the total premium. (See Table 2, page C-2). Across the four agencies, there are currently 5,495 part-time employees enrolled in agency health plans. Under current cost share arrangements, only 54 (1%) of these part-time employees pay a higher premium cost share compared to full-time employees.

Alternative Structure

This option would change the agency/employee premium cost share for medical and prescription drug coverage for part-time employees (defined as working less than 40 hours per week) to 60/40 as of January 1, 2012. A 60/40 cost share assigns 60% of the annual premium to the agency and 40% to the employee. Expressed in dollars, for an annual premium of $10,000, the agency pays $6,000 and the employee pays $4,000. This option would apply to all part-time agency employees who currently pay less than 40% of their annual premium.[3] All cost projections in this option include tax supported and non-tax supported positions.

Exhibit 4 shows projected employer costs across all agencies through FY16 under the current cost share structure compared to the 60/40 option for part-time employees beginning in calendar year 2012.



PROJECTED COST SAVINGS

Table 12 compares the projected annual agency health premium expenditures under the current cost share arrangements and under 60/40 cost share for part-time employees option implemented across all four agencies as of January 1, 2012. Under this option:

[3] The cost share for full-time employees and any part-time employees that currently pay 40% or more would not change.

- In FY12, the four agencies would save $12 million in health care costs for active employees.
- By FY16, the annual savings in health care costs for active employees would be $33 million.
- The largest savings would accrue to MCPS because it has the largest part-time workforce and currently does not differentiate cost share based on full-time or part-time status.
- This option would not yield savings for Montgomery College because its part-time employees already pay 62.5% of their premium. M-NCPPC has a relatively small number of part-time employees and would accrue less than $40,000 in savings annually.

Increasing or decreasing the cost share for part-time employees would adjust the savings accordingly.

Table 12. Annual Agency Health Premium Costs for All Agencies ($ in millions)

Cost Share Model	FY11 Budget	Projected Agency Premium Costs				
		FY12	FY13	FY14	FY15	FY16
All Agencies						
Current Cost Share	$306.9	$331.7	$361.9	$393.8	$428.4	$466.1
60/40 Cost Share for Part-Time Employees	--	$319.4	$336.4	$366.1	$398.3	$433.4
Difference	--	**($12.2)**	**($25.5)**	**($27.7)**	**($30.1)**	**($32.7)**
Difference by Agency						
MCPS	--	($11.3)	($23.6)	($25.6)	($27.8)	($30.2)
County Government	--	($0.9)	($1.9)	($2.1)	($2.3)	($2.5)
M-NCPPC	--	(<$0.1)	(<$0.1)	(<$0.1)	(<$0.1)	(<$0.1)
Montgomery College	--	$0	$0	$0	$0	$0

*The calculations for the projected costs assume current plan designs and no enrollment changes.

Effect on Individual Employees

The projected savings shown above do not reflect lower annual premium amounts; instead, they shift some of the projected annual premium cost increases from the agencies to their part-time employees. For the County Government and MCPS plans with the highest enrollments, Table 13 illustrates how this 60/40 cost share option would change annual employee premium costs for medical coverage paid by a part-time employee.

Table 13. Annual Part-time Employee Health Premium Cost Projections

	2011	2012	2013	2014	2015	2016
County Government - Carefirst High Option POS Plan (Family coverage, Choice group)						
80/20 Cost Share (Current)	$3,204	$3,500	$3,857	$4,247	$4,674	$5,140
60/40 for Part-time Employees	--	$7,000	$7,714	$8,494	$9,348	$10,280
Difference	--	**+$3,500**	**+$3,857**	**+$4,247**	**+$4,674**	**+$5,140**
MCPS - United Healthcare Select HMO (Family coverage)						
95/5 Cost Share (Current)	$711	$781	$847	$919	$997	$1,082
60/40 for Part-time Employees	--	$6,247	$6,778	$7,354	$7,980	$8,658
Difference	--	**+$5,466**	**+$5,931**	**+$6,435**	**+$6,982**	**+$7,576**

Issue Paper D

Health Benefits for Retired Employees

HEALTH BENEFITS FOR RETIRED EMPLOYEES

OVERVIEW: This paper presents options to lower the projected increases in the agencies' costs of retiree health insurance benefits. The cost containment strategies reviewed include eliminating the benefit for new hires, changing eligibility criteria, and modifying the current cost share arrangements.

Current and Projected Cost of Retiree Group Insurance

Under the current system, each agency sets eligibility criteria and group insurance benefit levels for its own retirees. All four agencies offer eligible retirees group insurance benefits in four categories: medical, prescription drug, dental, and vision coverage. The agencies' dual approach to funding retiree group insurance costs is summarized below.

Pay-As-You-Go Funding refers to annual group insurance benefit costs that the agencies pay for their currently retired employees. Over the past ten years (FY02-FY11), total agency spending on group insurance for retired employees more than doubled from about $31 million to $79 million. Absent changes to the current structure, these costs are estimated to increase another 57% to nearly $124 million by FY16.

Table 1. Projected Pay-As-You-Go Agency Expenditures on Retiree Group Insurance

Agency	FY11 Approved	FY16 Projected	FY11-FY16 Increase	
			$	%
County Government	$31.1 million	$51.3 million	$20.2 million	65%
MCPS	$42.7 million	$65.3 million	$22.6 million	53%
Montgomery College	$2.7 million	$3.3 million	$0.6 million	22%
M-NCPPC	$2.5 million	$3.8 million	$1.3 million	52%
Total	**$79.0 million**	**$123.7 million**	**$44.7 million**	**57%**

Other Post Employment Benefits (OPEB) Pre-Funding refers to agency contributions to their respective OPEB trust funds. In FY08, each agency established an OPEB trust fund to begin pre-funding their long-term retiree group insurance cost liability.[1] Funds set aside in an OPEB trust will be used to pay the group insurance costs that will come due when current employees retire.

As summarized in Table 2 (on the next page), the latest actuarial estimates (prepared in 2008) place the County's future liability for retiree group insurance costs – if paid out today and in today's dollars – at $2.7 billion.

[1] In 2004, the Governmental Accounting Standards Board (GASB) issued Statement No. 45 that required government agencies to disclose their "other post employment benefits" liability in financial statements. GASB 45 does not require that state and local governments actually fund their OPEB obligations, only that they report them.

Table 2. Agency OPEB Valuation as of June/July 2008

Agency	Accrued Liability
County Government	$1,161 million
MCPS	$1,361 million
M-NCPPC	$106 million
Montgomery College	$52 million
Total	$2,680 million

Updated actuarial estimates of the agencies' long-term liability for retiree health care costs are expected to be completed in early 2011. It is anticipated that these updates will recommend higher annual OPEB contributions from all four agencies.

Due to funding constraints, none of the agencies made OPEB contributions in FY10 or FY11. The Council's most recently adopted Fiscal Plan shows annual agency OPEB payments resuming in FY12 as summarized in Table 3 below.

Table 3. OPEB Contributions for FY12-FY16, as Adopted in the County's Fiscal Plan*

	FY12	FY13	FY14	FY15	FY16
All Agencies	$83.6 million	$102.6 million	$121.7 million	$139.8 million	$146.8 million

*Adopted by the Council on June 29, 2010.

Overview of Agency Health Plans for Retirees

Each agency determines the group insurance benefits offered to its retirees. Currently, each agency sponsors an array of health plans with varying structures. Key structural components of agency health plans for retirees that impact the overall cost of health benefits include:

- **Plan Design and Administration.** Each agency offers multiple health plans for retirees to choose from, and contracts with different insurance carriers for plan administration. Based on the design and administrator, each plan has its own structures for variables such as co-pays, deductibles, out-of-pocket maximums, and network of health care providers.

