Consolidated Fiscal Note – 2011-12 Session

Bill #: H0004-1A **Complete Date:** 02/09/11

Chief Author: DOWNEY, KEITH

Title: STATE WRKFRC REDUC; EARLY RTMT PRGM

Fiscal Impact	Yes	No
State	X	
Local		X
Fee/Departmental Earnings		X
Tax Revenue		X

Agencies: Minnesota Management & Budget (02/09/11) Minnesota State Retirement Sys (02/09/11) Public Employees Retirement (02/09/11)

This table reflects fiscal impact to state government. Local government impact is reflected in the narrative only.

Dollars (in thousands)	FY11	FY12	FY13	FY14	FY15
Net Expenditures					
General Fund		(22,846)	(50,875)	(79,374)	(107,895)
Minnesota Management & Budget		(23,733)	(51,762)	(80,261)	(108,782)
Minnesota State Retirement Sys		887	887	887	887
All Other Fund		(48,547)	(108,110)	(168,670)	(229,277)
Minnesota Management & Budget		(50,432)	(109,995)	(170,555)	(231,162)
Minnesota State Retirement Sys		1,885	1,885	1,885	1,885
Revenues					
General Fund					
Minnesota State Retirement Sys					
Net Cost <Savings>					
General Fund		(22,846)	(50,875)	(79,374)	(107,895)
Minnesota Management & Budget		(23,733)	(51,762)	(80,261)	(108,782)
Minnesota State Retirement Sys		887	887	887	887
All Other Fund		(48,547)	(108,110)	(168,670)	(229,277)
Minnesota Management & Budget		(50,432)	(109,995)	(170,555)	(231,162)
Minnesota State Retirement Sys		1,885	1,885	1,885	1,885
Total Cost <Savings> to the State		(71,393)	(158,985)	(248,044)	(337,172)

	FY11	FY12	FY13	FY14	FY15
Full Time Equivalents					
General Fund		(394.00)	(394.00)	(394.00)	(394.00)
Minnesota Management & Budget		(394.00)	(394.00)	(394.00)	(394.00)
All Other Fund		(837.00)	(837.00)	(837.00)	(837.00)
Minnesota Management & Budget		(837.00)	(837.00)	(837.00)	(837.00)
Total FTE		(1,231.00)	(1,231.00)	(1,231.00)	(1,231.00)

Consolidated EBO Comments

I have reviewed this Fiscal Note for accuracy and content.

EBO Signature: KATHARINE BARONDEAU
Date: 02/09/11Phone: 651-201-8026

Fiscal Note – 2011-12 Session

Bill #: H0004-1A **Complete Date:** 02/09/11

Chief Author: DOWNEY, KEITH

Title: STATE WRKFRC REDUC; EARLY RTMT PRGM

Fiscal Impact	Yes	No
State	X	
Local		X
Fee/Departmental Earnings		X
Tax Revenue		X

Agency Name: Minnesota Management & Budget

This table reflects fiscal impact to state government. Local government impact is reflected in the narrative only.

Dollars (in thousands)	FY11	FY12	FY13	FY14	FY15
Expenditures					
General Fund		(23,733)	(51,762)	(80,261)	(108,782)
All Other Fund		(50,432)	(109,995)	(170,555)	(231,162)
Less Agency Can Absorb					
-- No Impact --					
Net Expenditures					
General Fund		(23,733)	(51,762)	(80,261)	(108,782)
All Other Fund		(50,432)	(109,995)	(170,555)	(231,162)
Revenues					
-- No Impact --					
Net Cost <Savings>					
General Fund		(23,733)	(51,762)	(80,261)	(108,782)
All Other Fund		(50,432)	(109,995)	(170,555)	(231,162)
Total Cost <Savings> to the State		(74,165)	(161,757)	(250,816)	(339,944)

