Houston Six Months Into COVID-19

September marks half a year since COVID-19 arrived in Houston. In the early stages, the pandemic cost Houston more than 365,000 jobs. Only about 110,000 have been recouped to date. In a normal year, Houston might create 60,000 to 70,000 jobs, in a boom year, a little over 100,000. A boom is unlikely given the current state of the energy industry. And no one knows what "normal" will look like in a post-COVID world. A full recovery may take several years. Some industries are already well on the way to recovery. These tend to be sectors where the need for social distancing doesn't interfere with their ability to conduct business. Sectors which require face-to-face interaction, however, continue to struggle and will be among the last to regain all jobs lost in the pandemic.

ENERGY

Energy struggled prior to the pandemic. Crude topped $70 per barrel in October '18 then began to drift downward. The U.S. rig count peaked at 1,083 in December of '18. Energy employment plateaued at 238,880 jobs in June of '19. And drillers sank 16 percent fewer wells last year than in '18. Energy's future doesn't look bright. Global oil demand won't return to pre-pandemic levels until '22, according to separate forecasts by the International Energy Agency (IEA), the U.S. Energy Information Administration (EIA) and the Organization of Petroleum Exporting Countries (OPEC). A March survey by the Federal Reserve Bank of Dallas found most exploration firms need West Texas Intermediate (WTI) at $49 per barrel or higher to profitably drill a well. EIA doesn't forecast WTI to reach that level until late in '21. And Rystad Energy doesn't see drilling activity returning to last year's level for at least five years. Additional layoffs are expected as the industry adapts to weak demand and soft prices.

MANUFACTURING

Ninety percent of the losses in manufacturing were in durable goods, i.e., items that are not easily consumed or that wear out quickly. Two-thirds of those losses can be tied to the energy downturn. Fabricated metal products (i.e., pipes, valves, flanges) and oil field equipment manufacturing have cut a combined 9,600 jobs. Without an increase in drilling activity, the jobs are unlikely to return. Chemicals and refining, which employs one in four manufacturing workers in the region, remains a bright spot. The two downstream sectors added 1,100 jobs in the pandemic. The trend should continue as U.S. producers, benefitting from lower cost feedstocks, take market share from producers overseas.

CONSTRUCTION

Nearly one in eight Houston construction workers lost their jobs in the pandemic. Projects were delayed or cancelled, forcing contractors to reduce their payrolls.

A nationwide survey by the Associated General Contractors (AGC) found that 50 percent of its members had at least one project that was already underway halted in March; 38 percent had at least one project halted in April. The market continues to soften. Through July, City of Houston building permits are tracking $900 million (18.4 percent) below last year's pace. Construction starts in the nine-county area are down $3.7 billion (15.3 percent) compared to this time last year. Contractors remain busy because they entered the pandemic with sizable backlogs. But as those backlogs are worked off, few new projects are coming in. Construction will likely see further job losses as the pandemic wears on.

RETAIL TRADE

Retail, like energy, struggled prior to the pandemic. Local employment peaked at 321,600 jobs in December '16 and has ratcheted lower ever since. The sector reported losses in '17, '18 and '19. Earlier in the decade, retail consistently added 5,000 to 8,000 jobs per year. From February to April, retail sales fell $54.1 billion (18.3 percent) nationwide. If not for the $11.8 billon surge in online sales, the decline would have been worse. Local data is not available, but Houston likely experienced a similar trend. Since stores reopened in May, Houston's retail sector has recouped two-third of the jobs lost in March and April. But those gains may be ephemeral. Over 30 national retailers have declared bankruptcy. This includes Brooks Brothers, GNC, J Crew, JC Penny, Lord & Taylor, Pier 1 Imports, Stage Stores, Stein Mart, Sur la Table and Tuesday Morning. It doesn't include the mom-and-pop stores that closed without making headlines. Employment typically surges in the fall as retailers staff up for the holiday shopping season. Any hiring this year will be tempered by the ongoing economic uncertainty.

WHOLESALE TRADE

The pandemic accelerated the shift from brick-and-mortar to online shopping. Stores which were open sold off existing inventory and pared back new orders to conserve cash. Oil field service firms stopped buying new equipment and replacement parts for the same reason. This drop in demand forced wholesalers to scale back their own inventories and reduce payrolls. Signals are mixed as to wholesale's outlook over the next few months. The Wall Street Journal reports cargo shipments from the Far East to the U.S. are on the rise as merchants restock inventories depleted in the pandemic. On the other hand, the collapse in exploration activity continues to stifle any demand for oil field equipment. Wholesale trade will be one of the slower sectors to recoup its pandemic job losses.

