Early Severance Incentives: Do They Really Work?

The current state of funding for public education is putting enormous stress on the finances of school systems nationwide. The normal responses—program cuts, pay freezes, and staff layoffs—are demoralizing solutions to cost containment. Because staff salaries and fringe benefits make up the largest portion of the typical school system's operating budget, a properly structured severance incentive plan can be a powerful mechanism for controlling high salary costs while maintaining the quality of education within the school system.

But do severance incentives really work? The answer is yes, but to be truly successful, they must be properly studied, structured, and implemented. No detail can be left out.

The Right Formula

What is the formula for a successful early buyout plan?

First, recognize that a severance incentive is not the same as an early retirement incentive (ERI). They are two different concepts. An ERI requires that the employees be eligible for retirement and, in some cases, must actually retire, generally with a state retirement system. ERIs attract only those who are leaving soon anyway.

A better approach is a severance incentive where eligible employees are at or near the top of the pay scale, with no age requirement and no reference to retirement eligibility. If an employee is at the top of the pay scale and can be replaced by someone with a lower salary, or not replaced at all, the cost containment goal will be achieved. The important aspect is that the participating employee leaves the school district at the top of the pay scale, whether or not he or she retires.

The other caveat is that a significantly large number of exits must occur for a plan to succeed. Although stated in simple terms here, a general rule of thumb is three to five times the normal number of annual exits of top-of-scale staff.

Generally, ERIs should be avoided. Why? If the employee were going to leave in the next couple of years anyway, the plan would probably lose money. Severance incentives that prompt employees to exit service 3–20 years earlier than planned are much more likely to have a measurable budget reduction than ERIs.

INDEX OPEN

By Tim Bell and Dan Sheehy

Successful Early Buyout Incentive Plans

When planning an early buyout, consider the following characteristics of effective early buyout incentive plans:

- Involve preplanning to identify budget and staffing goals;
- Attract true early exits (3–20 years), rather than just those who were leaving soon anyway;
- Use top-of-pay-scale criteria rather than eligible-to-retire criteria;
- Reduce overall budget costs rather than simply pay out a bonus;
- Pay for themselves out of the savings they create;
- Provide significant lead time for recruiting quality new teachers;
- Provide a rare opportunity to reallocate staff and budget dollars;
- Are offered on a one-time basis, rather than continually year after year;
- Follow proper taxation and labor laws;
- Protect the school district with a release and waiver of claims agreement;
- Analyze the potential effects of an early buyout from a cost-benefit perspective;
- Follow an implementation time line to ensure that all details are covered;
- Provide one-on-one information sessions for each eligible employee;
- Consider current contractual obligations;
- Include a staff replacement plan to capitalize on early recruiting opportunities; and
- Offer a benefit that is meaningful enough to induce staff to exit many years earlier than they would have.

Before your district offers any incentive plan, study it in detail, taking into account the many elements of employee demographics and the overall effect the plan will likely have on the school system in both the short term and the long term.

Here are some additional guidelines for success.

> Too often, plans are implemented without enough preplanning, resulting in bonuses for a few people who were leaving soon anyway.

PREPLANNING AND PLAN OBJECTIVES

Generally, successful plans have a thorough planning period during which the school district sets goals, such as "reduce the budget by $3 million over three years," "lower class size by three students per class," or "allocate $1 million toward technology improvements." These goals can then be translated into the type of early buyout plan needed. Too often, plans are implemented without enough preplanning, resulting in bonuses for a few people who were leaving soon anyway.

EXPANDED ELIGIBILITY

There are hundreds of reasons individuals decide to leave their jobs, regardless of their ages and eligibility for pension benefits. To be effective from a cost-savings standpoint, the eligibility criteria should not be limited to those who are eligible to retire.

The success of the early buyout severance plan will be enhanced by expanding eligibility to include staff members at the top of the pay scale, regardless of pension eligibility. This approach attracts individuals who may not have been planning to leave a school system for another 5, 10, or 15 years. This is where a plan's long-term cost savings is generated.

Historical data show the percentage of participants in severance incentives in various categories: 25% are between ages 38 and 52; 28% are between 53 and 56; 28% are between 57 and 60; 15% are between 60 and 62; and 4% are 63 or older.

PARTICIPANT BENEFIT

A benefit that is perceived as "too little" in the eyes of the employees will attract only those who will leave soon anyway, which is a waste of school system funds. A monthly stream of income over a number of years provides the participant with a greater sense of security than a lump-sum payment (after taxes), which is easily spent within one or two years of departure.