	FY11	FY12	FY13	FY14	FY15
Full Time Equivalents					
General Fund		(394.00)	(394.00)	(394.00)	(394.00)
All Other Fund		(837.00)	(837.00)	(837.00)	(837.00)
Total FTE		(1,231.00)	(1,231.00)	(1,231.00)	(1,231.00)

Bill Description

This bill, as amended, requires a 15% reduction in the number of full-time equivalent employees employed in the executive branch and the costs associated with employing those persons by June 30, 2015. The bill provides any or all of the following as a means to accomplish the reduction: attrition, a hard hiring freeze, early retirement incentives, restructuring of benefit or pension programs as authorized by other law, furloughs, and layoffs. The bill also requires MMB to conduct an actuarial analysis to determine the maximum number of employees to whom early retirement incentives will be offered and the percentage of resulting savings estimated to be needed to pay pension funds to cover the funds of the incentives.

Assumptions

The bill requires the number of full-time equivalent employees employed in the executive branch to be reduced by 15%. Assume that on July 1, 2011, the total number of executive branch FTE's without MnSCU included is 32,831.

A reduction of 15% would require the executive branch to reduce its number of FTE's by 4,925 FTE's by June 30, 2015 (or 1,231 FTEs/yr).

FY2012 beginning total compensation base for the executive branch without MnSCU is $2.375 billion.

Reductions in workforce will be evenly distributed over each of the next four fiscal years beginning in FY2012 and so only one-quarter of the total workforce reduction required by the bill will occur in any given year; nevertheless the reductions made in previous fiscal years carry-over from fiscal year to fiscal year and so reductions made in previous years will have a cumulative effect on savings.

The MMB actuarial study required will cost $250,000.

12.5% of the FTE reductions will be achieved through the bill's pension early retirement incentive. MSRS has been assigned to the note and will be reporting the additional costs to fund the allowable additional pension service credit. MMB coordinated with MSRS to estimate the number of FTE reductions that would occur as a result of the pension early retirement incentive (12.5% of the executive branch FTE reductions is 154 FTE's per year).

12.5% of the FTE reductions will be achieved via the bill's insurance early retirement incentive. Assume that savings from this FTE reduction will be initially offset by the employer having to make a contribution to an early retiree's health care savings plan equaling two years of the employer's insurance contribution.

Employees who are offered and accept early retirement incentives will not be replaced.

35% of the FTE reductions will be achieved via layoffs.

The average total cost of a layoff is $30,000 per person. Layoff costs include vacation payoff, severance, insurance continuation, unemployment compensation, etc.

40% of the FTE reductions will be achieved through attrition, which would mean that about one in every five employees that leave the executive branch would not be replaced and the position would remain vacant.

Reductions in FTE's and costs are effective on July 1st of each fiscal year so the reductions/savings are realized for the entire fiscal year.

General fund impact is approximately 32% of total salary expenditures and/or FTE's.

Executive branch FTE reductions will lead to reductions or elimination of programs and services.

The state must continue to provide essential services regardless of some of the workforce reduction options provided for in this bill. Some of those essential services would include: medical care of patients and emergency outpatient care; activities essential to ensure continued public health and safety, including safe use of food, drugs and hazardous materials; law enforcement and criminal investigations; care of prisoners and other persons in the custody of government; activities essential to the preservation of the essential elements of the financial system of the government, including borrowing and tax collection activities of the government; activities that ensure the

production of power and the maintenance of the power distribution systems; emergency and disaster assistance; continuation of transportation safety functions; and the list goes on.

The methods offered to achieve the required 15% reduction are briefly discussed below.

Attrition. Attrition is a gradual reduction in the workforce that occurs when workers resign or retire and are not replaced. Excluding MnSCU, approximately 3,000 separations occur in the executive branch in any given year which is about 8% of the workforce. MMB anticipates that agencies would rely heavily on attrition to achieve the required reductions in force; however, because there is no way to know when or where separations will occur, nor how many of those employees/positions will continue to be needed under a more streamlined and less service-oriented workforce, there is no way to extrapolate or assume a cost savings using this approach.