- **Coordination with Medicare.** For all agency retirees, the structure of agency-provided health benefits changes once a retiree becomes eligible for Medicare. Between retirement and age 65, the medical plan offered by each agency is the retiree's primary plan. Once a retiree turns 65, Medicare becomes the primary coverage and the agency plan becomes secondary coverage.

- **Eligibility for Retiree Health Benefits.** Each agency establishes its own eligibility criteria for retiree health benefits. The current criteria are based on different combinations of an employee's years of credited service and/or age.

- **Level of Coverage and Dependents.** Retirees generally choose among three different levels of insurance coverage: self (covers only the employee); self+1 (covers the employee and one eligible dependent); and family (covers the employee and all eligible dependents). MCPS and M-NCPPC do not allow the addition of any new dependents once an employee has retired.

The tables on page D-5 summarize the agencies' retiree medical and prescription drug insurance plan options (either calendar year 2010 or 2011), and eligibility guidelines for retirees and their dependents.

Premium "Cost Share" for Retiree Health Benefits

Each year, based on the structure of each plan and projected total agency health care costs, agency actuaries calculate recommended annual premium amounts. Within each agency, the annual insurance premium varies by plan and level of coverage.

Similar to health insurance for active employees, the cost of the annual premium is shared between the agency and the enrolled retirees. A "cost share" ratio determines how much of the annual premium is paid by the agency and how much is paid by the retiree. For example, a "70/30" cost share allocates 70% of the cost to the agency and 30% to the retiree. An annual premium of $10,000 with a 70/30 cost share means an agency cost of $7,000 and a retiree cost of $3,000.

Table 4 (below) lists the current premium cost share arrangement for each agency. The agencies vary the cost share by hire date, years of credited service, and/or age.

Table 4. 2011 Premium Cost Share for Retiree Health Benefits by Agency

Employee Status or Plan Type	Enrollees (July/Aug 2010)	Health Premium Cost Share	
		Agency Pays	Employee Pays
Montgomery County Government			
Hired before Jan. 1, 1987*	4,446	80%	20%
Hired after Jan. 1, 1987 with at least 15 years eligible for insurance as active employee		70%	30%
Hired after Jan. 1, 1987 with between 5 and 15 years eligible for insurance as active employee		50%-70%	30%-50%
MCPS			
At least 5 years of credited service	7,424	64%	36%
Less than 5 years of credited service		50%	50%
Montgomery College			
Under age 65	439	60%	40%
Over age 65		40%	60%
M-NCPPC			
All Retirees	n/a**	85%	15%

*Employees hired before Jan. 1, 1987 are only eligible for retiree health insurance for the same number of years they were eligible for insurance as an active employee. In 1986 and 2002, these employees were given the option to switch to the same lifetime cost sharing arrangement as those hired after Jan. 1, 1987.
**M-NCPPC's retirement system combines Montgomery County and Prince George's County retirees and does not track which county the employee retired from.

Overview of Options

The rest of this issue paper outlines three approaches for containing the future costs of health care for agency retirees in Montgomery County. OLO chose these options, in part, based on research on strategies that other jurisdictions are considering to reduce their retiree health care costs. For a summary of comparative examples related to containing future costs of retiree health insurance, see Appendix (©119).

- Option #1 eliminates retiree group insurance benefits for new employees hired after a specified date in the future.
- Option #2 reduces the agency's cost share of the annual premium paid for retiree health insurance.
- Option #3 changes current eligibility criteria and/or benefit levels for retiree health insurance. The strategies include changing the minimum age and/or years of credited service requirements, revising the provision of health care benefits based on Medicare eligibility, and eliminating coverage for dependents.

For each option, estimating the agency savings from changes to retiree health insurance would require calculations by the agencies' actuaries. As a result, the options described in this issue paper explain how the agency costs would be reduced but do not provide any specific dollar estimates. <u>If the Council wants to further consider any of the options outlined in the paper, then detailed cost estimates can be requested from the agencies' actuaries.</u>

Implementation Issues

The structure of employee health benefits is not established in County or State law, but is instead established by each agency. The authority to change the structure of retiree health benefits lies with the governing body for each agency. For a discussion of general legal issues surrounding modification to health benefits, see the memos in the Appendix (©8 and ©22) from the County Attorney on: 1) Council authority to modify employee pay and benefits, and 2) the Council's role in collective bargaining. In general, the County Attorney has concluded (on several occasions) that the Council has the authority to change County Government retiree health benefits.

Table 5. Retiree Health Plan Options by Agency

Plan Type	County Government (Calendar Year 2011)	MCPS (effective 7/1/10)	Montgomery College (Calendar Year 2010)	M-NCPPC (Calendar Year 2011)
Medical Plans	• Carefirst BlueChoice POS – High Option • Carefirst BlueChoice POS – Standard Option • Kaiser Permanente HMO* • United Healthcare Select HMO • Carefirst Indemnity (with Rx discount)	All retirees: • Carefirst BlueChoice HMO • Kaiser Permanente HMO* • United Healthcare Select HMO Non-Medicare eligible only: • United Healthcare Select Plus POS • United Healthcare Select Plus Closed POS • United Healthcare Indemnity PPO Medicare-eligible only: • United Healthcare Medicare Supplemental Indemnity Plan	• CIGNA PPO • CIGNA HealthCare • Kaiser (under 65 only) • Kaiser Medicare Supplement (over 65 only)	• United Healthcare Choice Plus POS • CIGNA Open Access Plus In-Network EPO • United Healthcare Select EPO
Prescription Drug Plans	• Caremark High Option • Caremark Standard Option • Kaiser Permanente*	• Caremark Prescription Option A • Caremark Prescription Option B • Kaiser Permanente*	Included as part of each medical plan	• Caremark Prescription Plan

*Kaiser prescription plans are included within Kaiser medical plans, and only available to enrollees of the medical plan. MCPS allows Kaiser medical enrollees to opt out of the Kaiser prescription coverage.

Table 6. Retiree Health Benefit Eligibility by Agency, Calendar Year 2011

Type	County Government	MCPS	Montgomery College	M-NCPPC
Eligible Retirees	ERS Participants: employees eligible for retirement RSP Participants: varies based on years of service and age	Employees eligible for retirement	Employees eligible for retirement with at least 10 service years	Employees eligible for retirement
Eligible Dependents	Spouse, Domestic Partner and Children	• Spouse, Domestic Partner, and Children • No new dependents after retirement	Spouse, Domestic Partner and Children	• Spouse, Domestic Partner, and Children • No new dependents after retirement

OPTION #1: Eliminate Retiree Heath Benefits for New Hires

Current Structure

Employees who meet the eligibility requirements set by each agency (e.g., minimum age, years of service) receive health insurance benefits after they retire. Agency costs for current retiree health benefits were $79 million in FY11 and are projected to rise to $124 million by FY16. The agencies' long-term liability for current employees' future retiree health care costs exceeds $2.6 billion.

Alternative Structure

Eliminate retiree group insurance benefits for new employees hired after a specified date in the future, but maintain existing eligibility and benefit levels for current employees and retirees. For a discussion of the legal issues related to eliminating retiree group insurance benefits for new hires, see the County Attorney's memos attached at ©8.

Projected Cost Savings

Although this option would not yield significant agency savings in the short run, it would lead to very substantial savings in the long run. Because this option would only apply to employees hired after a specified future date, the agencies would continue to pay health care costs for current retirees and for the cohort of already hired employees once they retire. Over the course of many years, the agencies' costs for group insurance for retirees would be vastly reduced and eventually eliminated.

