Implementation of the Non-Foreign Area Retirement Equity Assurance Act
January 22, 2010

What does the Non-Foreign Area Retirement Equity Assurance Act, Subtitle B, National Defense Authorization Act for Fiscal Year 2010 (P.L. 111-84) do?

The legislation extends locality pay to non-foreign areas (Alaska, Hawaii, and United States territories and possessions, *e.g.*, Puerto Rico, Guam, Commonwealth of the Northern Mariana Islands, U.S. Virgin Islands, and American Samoa). Locality pay is being phased in over three years beginning in January 2010. The current non-foreign area cost-of-living allowances (COLA) is being reduced by 65% of the locality pay rates. Unlike COLA payments, locality pay is part of basic pay for retirement, life insurance, and government contributions to employee Thrift Savings Plans (TSP).

Who is covered by the provisions of P.L. 111-84?

The law covers Federal employees who were eligible for the non-foreign COLA under 5 C.F.R. 591 and employees who were paid an amount equivalent to COLA, under separate authority, by their agency.

As described in more detail below, employees who receive special pay rates established under 5 U.S.C. 5305 are covered differently than other employees.

Does the bill affect those who have already retired?

No, there are no retroactive provisions in the legislation.

Can I choose to continue receiving COLA and not receive locality pay?

No, all employees receiving COLA must transition to locality pay.

What is my locality pay rate going to be?

In 2010, the legislation sets the locality rate in all the non-foreign areas at one third of the Rest of U.S. (RUS) locality pay rate. The current RUS rate is 14.16% and one third of that rate is 4.72%.

In 2011, Federal employees in the non-foreign areas will receive two-thirds of the locality rate approved by the President for each area.

In 2012, Federal employees in the non-foreign areas will receive the full amount of the locality rate approved by the President for each area.

Why is locality pay being phased in over three years?

Locality pay is part of basic pay, so agency payroll costs will increase due to higher retirement contributions, Social Security and Medicare payments, and matching TSP contributions. The three year period spreads the impact over several years and gives agencies time to absorb and budget for these costs.

Will I stop receiving COLA payments after the three-year locality pay phase in?

NO, you will not stop receiving COLA after three years. COLA is being phased out at a rate of 65%. In other words, COLA will be reduced 65 cents for every dollar of locality pay received.

There is no "date certain" when COLA will end, nor can the Office of Personnel Management approximate future locality rates. In the past, locality rates have gone up by roughly 0.5 to 1% per year for different areas, so it is possible that Federal workers in non-foreign areas will be receiving COLA for many years.

COLA rates in Honolulu, Kauai, and Maui Counties were frozen at 25%, so COLA payments will stop in these counties once locality pay hits roughly 38% (25 is about 65% of 38). COLA rates in Hawaii County were frozen at 18%, so COLA payments will stop once locality pay hits roughly 28% (18 is about 65% of 28). The table below provides more information on what locality pay percentages would have to reach before COLA payments stop.

	Frozen COLA Rate	Locality Pay Needed for COLA to End
Alaska		
Anchorage, Fairbanks, and Juneau	23%	35%
Rest if Alaska	25%	38%
Hawaii		
Counties of Honolulu, Kauai, and Maui	25%	38%
Hawaii County	18%	28%
Guam and CNMI	25%	38%
Puerto Rico	14%	22%
US Virgin Islands	25%	38%

What is happening to my COLA rate in 2010?

The legislation specifies that all COLA rates be reduced by 65% of an area's locality pay rate. In 2010, the locality rate for all the non-foreign areas has been set to one third of the Rest of U.S. (RUS) locality pay rate. The RUS locality rate for 2010 is 14.16%, which results in a locality pay rate of 4.72%. The COLA reduction for 2010 is 65% of 4.72%, or approximately 3.07%. This means employees whose COLA rate was 25% in 2009 are receiving approximately 21.93% COLA in addition to 4.72% locality pay in 2010.

Because COLA is calculated on base pay but COLA is not being paid on the new locality pay, the legislation specifies an additional adjustment so that COLA is paid on the original base without locality pay. This requires dividing the reduced COLA by one plus the locality pay percentage (or 1.0472).

Example: 2009 COLA rate of 25% and 4.72 locality rate:
25% - (65% * 4.72) = 21.93% / 1.0472 = 20.94%.