Hard Hiring Freeze. A hard hiring freeze assumes that once a position is vacated, it cannot be filled. Because the state will always need to provide certain essential services (see last assumption), a hard hiring freeze is not possible without some exceptions.

Because there is no way to know where vacancies will occur, and it is assumed that positions providing essential services would still be required to be filled, there is no way to extrapolate or assume a cost savings using this approach.

Early retirement incentives. The bill provides for two early retirement incentives to assist the State in complying with the 15% workforce reduction. Before authorizing an early retirement incentive, the bill directs the Commissioner of MMB to perform an actuarial analysis to determine the maximum number of employees allowable under the program(s) and the percentage of savings that must be returned to cover additional costs to the pension funds.

MMB does not have the expertise to perform the actuarial analysis and so it will need to hire a consultant at an estimated cost of $250,000 to perform this analysis. This is an estimate after consulting with MSRS.

The total compensation savings resulting from the early retirement incentives proposed in this bill would be delayed because: a) the agency must pay separation costs at termination (a more detailed discussion on separation costs is found below); b) the agency must make significant contributions to a retiree's HCSP plan, or transfer a significant percentage of the total compensation savings realized by the early separation to the applicable pension fund to cover the increased cost to the pension fund of the early retirement incentive; and c) the state may not reemploy or contract with the retiring employee for five years after termination thereby eliminating the agency's ability to retain the services of an experienced resource which is often the most cost effective and efficient option.

Finally it is unknown how many of the employees who were approved for an early retirement incentive would have retired without an incentive. It is likely that a significant percentage of these employees would have fallen in this group leading to some costs that could have otherwise been avoided.

Furloughs. Employee furloughs are mandatory time off work with no pay. Furloughs are temporary in nature and do not result in a permanent reduction in the workforce and/or permanent reductions in costs, and therefore are not included in the fiscal impact of the bill.

It is anticipated that implementing furloughs would be met with intense resistance from the labor unions. The unions would likely take the issue before the courts resulting in additional costs to the state and no immediate savings.

The Federal government has also cautioned that when a State subjects federally funded program/employees to state-wide personnel actions (i.e. furloughs), the State will be required to demonstrate that is has adequately addressed the needs funded by Federal dollars. If a state fails to show that its actions adequately take into account the needs of the federally funded program, the funding is at risk and the employees/program may be discontinued.

Furloughs cannot be universally applied. Mandating furlough time in any 24/7 operation would require overtime for other workers to provide the needed staffing coverage.

Layoffs. Employee layoffs produce immediate costs before savings can be realized. Some of those costs include unemployment compensation, employer paid insurance continuation and separation costs (vacation pay off and severance) that are required by the labor contract. MMB estimates that average layoff costs range from $18,000 to $46,000 per person, or an average of $30,000 per layoff.

Wage Freeze. A wage freeze does not save any money and therefore is not included in the fiscal impact of the bill. A wage freeze prevents salary costs from rising in the future.

Restructuring Pension Programs to Defined Contribution Plans. Pursuant to 179A.03, Subd.19, retirement contributions or benefits are not a term or condition of employment and, therefore, proposed changes to the pension programs are the responsibility of the retirement systems. The retirement systems will need to discuss the impact of the costs/savings that may result from restructuring pensions programs to defined contribution plans and/or conducting a study to make recommendations for reforming the state employee retirement pension program.

Pursuant to the 2010 Omnibus Pension legislation, the executive directors of the three statewide retirement systems (MSRS, PERA and TRA), are currently conducting a study of various retirement plan alternatives for public employees in the State of Minnesota. A report is to be delivered to the Legislative Commission on Pensions and Retirement by June 1, 2011.