To date, the agencies have funded a relatively small portion of their long-term liability related to group insurance for retirees. If the agencies were to eliminate retiree group insurance benefits for new hires, the OPEB liability for current employees and retirees would still have to be paid. However, the agencies would not accrue any new OPEB liability related to newly hired employees.

Effect on Current and/or Future Retirees

This option would not affect current retirees or current employees who expect to retire from the County since it does not propose changing the retiree group insurance benefits for current retirees or employees already hired before some specified future date. However, employees hired after the specified date would no longer be eligible to receive group insurance benefits from the agencies after their retirement.

OPTION #2: Change Premium Cost Sharing Arrangements

Current Structure

As reviewed earlier, each agency establishes its own premium cost share arrangements for retiree health insurance benefits. Under current arrangements, agency contributions for retiree group insurance range from a low of 40% to a high of 85% of the total annual premium.

Alternative Structure

Reduce agency premium contributions for retiree health insurance to a maximum of a 50/50 cost share. A maximum 50/50 cost share means that, at most, the agency would pay 50% of the annual premium and the retiree would pay the other 50%. Expressed in dollars, for an annual premium of $10,000, a 50/50 cost share means that the agency would pay $5,000 and the retiree would pay $5,000.

For a discussion of the legal issues related to implementing a revised premium cost share arrangement for current and future retirees, see the County Attorney's memos attached at ©8.

Projected Cost Savings

Estimating the agency savings from changes to retiree health insurance premium cost shares requires calculations by the agencies' actuaries; however, the timing and magnitude of agency cost savings would vary based on how the agencies structured this option:

- If the agencies' applied the new cost share to future retirees only, this option would permanently shift the projected cost curve downward in the long run.
- If the agencies' applied the new cost share to current retirees, they would realize immediate savings.

Effect on Current and/or Future Retirees

If this option were implemented for current retirees, their annual premium costs would increase more than projected under current cost share arrangements. The amount of the increase would depend on a retiree's current cost share and whether they are Medicare-eligible or not. Table 7 compares annual contribution cost projections for two current retirees, one pre-65 retiree and one Medicare-eligible retiree, assuming a 50/50 cost share implemented January 1, 2012.

Table 7. Annual Retiree Health Premium Cost Projections

	2011	2012	2013	2014	2015	2016
County Government - Carefirst High Option POS Plan - Pre-65 Retiree (Self+1 coverage)						
70/30 Cost Share (Current)	$2,854	$3,118	$3,436	$3,783	$4,164	$4,579
50/50 Premium Cost Share	--	$5,197	$5,727	$6,306	$6,940	$7,632
Difference	**--**	**+$2,079**	**+$2,291**	**+$2,523**	**+$2,776**	**+$3,053**
County Government - Carefirst High Option POS Plan - Medicare-Eligible Retiree (Self+1 coverage)						
70/30 Cost Share (Current)	$1,648	$1,800	$1,984	$2,184	$2,404	$2,643
50/50 Premium Cost Share	--	$3,000	$3,306	$3,640	$4,006	$4,406
Difference	**--**	**+$1,200**	**+$1,322**	**+$1,456**	**+$1,602**	**+$1,763**

OPTION #3: Change Eligibility Criteria and/or Benefit Levels

Current Structure

As reviewed earlier, each agency establishes the parameters of the health insurance benefit provided to its retirees, including eligibility criteria and benefit levels.

Alternative Structures

There are many different ways to reduce agency costs of group insurance for retirees. The table below outlines four specific cost saving strategies related to eligibility and/or benefit levels for future retirees. For a discussion of the legal issues related to implementing changes to the retiree health benefits for current agency employees, see the County Attorney s memo attached at ©8.

Scenario	Description
# 3A: Change the number of years of service and minimum age requirements needed to qualify for retiree health benefits	To qualify for health benefits, a retiree would, for example, need: • A minimum of 15 years of credited service, and • Be at least 55 years of age. For most agencies, this means that eligibility for retiree health benefits would no longer be linked directly to general retirement eligibility.
# 3B: Eliminate retiree health benefits for individuals once they become eligible to receive Medicare	Retirees would no longer be eligible to receive any health benefits from the agency <u>once</u> they become eligible for Medicare at age 65. Under this option, retiree health benefits would serve to bridge the gap (if any) from when an employee retires to when that employee begins receiving Medicare. As an alternative, the agencies could provide Medicare-eligible retirees the option to continue to participate in agency health plans but require retirees to pay 100% of the premium.
# 3C: Revise eligibility criteria such that a retiree only receives health benefits as a Medicare supplement	Retirees would no longer be eligible to receive any health benefits from the agency <u>until</u> they are eligible for Medicare. Under this option, retiree health benefits would serve as supplemental or secondary insurance plans intended to pay health costs Medicare does not. As an alternative, the agencies could allow pre-Medicare eligible retirees to continue to participate in agency health plans but require retirees to pay 100% of the premium.
# 3D: Revise eligibility criteria such that health benefits for retirees are no longer available to a retiree's dependents	Eliminate the ability for retirees to cover any dependents under their health plan. As a result, retirees would no longer be able to choose Self+1 or Family coverage levels. As an alternative, the agencies could continue to offer coverage to retirees' dependents but require the retiree to pay 100% of the additional cost above single coverage.

Projected Cost Savings

Estimating the agency savings from these changes to retiree health insurance would require calculations by the agencies' actuaries. The four scenarios would reduce agency costs by decreasing the total number of individuals eligible for health benefits, decreasing the timeframe within which retirees can receive benefits, or by eliminating the most expensive levels of coverage (Self+1 and Family).

Applying any of the changes to current employees (who have not yet retired) would yield savings sooner then applying the changes to new hires only. If an agency allowed retirees to maintain health coverage but at a 100% cost share, agency savings would be slightly lower because of ongoing plan administration costs.

Effect on Current and/or Future Retirees

This option does not propose changing the retiree health benefits for current retirees; however, these scenarios could apply to current employees and/or new employees hired after a specified date. Depending on which scenarios were implemented, some future retirees would no longer be eligible for coverage, would be eligible for coverage for a shorter time period, or would no longer be able to enroll dependents in their health benefit plans.

Issue Paper E

Workforce Size

WORKFORCE SIZE

OVERVIEW: The primary cost driver behind increased personnel costs in the County during the past decade has been higher costs per employee as opposed to a large growth in the number of employees on payroll. Nonetheless, reducing workyears represents one way to reduce personnel costs. This issue paper provides a macro-perspective on the number of workyears that would need to be eliminated in each agency in order to reduce personnel costs, calculated in increments of $10 million.

See page E-3 for brief descriptions of the Organizational Reform Commission and Cross-Agency Resource Sharing Committee. Both of these groups have been tasked with developing specific recommendations to reduce workforce size.

FY02-FY11 Agency Tax Supported Workyears and Personnel Costs

The workforce sizes of all four agencies fluctuated during the past decade. In FY11, the total tax supported workforce of the four agencies combined is 29,400 workyears; this represents a 10% increase from the 26,702 tax supported workyears in FY02.

Over the past decade, all four agencies experienced large increases in personnel costs. Total tax supported personnel costs across the four agencies increased by 64%, from $1.7 to $2.8 billion.

Table 1 compares FY02 and FY11 approved tax supported workyears and personnel costs for each of the four agencies. Of the four agencies, only MCPS and Montgomery College have total workforces that are notably larger today compared to ten years ago. Between FY02 and FY11:

- MCPS' workyears increased 14% while MCPS enrollment increased 6%;
- Montgomery College's workyear growth of 30% paralleled its enrollment growth of 32%;
- The number of FY11 County Government workyears is nearly identical to the FY02 level; and
- M-NCPPC experienced a 10% decrease in workforce size over the past decade.