Because a lump-sum payment may be perceived as a bonus, employees most likely to participate are those who will retire within the next three years, which eliminates any chance of a protracted cost savings to the district. Alternatively, the employer gains from the multiyear payout approach by being able to pay the benefit over time, thereby reducing the shock on cash flow in the first several years of the plan, and by creating a participant demographic that generates a real savings.

Several tax approaches are available to pay the benefit over time and maximize savings to the school district. Each should be looked at closely to determine which is appropriate for the case being considered.

In addition, to maximize its effectiveness, the early buyout plan should be offered during a one-time, 45-day window. Consider allowing the choice of more than one date for the participant's final date of employment or exit date. This approach can increase participation and give the school system greater lead time to recruit and reallocate personnel.

It would be imprudent to place any type of severance incentive plan into a collective-bargaining agreement. Here, a plan will quickly lose its effectiveness as an incentive for staff to exit early and will instead become a bonus at normal retirement.

COUNSELING AND HIRING

Providing comprehensive counseling to all eligible staff members will greatly increase participation. Usually, employees feel reluctant to discuss the plan and their options with a member of the administration. Administrators are not inclined to counsel employees in light of the liability under which they may place themselves and the school system. Having a team of counselors unaffiliated with the employer available to assist employees with the process of considering the plan serves all parties well.

> The most effective plans encourage top-of-pay-scale staff to exit, creating opportunities to replace the departed with staff at much lower salaries.

In most cases, school districts are replacing 100% of the vacated positions with lower-salaried employees, achieving the balance of significant cost savings with no reduction in staff. Opponents of early buyouts argue that a district loses its best and most experienced teachers, yet recent history suggests that not all of the most seasoned and productive staff opt to leave their classrooms under a severance incentive. In addition, surveys of our firm's clients indicate that the combination of the remaining experienced teachers and the energy of newly hired staff creates a better working and learning environment

ELIGIBILITY REQUIREMENTS

Most plans that fail to achieve measurable budget reductions are ERIs. Because ERIs set the eligibility requirements at "30 or more years of service" or "eligible to retire with a full pension," they attract only staff who plan to leave soon anyway. A true early buyout incentive is *not* tied to retirement, but rather it focuses on those who are at the top of the pay scale and has no retirement requirements. Consider the following examples of a school district that has a 14-step salary schedule: "Employees must have 14 or more years of service with the school district" or "Employees must be on salary step 14 or higher."

TAXATION

Many plans are implemented without proper attention to the taxation of benefits. The laws can be complex, and tax counsel is highly recommended. Generally, there are three or four solid tax approaches: (1) a "bona fide" severance plan following U.S. Department of Labor regulations, (2) immediate up-front taxation, (3) postemployment 403(b), or (4) annual service requirements.

Start Planning

The best, but not the only time to start planning an early buyout incentive is early first semester. The goal is to have the plan offering closed by February so that recruiting can begin by March. Again, this is the ideal timing, as a plan can be started any time of the year and still be successful.

Over the past decade, we have worked with hundreds of school system administrators who state that the cost savings and the opportunity to reallocate financial and staff resources are the two main reasons for offering a severance incentive plan. The most effective plans encourage top-of-pay-scale staff to exit, creating opportunities to replace the departed with staff at much lower salaries. As an added bonus, almost every school system has reported an improved educational environment after a successful voluntary severance incentive has been offered. ■

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PRESIDENT'S MESSAGE (continued from page 8)

Affiliate Relations

Procedures for affiliate visitations were revised in cooperation with the Affiliate Executive Directors group to assure that the resources that are expended by the ASBO Board and the affiliates meet the needs of the members.

The successes of the past year have been the result of cooperative efforts of many volunteers and groups: the committees and committee leaders, the affiliate executive directors and affiliate leaders, the ASBO Board, the vendors and sponsors; however, the glue that holds it all together is the ASBO staff in Reston, Virginia. They work tirelessly with all ASBO groups and constituents to ensure that the members have the best services possible. I must extend my personal thanks to the staff for the support that they have provided during my tenure on the Board and especially during my term as president.

New Beginnings

Just as December is a month for celebration and reflection, January is a month for new beginnings. Named for the Roman god Janus with two faces—one looking to the past and one looking to the future—January provides us with the opportunity to look to the future. Our accomplishments of the past will provide the foundation for our future.

I have enjoyed the privilege and opportunity to serve as your president during 2005. It has been an exciting year with many challenges and opportunities. Throughout the year we have had the opportunity not only to celebrate the successes in our profession but also to celebrate the success of children. Because of what we do every day in our jobs, we can reflect and celebrate the past and look forward to success in the future Thanks for all you do for children. ■