Expenditure and/or Revenue Formula

Total exec branch FTE's = 32,831
Total compensation exec branch = $2.375 billion
$2.375 billion /32,831 FTE's = $72,345 total comp per FTE

Total exec branch FTE reduction = 32,831 * 15% = 4,925 FTE's
Executive branch FTE's reduction per year = 4,925/4 = 1,231 FTE's/yr

FY2012 costs
$250,000 one-time actuarial study costs
+ $12,928,125 layoff costs (1,231 * 30,000 * 35%)
+ $1,713,252 estimated costs insurance ERI (annual avg insurance employer contrib. * redux in FTE's due to insurance ERI ($11,132 * 154)
= $14,891,377

FY2012 savings
$89,056,695 salary and benefit savings ($72,345 per FTE * 1,231 FTE's reductions per year)

Total salary and benefit savings FY 2012 = $89,056,695 - $14,891,377 = $74,165,318.

FY 2012 Gen Fund savings (32%) = $23,732,901; FY 2012 Other Fund savings (68%) = $50,432,414

FY2013 costs
+ $12,928,125 layoff costs (1,231 * 30,000)
+ $3,426,504 estimated costs insurance ERI (annual avg insurance employer contrib. * redux in FTE's due to insurance ERI ($11,132 * 308)
= $16,354,629
Note: FY2013 insurance ERI costs are double FY2012 because it is assumed that 2 years of the employer's insurance contribution will be contributed to a retiree's health care savings plan.

FY2013 savings
$89,056,695 salary and benefit savings FY2013 ($72,345 per FTE * 1,231 FTE's reductions per year)
+ $89,056,695 salary and benefit savings carried forward from reductions made in FY 2012
= $178,111,390 cumulative salary and benefit savings FY2013

Total salary and benefit savings FY2013 = $178,111,390 - $16,354,629 = $161,756,761.

FY 2013 General Fund savings = $51,762,164; FY 2013 Other Fund savings = $109,994,597

FY2014 costs
+ $12,928,125 layoff costs (1,231 * 30,000)
+ $3,426,504 estimated costs insurance ERI (annual avg insurance employer contrib. * redux in FTE's due to insurance ERI ($11,132 * 308)
= $16,354,629
Note: FY2014 insurance ERI costs are double FY2012 because it is assumed that 2 years of the employer's insurance contribution will be contributed to a retiree's health care savings plan.

FY2014 savings
$89,056,695 salary and benefit savings FY2014 ($72,345 per FTE * 1,231 FTE's reductions per year)
+ $89,056,695 salary and benefit savings carried forward from reductions made in FY 2012
+ $89,056,695 salary and benefit savings carried forward from reductions made in FY 2013
= $267,170,085 cumulative salary and benefit savings FY2014

Total salary and benefit savings FY2014 = $267,170,085 - $16,354,629 = $250,815,456.

FY 2014 General Fund savings = $80,260,946; FY 2014 Other Fund savings = $170,554,510

FY2015 costs
+ $12,928,125 layoff costs (1,231 * 30,000)
+ $3,426,504 estimated costs insurance ERI (annual avg insurance employer contrib. * redux in FTE's due to insurance ERI ($11,132 * 308)
= $16,354,629
Note: FY2015 insurance ERI costs are double FY2012 because it is assumed that 2 years of the employer's insurance contribution will be contributed to a retiree's health care savings plan.

FY2015 savings
$89,056,695 salary and benefit savings FY2015 ($72,345 per FTE * 1,231 FTE's reductions per year)
+ $89,056,695 salary and benefit savings carried forward from reductions made in FY 2012
+ $89,056,695 salary and benefit savings carried forward from reductions made in FY 2013
+ $89,056,695 salary and benefit savings carried forward from reductions made in FY 2014
= $356,226,780 cumulative salary and benefit savings FY2015

Total salary and benefit savings FY2015 = $356,226,780 - $16,354,629 = $339,872,151.