The data indicate that the growth in personnel costs significantly outpaced the growth in work-force size over the last decade. The primary cost driver for increased personnel costs was higher costs per employee rather than growth in workforce size. Nonetheless, reducing workyears is an option for reducing future year personnel costs.[1]

Table 1. FY02 and FY11 Approved Tax Supported Workyears and Personnel Costs by Agency

Agency	FY02 Workyears	FY11 Workyears	% Change	FY02 Personnel Costs	FY11 Personnel Costs	% Change
MCPS	17,085	19,439	+14%	$1.07 billion	$1.76 billion	+64%
County Government	7,347	7,374	+0.4%	$492 million	$786 million	+60%
Montgomery College	1,363	1,773	+30%	$94 million	$170 million	+81%
M-NCPPC	907	814	-10%	$55 million	$78 million	+42%
Totals	**26,702**	**29,400**	**+ 10%**	**$1.71 billion**	**$2.80 billion**	**+64%**

[1] Even if workforce size and salaries remain constant in future years, personnel costs will increase due to projected increased costs of retirement and group insurance benefits.

Where are the Workyears?

Within each agency, employees provide a variety of functions and services. Table 2 shows how each agency distributes workyears by function and/or organizational unit. For example:

- Nearly one-half of County Government workyears are distributed to public safety functions;
- Slightly more than half (53%) of MCPS workyears are assigned to K-12 instruction in Elementary, Middle, and High Schools;
- Campus-based faculty and staff account for 51% of Montgomery College workyears; and
- About three-fourths of M-NCPPC's workyears are assigned to the Parks Department.

Table 2. Agency Workyears by Selected Departments or Functions from FY11 Approved Budgets

Function and/or Organizational Units	Workyears	
	Number	% of Total
County Government	**7,374**	**100%**
Public Safety	3,648	49%
Health and Human Services	1,043	14%
Transportation	1,032	14%
General Government	926	13%
Libraries, Culture, and Recreation	650	9%
All Other	76	1%
MCPS*	**20,743**	**100%**
K-12 Instruction: Elementary Schools	5,214	25%
Office of Special Education & Student Services	3,928	19%
K-12 Instruction: High Schools	3,268	16%
K-12 Instruction: Middle Schools	2,451	12%
Department of Transportation	1,742	8%
Division of School Plant Operations	1,328	6%
Office of Curriculum and Special Programs	938	5%
All Other	1,874	9%
Montgomery College**	**1,711**	**100%**
Campus Faculty and Staff (Rockville, Takoma Park, Germantown)	867	51%
All Other (includes Central Administration)	844	49%
M-NCPPC***	**905**	**100%**
Parks Department	688	76%
Planning Department	143	16%
Central Administrative Services and Commissioner's Office	74	8%

*MCPS workyears include both tax supported and non-tax supported workyears.
**Montgomery College workyears based on Summary of Positions in FY11 Approved Operating Budget.
**M-NCPPC workyears do not reflect any reductions or allocation changes made since FY11 budget approval.

Related Efforts Underway that are Focused on Workforce Size

There are currently two major efforts underway to address issues related to agency workforce size. The information presented here is intended to complement and not duplicate the work of these two groups and the recommendations they are expected to develop.

The Organizational Reform Commission (ORC), established by County Council Resolution in May 2010, is charged with developing recommendations to reorganize/consolidate functions or revise government processes to achieve significant cost savings or efficiencies. The ORC consists of four members appointed by the Council and four members appointed by the County Executive. The ORC is expected to submit its report of recommendations by January 31, 2011. For more on the ORC and its progress to date, see Appendix (©48).

The Cross-Agency Resource Sharing Committee (CARS), established by the Chief Administrative Officer in March 2010, is a forum for coordination among County agencies to share ideas/best practices, develop potential resource-sharing strategies to achieve operational efficiencies, reduce costs, and improve the quality of services offered to residents.

CARS has organized its work into the following nine subject workgroups: Information Technology; Utilities; Facilities Planning, Design, Construction and Maintenance; Procurement; Space Utilization; Fleet; Mailing, Printing, and Document Management; Employees and Retirees Benefit Plan Administration; and Administrative Functions (payroll, budget, finance, training, etc). CARS is expected to recommend specific proposals for FY12 budget savings. For more on CARS and its progress to date, see Appendix (©54 and ©57).

Calculation of Workyear Reduction Required for $10 million in Savings

In FY11, the cost (salary plus benefits) of a hypothetical "average workyear" across the four agencies is $91,900. **This means that close to 110 workyears across the four agencies would need to be eliminated in order to save $10 million in annual personnel costs.** The comparable calculation for each agency to achieve personnel costs savings in increments of $10 million is summarized in Table 3.

Table 3 (on the next page) presents average cost per workyear for each of the four agencies. The average cost per workyear represents the mean personnel cost (salary plus benefits) of all employees in the agency. Because the average cost per workyear does not reflect differences between types of positions, the table also provides data for two broad subsets of workyears in County Government (public safety and non-public safety) and teacher workyears in MCPS.

Table 3. Number of FY11 Workyears that Represent Increments of $10 Million in Personnel Costs by Agency

Agency	Average Cost per Workyear	Number of Workyears Equal to $10 Million in Personnel Costs
County Government		
Public Safety Workyear	$112,900	89 workyears
Non-Public Safety Workyear	$91,700	109 workyears
MCPS*		
Agency Average Workyear	$87,800	114 workyears
Teacher "New Hire" Workyear **	$65,200	153 workyears
M-NCPPC		
Agency Average Workyear	$84,000	119 workyears
Montgomery College*		
Agency Average Workyear	$79,000	127 workyears

* The average cost per workyear for MCPS and Montgomery College only include locally-paid benefits.
** The teacher "new hire" category reflects the cost of reducing workyears by not hiring new teachers as opposed to laying off currently employed workyears.

Workyear Reduction Equivalencies

A decision to eliminate workyears would necessitate corresponding reductions in service delivery. To provide some perspective on what an increment of $10 million in workyears represents in each agency, Table 4 (on the next page) provides some illustrative examples. **The examples selected are not offered as recommendations for reduction, but rather to illustrate in a tangible way what every increment of $10 million in workyears can "buy" in each agency (using average cost per workyear data for each agency).**

Implementation

Eliminating funding for personnel can be accomplished as a budget action and can be implemented through the elimination of vacant, unfilled positions and/or by the elimination of filled positions. Each agency has different procedures it is required to follow if a decision is made to reduce filled positions through a reduction-in-force (RIF).

Workforce reduction could achieve savings beginning in FY12. Savings would carry into future years as long as an agency does not reverse the reduction by re-creating or adding new workyears.