This is done primarily because it easier for payroll purposes to apply the adjusted COLA to the sum of the original base pay plus locality pay than it is to add COLA and locality separately. The effective COLA rate remains 21.93. In other words:
Original base pay + 21.93% COLA + 4.72% locality pay =
(Original base pay + 4.72% locality pay) x 20.94% COLA.

How does this affect postal employees?

Postal employees who would be eligible for locality in the 48 contiguous states, such as Postal Inspectors and employees of the Postal Service Office of Inspector General are covered by the locality pay provisions in the same manner as non-postal employees.

Other postal employees, such as clerks, mail handlers, letter carriers, and postal supervisors, in the non-foreign areas continue to receive Territorial COLA, or T-COLA, at the frozen rate because their mainland counterparts do not receive locality pay. However, the legislation altered the method for calculating T-COLA. When locality pay rates in a non-foreign area exceed the frozen COLA rate, postal employees receive the higher amount as their T-COLA, which continues to be tax exempt and not included in retirement calculations. The cap on the amount of T-COLA an employee may receive has been removed by the legislation.

How will pay be set for Special Pay Rate Employees in Non-Foreign Areas?

COLA rates are applied to the special rate schedules established under 5 U.S.C. 5305. In the contiguous 48 states, special rates are applied to the base general schedule and employees receive the greater of their special rate or the locality pay rate for their duty station. As locality rates increase, the pay differential between special rates and locality pay may decrease, and when the locality pay rate exceeds the special rate, the special rate is eliminated altogether.

During the three-year phase-in period, special rates in the non-foreign areas must be increased by at least the amount of locality pay given to non-special rate employees at the same minimum step. This will maintain the existing differences between regular pay and special pay rates during the phase-in period.

The legislation allows special rates to exceed the Executive Schedule Level (EX) IV pay cap during the three-year phase-in period. At the end of the three years, special rate employees who are above the EX IV pay cap will be put on retained pay.

After the phase-in period, special rates in the non-foreign areas will be treated in the same manner as special rates in the contiguous states – employees will receive the higher of their special rate or the locality pay rate where they work.

Agencies will continue to review special rates and may request special rates be increased as needed for recruitment and retention purposes.

Special rates at the Department of Veterans Affairs will be set in a manner consistent with OPM policy.

Certain Special Rate table rates are affected by the EX IV pay cap. Does the legislation address the cap?

Yes. All special rates are capped at EX IV under 5 U.S.C. 5305(a)(1). The legislation allows special rate employees in the non-foreign areas to exceed the EX IV cap during the three-year phase-in period. At the end of the three year period, employees whose pay (including locality pay) exceeds the EX Level IV cap will be put on retained pay until increases in the cap exceeds the employees' pay.

COLA does not count against the cap, and employees will continue to receive the gradually reducing COLA like other employees.

How are SES, SL, and ST employees affected by the bill?

Senior Executive Service (SES), Senior Level (SL), and Scientific and Professional (ST) positions established under 5 U.S.C. 3104 are not authorized to receive locality pay in the continental United States. Nevertheless, the legislation does provide that employees in these pay plans whose duty station is in one of the non-foreign areas on January 1, 2010, receive the locality pay rate and corresponding COLA for that area as long as they remain in a SES, SL, or ST position in the non-foreign areas. They will no longer receive locality pay if they take a position in the 48 contiguous states.

SES, SL, and ST employees assigned to positions in the non-foreign areas after January 1, 2010, are not eligible for locality payments, as their mainland counterparts do not receive such pay. These employees remain eligible for the offset COLA rate in effect for their duty station in addition to their base pay.

These provisions apply regardless of whether a position is covered by a certified appraisal system.

Have Post Differentials been affected?

Post differentials are based on environmental conditions that differ substantially from the continental United States and warrant an additional allowance as a recruitment incentive, and post differentials are paid only to non-local hires. Post differentials have been approved for Guam (20%), the Commonwealth of the Northern Mariana Islands (CNMI) (20%), American Samoa (25%), and Johnston, Midway and Wake Atolls (25%). Of those areas, only Guam and CNMI receive a COLA, which was 25% in 2009. Total of post differential and COLA cannot exceed 25%, so employees in Guam and CNMI did not receive any of the authorized post differential because of the cap.

This legislation does not directly address post differentials. However, as locality pay is phased in and COLA reduced, employees currently subject to that 25% cap may receive an increased post differential. Additionally, post differentials are calculated on an employee's base pay plus the applicable locality pay rate, so post differentials are increasing as a result of increases in locality pay.