FY 2015 General Fund savings = $108,782,239; FY 2015 Other Fund savings = $231,162,257

Total Reductions in FTE's force
FY 2012 FTE's (32,831) * 15% reduction = 4,925 FTE's

Assume reductions equally distributed
FY2012 = 1,231; General Fund FTE reductions = 394; Other Fund FTE reductions = 837
FY2013 = 1,231; General Fund FTE reductions = 394; Other Fund FTE reductions = 837
FY2014 = 1,231; General Fund FTE reductions = 394; Other Fund FTE reductions = 837
FY2015 = 1,231; General Fund FTE reductions = 394; Other Fund FTE reductions = 837

Long-Term Fiscal Considerations
Assuming the early retirement incentives end and the executive branch is no longer reducing its force through layoffs, the ongoing savings beginning in FY2017 and beyond are $356 million per year of which approximately $114 million would be general fund savings.

Local Government Costs
N/A

References/Sources
Erin Leonard, Assistant Director and Fiscal Note Coordinator, MSRS

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EBO Comments

I have reviewed this Fiscal Note for accuracy and content.

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Fiscal Note – 2011-12 Session

Bill #: H0004-1A **Complete Date:** 02/09/11

Chief Author: DOWNEY, KEITH

Title: STATE WRKFRC REDUC; EARLY RTMT PRGM

Fiscal Impact	Yes	No
State	X	
Local		X
Fee/Departmental Earnings		X
Tax Revenue		X

Agency Name: Minnesota State Retirement Sys

This table reflects fiscal impact to state government. Local government impact is reflected in the narrative only.

Dollars (in thousands)	FY11	FY12	FY13	FY14	FY15
Expenditures					
General Fund		887	887	887	887
All Other Fund		1,885	1,885	1,885	1,885
Less Agency Can Absorb					
-- No Impact --					
Net Expenditures					
General Fund		887	887	887	887
All Other Fund		1,885	1,885	1,885	1,885
Revenues					
General Fund					
Net Cost <Savings>					
General Fund		887	887	887	887
All Other Fund		1,885	1,885	1,885	1,885
Total Cost <Savings> to the State		2,772	2,772	2,772	2,772

	FY11	FY12	FY13	FY14	FY15
Full Time Equivalents					
-- No Impact --					
Total FTE					

Bill Description
HF4 requires a 15% reduction in the state government workforces by 6/30/2015 using an early retirement program, furloughs, layoffs, hiring freeze, wage freeze and restructuring pension programs into defined contribution plans.

- The bill requires actuarial analysis to be completed by MMB to determine the minimum and maximum number of employees who will be eligible for the incentive.

- The early retirement program gives employees one month additional service credit for every year of service in a Minnesota public retirement plan. All other retirement provisions remain the same.

- The agency of the employee utilizing the incentive is required to pay the applicable retirement plan the difference in actuarial present value between their actual benefit earned and the enhanced incentive benefit.

Assumptions
The employee utilizing the incentive gets one additional month of service credit for every full year of service in a Minnesota Public Pension Plan. The formula multiplier is as defined in current law.

Based on discussions with MMB, approximately 154 individuals would be expected to utilize the early retirement incentive for additional service credit each year; a total of 616 over the four year period. The cost of the incentive per person is approximately $18,000.

Expenditure and/or Revenue Formula

Enhanced Benefit- Impact on Employee/Retiree
Example of monthly benefits under current law versus proposed additional service and the difference.

The examples assume a $50,000 high-five average salary with 25 years of service because we expect higher paid state employees to utilize the early retirement program. The enhanced benefit would give the employee an additional 25 months of service credit which equals a total of 27 years, 1 month total credit in their benefit calculation.

25 Years of Service Credit (50,000) high-five			
Age	Current Law	Proposed Added Service	Additional Benefit Amount
60	15,935	17,380	1,445
62	17,610	19,020	1,410
65	21,250	22,950	1,700

Impact on Retirement Fund- Actuarial

Defined benefit plans like the Minnesota State Retirement System (MSRS) utilize a number of demographic and actuarial assumptions to determine the value of the retirement benefit on an actuarial or present value basis.