Table 4. Examples of What $10 Million in Workyears Represents
(all examples based on the average cost per workyear data for each agency shown in Table 3 above)

$10 Million in Personnel Costs Pays for…	Which Represents…
County Government	
89 Public Safety Workyears	• 100% of career firefighters assigned to the following stations combined: Silver Spring #1, Kensington #18, and Gaithersburg #28
	• 69% of the police officers serving the Rockville District
	• 66% of the police officers in both the Criminal and Special Investigations Divisions
	• 60% of all uniformed sheriff officers
	• 30% of all uniformed correctional officers
109 Non-Public Safety Workyears	• 100% of staff in the following libraries combined: Aspen Hill, Chevy Chase, Germantown, Kensington Park, Little Falls, Long Branch, Poolesville, Quince Orchard, Twinbrook, Wheaton, and White Oak
	• 100% of staff in the Department of Technology Services
	• 100% of staff in the following departments/offices combined: Department of Economic Development, the Office of Consumer Protection, the Office of Human Resources, the Office of Management and Budget, the Regional Services Centers, and the Office of Legislative Oversight
	• 90% of staff in the State's Attorney's Office
	• 70% of staff in DHHS' Aging and Disability Services
MCPS	
153 Teacher "New Hire" Workyears	• 100% of all elementary and middle school staff development teachers
	• 100% of high school staff development, vocational education, vocational support, career preparation, academic intervention, and special program teacher positions combined
	• 85% of elementary music teachers
	• 8% of high school instruction teacher positions
	• Increase in average elementary and middle school class sizes by 1 student
114 Agency Workyears	• 100% of Assistant Principal positions
	• 95% of school- and central office-based positions for Enriched and Innovative programs (e.g., magnet and signature programs)
	• 88% of technology support positions
	• 51% of elementary school Instructional Media Center positions
	• 25% of school counselor positions at all levels
Montgomery College	
127 Agency Workyears	• 80% all staff at the Germantown campus
	• 56% of all staff at the Takoma Park campus
	• 26% of all staff at the Rockville campus
	• 25% of all Instructional Faculty across all three campuses
M-NCPPC	
119 Agency Workyears	• 100% of Parks Department Park Police Division staff
	• 100% of the combined staff of the Parks Department Central Maintenance and Facilities Management Divisions
	• 83% of all Planning Department staff
	• 17% of all Parks Department staff

Issue Paper F

Operating Expenses

OPERATING EXPENSES

OVERVIEW: This paper reviews the major components of tax supported operating expenses for County Government and Montgomery County Public Schools (the two largest County agencies), and outlines two approaches for achieving operating expense savings in $10 million increments: an across-the-board reduction, and a targeted reduction.

Definition of Operating Expenses

"Operating expenses" include all of an agency's operating budget expenditures other than personnel costs, and exclude capital budget spending. Examples include spending for contractual support, utility payments, facility and vehicle maintenance, office and program supplies, and technology.

Operating expenses are closely related to other agency budget decisions. An agency often incurs additional operating expenses as a by-product of workforce and facility decisions. For example, over the past decade, the County Government opened and staffed new government facilities (e.g., fire stations, libraries, recreation centers) and MCPS opened and staffed new schools. While personnel and capital expenditures are the largest costs associated with most service expansions, adding new positions and opening new facilities increase operating costs for items such as technology, building maintenance, and utilities.

Additionally, the percent of each agency's budget allocated for operating expenses is in part a function of what activities or services the agency decides to contract out versus deliver via agency employees.

FY11 Operating Expense Appropriations

Montgomery County Government. The County Government's FY11 approved operating budget includes $377.6 million in tax supported operating expenses;[1] this amount represents 32% of the County Government's approved tax supported budget. As a percent of the total tax supported budget, the County Government's operating expenses remained essentially constant between FY02 and FY11.

The table on the next page shows the 12 departments (and non-departmental accounts) with the largest FY11 operating expense appropriations. **The operating expenses for these 12 functions equal $306.1 million, or 91% of total FY11 tax supported operating expenses.**

The Council also appropriates non-tax supported funds for operating expenses. In general, resources in non-tax supported funds must be expended for a specific purpose and are not transferable for other uses. Some FY11 examples include:

- Solid Waste Disposal ($88.5 million);
- Health and Human Services' Grant-Funded Contracts ($30.4 million);
- Parking Lot Districts ($16.3 million); and
- Liquor Control Operating Expenses ($14.7 million).

[1] The FY11 operating expense total of $377.6 million cited above excludes retiree group insurance costs because this report classifies retiree group insurance as a personnel cost.

Table 1. Selected FY11 County Government Tax Supported Operating Expense Appropriations (representing 91% of total FY11 tax supported operating expenses)

Department/Account	Total $ Amount	Examples of Major Operating Expenses
Health & Human Services	$73.3 million	Contracts and Services • Aging & Disability: $14.2 million • Children, Youth & Families: $13.8 million • Public Health: $13.4 million • Behavioral Health & Crisis Services: $8.3 million • Special Needs Housing: $6.4 million
Transit Services	$46.3 million	• Ride-On Fuel/Maintenance: $33.0 million • Call-N-Ride Program: $3.2 million
Police	$35.6 million	• Police Car Fuel/Maintenance: $10.6 million • Communications Services: $3.6 million • Officers' Uniforms & Equipment: $3.0 million
Utilities (General Fund)	$28.6 million	• Electricity (Facilities): $16.4 million • Electricity (Street Lights): $8.3 million • Natural Gas: $2.8 million • Electricity (Traffic Signals): $1.8 million
Fire & Rescue	$26.9 million	• Insurance & Risk Management: $13.9 million • Fire Department Allocations: $6.7 million • Fire & EMS Vehicle Fuel/Equipment: $3.0 million
Leases (General Fund)	$20.9 million	• Building Rentals and Leases: $20.9 million
Risk Management (General Fund)	$16.9 million	• Liability and Property Coverage: $16.9 million
Transportation	$13.5 million	• DOT Vehicle Fuel/Equipment: $5.4 million • Tree Maintenance: $1.5 million
Technology Services	$12.0 million	• Software Licenses / Maintenance: $7.9 million
Working Families Income Supplement	$11.8 million	• Earned Income Tax Credit: $11.8 million
General Services	$10.4 million	• Facility Maintenance Contracts: $4.4 million • Janitorial Services: $2.9 million • Plumbing, Electrical, HVAC Supplies: $1.1 million
Recreation	$9.9 million	• Recreation Facility Utilities: $3.2 million • Recreation Supplies & Equipment: $1.2 million
Total	**$306.1 million**	

Montgomery County Public Schools. MCPS' FY11 approved operating budget includes $178.4 million for tax supported operating expenses; this amount represents 9% of MCPS' FY11 tax supported budget. The table below provides an overview of MCPS' FY11 tax supported budget for operating expenses divided into seven categories.

In addition, MCPS' major non-tax supported operating costs include supplies, materials and contracts for its food service operations ($17.4 million), and publishing services ($2.5 million). As with County Government, MCPS non-tax supported resources must be used for a specific purpose and are not transferable for other uses.

Table 2. FY11 MCPS Tax Supported Operating Expenses by Category

Category	Total $ Amount	Examples of Major Operating Expenses
Utilities	$43.5 million	• Utilities for MCPS buildings (entire amount)
Special Education Non-public Placements	$35.5 million	• Tuition for students with disabilities in non-public (private) placements (entire amount)
Textbooks	$23.3 million	• Textbooks, instructional materials and media (entire amount)
Supplies and Materials	$21.0 million	• Plant operations and maintenance: $8.6 million • Transportation fuel and bus parts: $12.4 million
Contracts	$20.6 million	• Maintenance, transportation, and other services: $7.0 million • Technology: $8.4 million • Special education-related services: $5.2 million
Equipment and Furniture	$13.4 million	• Transportation (bus replacement): $9.5 million • School furniture and instructional equipment: $1.4 million • Maintenance and plant operations: $1.5 million • Technology: $1.0 million
Other Expenditures	$21.1 million	• Facilities – Relocatables: $2.0 million • Maintenance: $1.6 million • Insurance: $2.8 million • Local travel reimbursement: $1.8 million • Extracurricular activities stipends/activity buses: $8.9 million • All Other: $4.0 million
Total	**$178.4 million**	

Potential Reductions in Operating Expenses

Reducing operating expenditures is an option for achieving budget savings, although it should be recognized that any substantial reductions will have repercussions for agency operations and service delivery. There are two primary ways to achieve a targeted amount of savings through operating expense reductions:

- An "across-the-board" reduction that reduces all agency departments/accounts by a uniform percent that does not account for differences in type or uses of operating expenses across departments (e.g., a 3% reduction for all departments/accounts); or

- Targeted reductions using priority-based criteria established by the agencies. For example, an agency could achieve a specific amount of operating expense savings by eliminating entire programs (potentially reducing both personnel costs and operating expenses); scaling back eligibility, participation, or operating hours for select programs and services; or reducing specific operating expense categories (contracts, supplies, etc.).