I plan to retire soon and understand there is a buy-back provision. How do I know if I am eligible?

The buy-back provision applies only to employees who retire between January 1, 2010, and December 31, 2012. If you retire outside that three-year window, you cannot participate in the buy-back.

How does the buy-back provision work? What am I buying back?

The buy-back provision allows employees who retire between January 1, 2010, and December 31, 2012, to elect to treat part of their COLA as if it were locality pay, but only up to the amount of locality pay they would have received if locality pay were not being phased in.

The provision is referred to as a "buy-back" provision because if you choose to take advantage of it, you have to pay the retirement contributions you would have paid on the amount of money you treat as locality pay. Most employees under the Civil Service Retirement System (CSRS) will be required to pay 7% on the amount treated as locality pay, while most employees under the Federal Employees Retirement System (FERS) would need to pay 0.8%. You will also be required to pay interest. The current interest rate for these payments is 3.875%. You do not have to pay income Federal income or Social Security taxes on the amount of COLA treated as locality pay.

For most employees who retire during 2010-2012, choosing the buy-back will be highly advantageous. Most employees should recoup their retirement payments with their higher retirement pay within 6 to10 months.

Some examples may help illustrate how the buy-back provision works. These examples use the Rest of the U.S. (RUS) locality rate for 2010 throughout, even though Hawaii and Alaska are expected to have separate, higher locality rates starting in 2011. The current RUS rate 14.16%, so the locality pay rate received by covered employees in 2010 is approximately 4.72% (one third of the RUS rate in the first year).

As an example, if an employee retires on August 31, 2010, and elects to participate in the buy-back, he or she will pay retirement contributions to buy back the 9.44% of locality pay not received as a result of the phase in from January 1-August 31, 2010. When his or her annuity is calculated, the employee will get credit for the full RUS rate of 14.16% during the 8 months of 2010 that he or she worked.

As another example, consider an employee who retires on June 30, 2011. In the second year, again using the 2010 RUS locality rate for simplicity, the locality pay received would be 9.44% (or two-thirds of 14.16%). The employee will be able to pay retirement contributions to buy back the 4.72% not received during the 6 months of 2011 that he or she worked, as well as the 9.44% of locality not received during the entire first year. When his or her annuity is calculated, the employee will get credit for the full RUS rate of 14.16% for all of 2010 and the 6 months of 2011 that he or she worked.

In the third year, employees would get the full locality payment, so they will not need to pay any additional retirement contributions, but they are permitted to continue to opt to buy back their 2010 and 2011 contributions if they retire any time in 2012.

If I retire before the three year window closes, how do I buy-back the rest of my "high-three" years?

You cannot buy back time after you retire, and you cannot buy back time prior to 2010, so there is no way to buy back the rest of the three-year window. Your high 3 years used for your annuity calculation will be increased somewhat by locality pay and the buy-back provision, but only the portion of your high 3 after January 1, 2010, and before you retire will include locality pay.

How does the buy-back affect my "high-three" calculations?

With the buy-back, an employee's "high-three" will be calculated as if he or she had received the full locality rate for the time worked during the three-year buy-back window. If an employee retires on December 31, 2011, and participates in the buy-back, two of the high-three years will reflect full locality pay, with the first year of locality pay at the RUS rate. If an employee retires on December 31, 2012, and participates in the buy-back, all three years of the "high-three" years will reflect full locality pay.

How do I participate in the buy-back?

To participate, contact your human resources office to learn what processes to follow. Remember, you <u>must retire by December 31, 2012, to participate and you must elect to participate before you retire.</u>

You would pay your buy-back contribution at the time you retire. Because you cannot participate in the buy-back unless you actually retire by December 31, 2012, there is no mechanism to withhold payments from paychecks in advance to count towards your buy-back contribution. It is up to you to set aside enough money to pay your contribution at the time you retire.

Most employees under the Civil Service Retirement System (CSRS) will be required to pay 7% while most employees under the Federal Employees Retirement System (FERS) will need to pay 0.8%. (Certain employees such as firefighters and air traffic controllers would be required to pay 7.5% or 1.3%, depending on their retirement system.) You will also be required to pay interest. The current interest rate for these payments is 3.875%. You do not have to pay income Federal income or Social Security taxes on the amount of COLA treated as locality pay. Most employees should recoup their payments with their higher retirement pay within 6 to10 months.