The comparison of present value of the benefit below assumes an employee with 25 years of service retires at age 62 with a high-five of $50,000.

Actuarial Present Value (current law)	$219,605.51
Actuarial Present Value (proposed)	$237,188.91
Difference (enhanced value)	$17,583.41

The enhanced value resulting from the early retirement program is the cost to the pension program at the time of retirement. Approximately, $18,000 for each employee retiring under these assumptions would need to be invested in the pension plan immediately to avoid additional costs. Approximately 68% of benefits paid out to retirees results from investment income; assuming an 8.5% rate of return, the pension fund would need to earn

investment income on any additional costs associated with the retirement program. If payment is delayed the cost increases. The bill does not specify how many years the potential savings resulting from the early retirement program will be transferred to MSRS nor does it indicate the specific percentage of the savings that MSRS will receive.

Under the assumptions in the example, the early retirement program would cost approximately $18 Million per 1,000 employees who utilize the program. Assuming a reduction in workforce of 5,000 employees, the cost exceeds $90 Million.

However, depending on the employees who utilize the program, the range of present value at retirement is from $5,000 to receive an enhanced benefit to an enhanced present value of approximately $50,000. The costs will be higher if the average salary of those utilizing the program is greater than $50,000.

Long-Term Fiscal Considerations
The possible restructuring of the pension plans to defined contribution are included in a study which was mandated by the 2010 Legislature; this study is due to the Legislature June 1, 2011.

References/Sources
Mercer Consulting- MSRS Actuarial Factor Tables

FN Coord Signature: ERIN LEONARD
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EBO Comments

I have reviewed this Fiscal Note for accuracy and content.

EBO Signature: BRYAN DAHL
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Fiscal Note – 2011-12 Session

Bill #: H0004-1A **Complete Date:** 02/09/11

Chief Author: DOWNEY, KEITH

Title: STATE WRKFRC REDUC; EARLY RTMT PRGM

Fiscal Impact	Yes	No
State		X
Local		X
Fee/Departmental Earnings		X
Tax Revenue		X

Agency Name: Public Employees Retirement

This table reflects fiscal impact to state government. Local government impact is reflected in the narrative only.

Dollars (in thousands)	FY11	FY12	FY13	FY14	FY15
Expenditures					
-- No Impact --					
Less Agency Can Absorb					
-- No Impact --					
Net Expenditures					
-- No Impact --					
Revenues					
-- No Impact --					
Net Cost <Savings>					
-- No Impact --					
Total Cost <Savings> to the State					

	FY11	FY12	FY13	FY14	FY15
Full Time Equivalents					
-- No Impact --					
Total FTE					

Bill Description
The bill requires the State to reduce the number of full-time equivalent employees and costs directly associated with employing those persons by 15% by June 30, 2015. There are very few PERA members who are considered State employees. Only one agency, the Department of Military Affairs, is an executive branch agency that pays into PERA on behalf of State employees. We found 11 active employees in the Department of Military Affairs who would be at least age 50 within the next 2 years and would be immediately eligible to receive an annuity immediately before separation from state service.

The bill would increase the credited service for each of those 11 employees. Ten of the eleven employees would receive roughly 2 additional years of service. The eleventh employee would receive an additional 7 months of credited service. The benefit formula is equal to credited years of service x high-5 salary x 3%. Adding the additional credited service to the pensions of those eleven employees would increase pension costs roughly $36,400 per year. The present value of the additional pension amounts comes to roughly $380,000. According to the bill, the Department of Military Affairs would need to pay that amount to PERA, so PERA would not have any “out of pocket” costs should this bill become law.

FN Coord Signature: DAVE DEJONGE
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EBO Comments

I have reviewed this Fiscal Note for accuracy and content.

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