Because targeted reductions depend on important policy decisions that would need to be made by each agency, the remainder of this section details the impacts of an "across-the-board" reduction in all tax supported departments and accounts in County Government and tax supported categories in MCPS in order to achieve savings in increments of $10 million.

Montgomery County Government "Across-the-Board" Reduction. To achieve $10 million in savings, each County Government department and non-departmental account would have to reduce operating expenses by approximately 2.7% below FY11 appropriated amounts. The table below illustrates how the $10 million in operating expense savings would be distributed across departments and accounts.

Table 3. Impact on County Government Departments/Accounts from an "Across-the-Board" Operating Expense Reduction that Achieves $10 Million in Savings

Department/Account	Dollar Reduction (2.7% Cut)
Health & Human Services	$1,941,000
Transit Services	$1,226,000
Police	$944,000
Utilities	$758,000
Fire & Rescue	$713,000
Leases	$555,000
Risk Management	$447,000
Transportation	$358,000
Technology Services	$318,000
Working Families Income Supplement	$312,000
General Services	$274,000
Recreation	$262,000
All Other	$1,892,000
Total	**$10 million**

An across-the-board reduction treats all operating expenses the same. Some operating expenses, however, are influenced by factors outside an agency's control (e.g., fuel prices), or may be difficult or impossible to eliminate. For example, the County Government likely could not significantly reduce spending on electricity for traffic signals (unless it achieved greater energy efficiency). In addition, some operating expenses, even those that are arguably discretionary, often support high priority programs and services.

An alternative form of this reduction type is to create exemptions to the across-the-board reductions for certain categories of spending (such as public safety services or "safety net" programs). Exempting some categories from across-the-board reductions would necessarily require greater percent decreases in non-exempt expenses to achieve the targeted reduction.

Montgomery County Public Schools. To achieve $10 million in savings, all seven MCPS operating expense categories would have to be reduced by approximately 5.6% below FY11 approved levels. If special education non-public placements (mandatory under Federal law) were exempt from this "across-the-board" reduction, the remaining six operating expense categories would have to be reduced by 7% each to achieve $10 million in savings. The table below illustrates how the $10 million in operating expense savings would be distributed across categories under each across-the-board scenario.

Table 4. Impact on MCPS Operating Expense Categories from an "Across-the-Board" Reduction that Achieves $10 Million in Savings

Category	Dollar Reduction Associated with a…	
	5.6% Cut (no exemptions)	7% Cut (exempts non-public placements)
Utilities	$2,400,000	$3,100,000
Special Education Non-public Placements	$2,000,000	**Exempt**
Textbooks	$1,300,000	$1,600,000
Supplies and Materials	$1,200,000	$1,500,000
Contracts	$1,100,000	$1,400,000
Equipment and Furniture	$800,000	$900,000
Other Expenditures	$1,200,000	$1,500,000
Total	**$10 million**	**$10 million**

As with County Government, an across-the-board reduction in MCPS treats all operating expenses the same. Some operating expenses, however, are influenced by factors outside of an agency's control (e.g., fuel prices), or may be difficult or impossible to eliminate. In addition, some operating expenses, even those that are arguably discretionary, often support high priority programs and services.

Implementation

Eliminating funding for operating expenses can be accomplished as a budget action within each agency.

Issue Paper G

Debt Service

DEBT SERVICE

OVERVIEW: This paper presents options to reduce projected annual debt service expenditures through reducing scheduled general obligation bond issuance. In addition, this paper identifies the potential consequences of reducing the amount of debt issued.

Current and Projected Costs for Debt Service

Each year, the County issues general obligation bonds to raise funds for the construction, improvement, or maintenance of the County's publicly-owned infrastructure. In 2008, the Council approved the County's Debt Policy (Appendix ©31), which determines how the County issues and manages debt. The Debt Policy establishes several debt capacity measures the County adheres to in order to maintain its AAA bond rating.

The County typically pays back these general obligation bonds (plus interest) over a 20-year period. As a result, the County must make annual payments to pay off the borrowing and other long-term obligations, referred to as annual debt service payments. The County funds its annual debt service payments through the operating budget, and total debt service payments each year depend on how much debt the County issued in past years. General obligation bond debt typically represents about 90% of the County's total annual debt service costs.

In FY11, general obligation bond debt service payments totaled $236 million, a 47% increase over the FY02 total of $161 million. For FY11, the Council authorized the issuance of $325 million in bonds. The approved Fiscal Plan assumes continued bond issuances of $325 million per year through FY16. As such, annual general obligation debt service payments are scheduled to increase by 51% over the next five years as shown in the table below.

Table 1. General Obligation Bond Debt Service Payments, FY11 Approved and FY16 Projected

	FY11 Approved	FY16 Projected	FY11-FY16 Increase	
			$	%
Debt Service	$236 million	$356 million	$120 million	51%

In recent years, the County has issued approximately 94% of its bond issuance limit each year (excluding FY08 when no debt was issued). If this trend continues over the next five years, projected general obligation bond debt service payments would be lowered to approximately $347 million in FY16.

Currently, Montgomery County general obligation bond proceeds fund 57% of capital expenditures in the FY11-FY16 Capital Improvements Program (CIP). About one half of all general obligation bond proceeds funds MCPS projects; another quarter funds transportation projects (e.g., roads, storm drains, traffic improvements, sidewalks, bikeways, etc.); and the remainder funds other projects such as regional parks, fire stations, and recreation centers.

Overview of Options

Since general obligation bond debt represents around 90% of annual debt service costs, the two options to reduce future costs presented below focus on general obligation bond debt.

- Option #1 reduces the current general obligation bond issuance limit by 25% for the entire five-year time period from FY12 through FY16.

- Option #2 reduces the current general obligation bond issuance limit by 50% for the entire five-year time period from FY12 through FY16.

Both options assume that, for each fiscal year, the County issues general obligation bonds up to the authorized maximum.

Implementation Issues

Options to lower bond issuance limits fall within the Council's authority and are implemented through the Council's Spending Affordability Guidelines process. Since general obligation bond issuance funds over 50% of the projects in the approved FY11-16 CIP, determining the financial and programmatic effects of changing bond issuance limits for a specific option is difficult.

Some potential considerations related to lowering the level of bond issuance are highlighted below. The potential impact of changing the amount of debt issued may be favorable or unfavorable, depending upon the perspective of individual stakeholders.

- Less bond capacity means fewer resources for infrastructure projects that are already in the current six-year capital program, as well as less capacity to provide additional funding for projects that are underway and may require additional funding to be completed.

- Capital project costs tend to increase over time due to inflation, and delaying capital projects may result in higher costs in the future due to rising costs of construction and maintenance.

- The issuance of bonds for the construction of new facilities often results in new operating costs as well. Some facilities, such as new libraries or recreation centers, require annual operating appropriations for personnel costs, utilities, etc. once they are opened. Delaying certain capital projects may also delay when those operating costs are incurred.

- A portion of capital borrowing supports maintenance of existing facilities that can result in decreased maintenance or repair costs in the future. For example, the CIP includes projects to resurface roads or to replace building roofs. In some cases, delaying planned infrastructure maintenance could result in higher operating costs in the long-term to County agencies than would be saved by reducing borrowing amounts in the short-term.

Options to Reduce General Obligation Debt Service Payments

Current System

The County's current bond issuance limits are $325 million per year. If the County issues bonds as projected, annual debt service payments are projected to increase 50% from FY11 to FY16.

Alternative Structure/Projected Cost Savings

This alternative shows two options to reduce projected annual debt services payments by reducing the general obligation bond issuance limits. The options show the overall scale and timing of savings associated with different bond issuance levels. As previously noted, any decision to change bond issuance limits would need to take into account policy, programmatic, and budgetary factors.

- **Option #1** reduces the current bond issuance limit by 25%. This reduction would lower debt service payments by $2 million in FY12, and by $94 million in total through FY16.
- **Option #2** reduces the current bond issuance limit by 50%. This reduction would lower debt service payments by $4 million in FY12, and by $189 million in total through FY16.

Table 2 shows the difference in projected annual general obligation bond debt service payments for two debt issuance options, compared to the current issuance limit.

Table 2. Projected Annual General Obligation (GO) Bond Debt Service Payments, ($ in millions)

Option	Annual GO Bonds Issued (FY12-16)	Projected GO Bond Debt Service Payments					Total FY12-FY16
		FY12	FY13	FY14	FY15	FY16	
Current Bond Issuance Limit	$325 million	$265	$293	$315	$335	$356	$1,565
Option #1: 25% Reduction to Bond Issuance Limit	$244 million	$263	$282	$296	$308	$321	$1,471
	Difference	**($2)**	**($11)**	**($19)**	**($27)**	**($35)**	**($94)**
Option #2: 50% Reduction to Bond Issuance Limit	$163 million	$261	$271	$277	$281	$286	$1,376
	Difference	**($4)**	**($22)**	**($38)**	**($54)**	**($70)**	**($189)**

Source: Montgomery County Department of Finance

Of note, the options above illustrate how reductions in new debt issuance affect future year debt service payments. Important timing considerations include:

- Each option assumes a reduced but constant level of new borrowing in each year from FY12 through FY16. As the CIP currently contains many active projects that would be difficult to halt mid-construction, smaller reductions in borrowing in the early years with higher reductions in later years is likely the most realistic approach to reducing future debt service payments.
- FY12 is an "off-year" for the CIP. This year, the Council only will consider amendments to the approved FY11-16 CIP. The FY13-16 CIP will be the next opportunity for the Council to consider changes to the timing and funding of the complete package of CIP projects.

Issue Paper H

Revenue

REVENUE

OVERVIEW: This paper presents four options to generate additional revenue for tax supported expenditures. One option is presented for each of the following sources of local revenue: property tax, income tax, excise taxes, and user fees.

Note: The revenue projections cited in this paper are based on data contained in the most recent Fiscal Plan, adopted by the Council on June 29, 2010. The Executive Branch is scheduled to provide updated revenue projections as part of the Fiscal Plan update on December 14, 2010.

Current and Projected County Revenue

In FY11, according to the Fiscal Plan adopted by the Council in June 2010, included in the Appendix (©44), Montgomery County will receive an estimated $3.8 billion in total tax supported revenue to fund the provision of County programs and services. Tax supported revenue includes revenue from taxes, user fees, service charges, intergovernmental aid, etc. that is available for unrestricted use. The estimated FY11 total is a 59% increase over the FY02 tax supported revenue of $2.4 billion.

As summarized in the table below, the Fiscal Plan also shows that revenue is projected to grow at an average annual rate of 3% over the next five years.

Table 1. Approved FY11 and Projected FY16 Tax Supported Revenue (all sources)
Source: Fiscal Plan adopted by the Council in June 2010

Agency	FY11 Approved	FY16 Projected	FY11-FY16 Projected Increase	
			$	%
Tax Supported Revenue	$3.8 billion	$4.4 billion	$0.6 billion	16%

County Revenue Sources

Table 2 shows the percent of total FY11 tax supported revenue generated by source. The table also presents the annual average rate of growth from FY02 through FY11 for each revenue source. Property tax and income tax account for two-thirds of the County's tax supported revenue in FY11.

Table 2. Montgomery County Tax Supported Revenue by Source

Revenue Source	Percent of FY11 Total Tax Supported Revenue	Annual Average Rate of Growth, FY02-FY11
Property Tax	39%	5.8%
Income Tax	28%	2.2%
Other Taxes	12%	11.1%
Intergovernmental Aid	16%	6.5%
Other Revenue *	5%	6.5%

*includes service charges, fines, miscellaneous revenue, investment income and user fees.

Overview of Options

Should there be interest in seeking additional tax supported revenue to pay for existing spending commitments and emerging budget priorities, the choices are either to: (1) adjust the rates for current revenue sources; or (2) identify new revenue sources.

The rest of this issue paper outlines four options to generate additional revenue. The additional revenue generated from the first three options would be available for unrestricted use. The fourth option, a Transportation Utility Charge, would produce revenue that is restricted for transportation projects that add new capacity.

The table below summarizes the options and the estimated revenue yield from each. Options 1, 3, and 4 could be implemented locally; Option 2 would require a change in State law.

#	Option	Estimated Yield
Property Tax		
1	Override charter limit on property tax revenue	**FY12:** $18 million per 1 cent rate increase **FY12-FY16 (cumulative):** $100 million per 1 cent rate increase
Income Tax		
2	Amend State law to phase out County income tax distributions to municipalities	**FY12:** $3 to $6 million **FY12-FY16 (cumulative):** $45 to $90 million
Other Taxes		
3	Maintain FY11-12 fuel/energy tax rate increases	**FY 13:** $108 million **FY13-FY16 (cumulative):** $432 million*
	Continue allocation of recordation taxes to the General Fund	**FY12:** $13 million **FY12-FY16 (cumulative):** $65 million**
Fees		
4	Enact a Transportation Utility Charge	Depends on rate structure

*Reflects revenue generated by continuation of existing rate.
**Continuation of FY11 policy of not restricting use of recordation tax revenue. Note that this is not new money. Instead, it reduces the CIP and shifts this money to the operating budget.

Other options that could yield additional revenues are listed in the Appendix (©4). The additional options are either variations of those described above or different options that could produce short-term and/or long-term revenues.

OPTION #1: Override Charter Limit

Current Structure

The property tax is the County's largest and most stable revenue source, with FY11 estimated revenue at $1.5 billion. Property taxes represent almost 40% of total tax supported revenue in FY11 (which includes intergovernmental aid).

The amount of property tax collected each year is a function of the property tax rate (established annually by the Council) and the County's "assessable base." The assessable base refers to the value of property that is subject to the tax. Since FY02, the County's assessable tax base increased on average by 9.2% per year.

Section 305 of the County Charter limits the annual growth in property tax revenue to the rate of inflation plus taxes from new development and several other minor factors, unless the Council unanimously decides to override this limit.[1] Over the past decade, the Council voted to exceed the Charter limit four times. In FY11, property tax revenue is $577 million higher than it was in FY02; roughly $206 million of this amount is attributable to the overrides of the Charter limit.

The Council's approved Fiscal Plan, based on the current Charter limit, estimates the property tax will generate an additional $225 million in new revenue through FY16.

Alternative Structure

The Council could override the Charter limit on property tax revenue growth for one or more years to generate new property tax revenue that exceeds the rate of inflation.

Projected Yield and Impacts

According to the Department of Finance, a one cent increase in the property tax rate in FY12 would generate an additional $17.9 million in tax revenue in the first year. By FY16, the same one cent increase in the property tax rate would generate an estimated $22.7 million in added revenue.

For every one cent increase in the property tax rate, homeowners with home values ranging from $350,000 to $700,000 would see annual property tax payment increases ranging from $35 to $70 dollars, not taking into account various property tax credits. The average taxable assessment for commercial properties is $2.8 million. Although there is a wide range of commercial assessments, on average, for every one cent increase in the property tax rate, the annual property tax payment increase for commercial property would be $276.

Implementation

The Council's existing taxing authority authorizes the Council to implement this option. However, implementation is contingent on the affirmative vote of all nine Councilmembers to override the Charter limit.

[1] In 2008, County voters approved a Charter amendment to require the affirmative vote of all nine Councilmembers to override the Charter limit on property tax revenue. Prior to 2008, the Charter required an affirmative vote of seven Councilmembers to override the Charter limit.

OPTION #2: Amend State Law to Phase Out Municipal Income Tax Distributions

Current Structure

Montgomery County currently has a County income tax rate of 3.2%, the maximum allowed under State law. State law requires the Maryland Comptroller to distribute 17% of municipal residents' County income tax revenue to municipalities. For a municipal resident, this means that 83% of their County income tax is distributed to the County and 17% is distributed directly to the municipality where they live. For County residents who do not live in a municipality, 100% of their County income tax is distributed to the County.

From FY05 to FY09, the State distributed about $154 million in County income tax revenue to the County's 19 municipalities and three special taxing districts, including $35.8 million in FY09. On average, income taxes account for nearly 19% of municipalities' revenue.

State law imposes an extensive list of mandates on counties and assigns municipalities a limited role in the delivery of many services. Under State law, counties must fund public schools, libraries, local community colleges, and the circuit courts. County governments are also responsible for basic services such as police, fire, local corrections, sanitation, local highways, health, and parks and recreation.

Municipalities can choose to regulate trash disposal, to establish park and recreation facilities, or to operate police forces or fire departments. In practice, most Montgomery County municipalities maintain sidewalks and streets, provide waste collection services, and enforce building codes. The cities of Gaithersburg, Rockville, and Takoma Park provide a wider array of services, including municipal police forces.

Alternative Structure

Seek changes in State Law to reduce or eliminate municipal income tax distributions. This option describes two potential alternatives of implementing this change:

- Reduce municipal income tax distribution by 50% (to a total distribution of 8.5% annually), phased in over the next five years; or
- Eliminate municipal income tax distributions, phased-in over the next five years.

Projected Yield and Impacts

Given the inherent difficulty of forecasting annual income tax revenue, the estimated yields for reducing municipal income tax distributions described below are illustrative. Both alternatives assume that 17% of municipal residents' income tax payments equal $30 million annually, which is equivalent to the five-year average for this revenue source. Actual revenue will be higher or lower than that amount, depending on the economy and the amounts of actual revenue collected.

Table 3. Estimated Annual Increase in County Revenue from Changes to Municipal Income Tax Distribution ($ in millions)

Alternative (each phased-in over five years)	Annual Increase in County Revenue					Five-Year Increase
	FY12	FY13	FY14	FY15	FY16	
50% reduction in municipal income tax distributions	$3M	$6M	$9M	$12M	$15M	**$45M**
Elimination of municipal income tax distributions	$6M	$12M	$18M	$24M	$30M	**$90M**

This revenue strategy would not increase residents' income taxes; it would only change the distribution of the income taxes already collected. However, since it would reduce a primary municipal revenue source, municipal residents could face:

- Increases in municipal property tax rates if the municipalities sought to replace the lost income tax revenue;
- Reductions in municipal programs and services.

Implementation

Implementation of this option would require a change to Section 2-607 of the Tax-General Article of the Maryland Code.

OPTION # 3: Continue FY11 Energy Tax Rates and Allocation of Recordation Taxes to General Fund

Current Structure

Taxes other than income and property are the County's third largest revenue source, with FY11 estimated revenue of $453 million. The specific taxes that comprise this source include the admission and amusement tax, fuel/energy tax, telephone tax, transfer tax, recordation tax, and hotel/motel tax.

To generate additional revenue and dedicated funding streams, tax rates among these other taxes have increased several times since FY02. In FY11, the Council approved two measures to temporarily increase the amount of other tax revenue available for unrestricted agency use.

- **Recordation Tax Revenue Reallocation: Expedited Bill 14-10** allocated 100% of recordation tax revenue for the General Fund in FY11 and suspended the allocation of any recordation tax revenue for County Government and MCPS capital projects, Montgomery College technology projects, and rental assistance programs. This reallocation increased the County's unrestricted revenue by $13 million in FY11.

- **Energy Tax Rates Increased: Council Resolution 16-1354** increased energy tax rates from May 19, 2010 to June 30, 2012. Compared to the approved yield at the beginning of FY10, higher energy tax rates are estimated to increase County revenue by $115 million in FY11 and $122 million in FY12.

These recordation and energy tax changes are scheduled to sunset in FY12 and FY13, respectively.

Alternative Structure

This strategy would continue the 100% reallocation of recordation tax revenue beyond FY11 and sustain current energy tax rates beyond FY12 by eliminating their current sunset dates.

Projected Yield and Impacts

Maintaining the FY11 recordation tax allocation does not raise new revenue, but directs an additional $13 million to the County's General Fund annually beginning in FY12. This strategy, however, would continue to delay or defer a stream of dedicated funding for MCPS and County Government capital projects, Montgomery College educational technology projects, and rental assistance programs for low income households.

Maintaining the increase in energy tax rates past FY12 would yield an estimated $108 million in additional annual revenue beginning in FY13. Compared to the rates in effect at the beginning of FY10, continuing the increase in energy tax rates would cost the average household an additional $152 per year and the average business an additional $1,423 per year.

Implementation

Both options fall within the Council's existing taxing authority. The Council could remove the restrictions on the use of recordation tax revenue by amending Chapters 9 and 17 of the County Code. The Council could adjust energy tax rates by resolution.

OPTION #4: Enact Transportation Utility Charge

Current Structure

County transportation projects account for roughly 25% of general obligation bond proceeds; and annual general obligation debt service payments are scheduled to increase by 51% over the next five years as indicated in Issue Paper G, Debt Service (page G-1).

Alternative Structure

This option would establish a Transportation Utility Charge, creating a dedicated revenue stream for funding capacity-adding transportation improvement projects. Transportation utility charges are a financing mechanism that treats the transportation network as a utility and charges properties in proportion to their use, rather than their value as with the property tax.[2] The rate structure could be based on average property trip generation rates by land use class, property square footage, and other characteristics, or a flat fee.

This transportation funding strategy was recommended previously by two infrastructure financing workgroups in the 1990's: the Economic Advisory Committee Infrastructure Financing subcommittee in 1992 and the Infrastructure Financing Working Group in 1994.

The County established a similar type of fee structure to support the County's stormwater management infrastructure in 2002, the Water Quality Protection Charge, which assesses fees based on the amount of impervious surface on a property.

Estimated Yield and Impacts

The amount of revenue generated through a Transportation Utility Charge would be determined by the approved rate structure. As a point of reference, the Water Quality Protection Charge will generate an estimated $11.7 million in revenue in FY11.

Transportation Utility Charge revenues would be restricted for the construction of capacity-adding transportation infrastructure. Transportation Utility Charge collections could provide current revenue for transportation projects. Alternatively, if the structure of the transportation utility charge mirrored the Water Quality Protection Charge, revenues from the charge could be used to secure revenue bonds to finance transportation projects approved in the Capital Improvements Program. The revenue bonds issued under this approach would not compete for the County's general obligation debt.

As a fee (rather than a property tax), the County could assess this new charge for both tax-exempt and non tax-exempt properties. In addition, these fees would not count against the Charter property tax limit. Unlike the property tax, however, these charges would not be tax-deductible.

Implementation

This option falls within the Council's existing authority. Implementation could be accomplished through enactment of a new County law.

[2] Junge, Jason and Levinson, David, *Economic and Equity Effects of Transportation Utility Fees*, July 2009