TRANSPORTATION AND WAREHOUSING

Passenger traffic through the Houston Airport System (HAS) traffic has improved. Early in the pandemic, it was down 90 percent. Today, traffic is down only 75 percent. Though container volume at the Port of Houston is down 4.5 percent, the total weight of those containers is up 3.9 percent. Shippers, to economize, appear to be packing more cargo into each box. Nationwide, rail traffic is down 15.8 percent through July of this year, according to the American Railroad

Association. The American Trucking Association reports freight volumes are off 8.3 percent. Several air carriers have announced massive layoffs will begin in October without any additional assistance from the federal government. Manufacturing outside of oil and gas has begun to pick up, which should nudge demand for transportation services. And as companies restock inventories, traffic at area ports and intermodal terminals should increase, giving employment a boost.

FINANCE, INSURANCE, REAL ESTATE, & RENTAL

Finance has fared well, with employment at banks, brokerages and insurance agencies now above pre-pandemic levels. Consumers rushing to buy or refinance a home, the opening of dozen or so bank offices and branches, and until recently a hot stock market has helped create finance jobs during the pandemic. This momentum should support additional growth over the coming months. Commercial real estate has struggled, however. The market recorded negative absorption for office, industrial and retail space in the second quarter. Some tenants have adopted a wait-and-see attitude, wanting to assess the impact of the recession on their business before considering new space. Others are struggling to pay their current rent. Brokers have reported an uptick in inquiries in recent weeks, suggesting demand may improve by Q4/20 or Q1/21. Employment in commercial real estate will remain flat until that happens.

ADMINISTRATIVE SERVICES

The sector includes services to buildings (janitors, housekeepers, security guards), employment services (contract workers), and garbage collection. Employment in building services has grown during the pandemic. This is another case of mixed signals. With so many Houstonians working from home, offices don’t need to be cleaned. But if when someone is in the office, it needs to be cleaned more often and disinfected. There’s no mystery in employment services. With sales down, businesses needed to cut costs. Contract workers were the first to go. Growth in employment services depends on the strength and speed of the recovery. Growth in services to buildings depends open how soon Houstonians return to their place of work.

PROFESSIONAL, TECHNICAL & BUSINESS SERVICES

Not knowing the duration of the pandemic, businesses acted quickly to minimize risk and conserve cash. Expansion plans were shelved, mergers put on hold, new product launches delayed, construction projects canceled, and lease negotiations strung out. This impacted professional service firms who provide the due diligence, financial guidance, design services, and technical consulting for these mergers, expansions and projects. Layoffs occurred, but not as deeply as in other industries. Job losses amounted to 3.5 percent of February employment. As economic activity picks up, so will employment in professional services. The sector has already recouped nearly half the jobs it lost early in the pandemic and will likely be among the first to return to pre-COVID employment levels.

HEALTH CARE AND SOCIAL ASSISTANCE

Nearly all the health care losses occurred in outpatient services and social assistance. Dental offices were particularly hard hit since some practices only saw emergency patients and others closed entirely to avoid transmission of the virus and to conserve personal protective equipment. Governor Greg Abbott's order postponing all elective surgeries affected employment early on but TWC's data shows health care has recouped all the jobs initially lost in the pandemic. Social assistance includes community relief services (food, housing, shelter) and day care facilities. Relief services saw a surge, so it's likely that the remaining jobs losses were in day care. Though Governor Abbott allowed certain facilities to remain open thousands more across the state closed when cautious parents decided to keep their children at home. Though the day cares need to reopen so parents can return to work, parents remain reluctant to place their children in them, so many remain closed or operate at reduced capacity.

ARTS, ENTERTAINMENT, RECREATION

Governor Abbott's order directing Texans to minimize all nonessential gatherings and contact with people not in the same household hit this sector especially hard. Amusement parks, bowling centers, fitness centers, museums, racetracks, sports stadiums, theaters and zoos had to close. Employment fell 48.8 percent in March and April. Only clothing and apparel stores saw a bigger percentage drop. The need for social distancing continues to drag on these activities. The Astros are playing without fans in the stadiums. The Texans will adopt a similar model. Some fitness centers have reopened but many remained closed. Bowling alleys and museums have strict social distancing guidelines. A full recovery won't occur until the virus is no longer a threat to public health.

RESTAURANTS AND BARS

Nationwide, restaurant and bar receipts fell $35.3 billion (54.1 percent) from February to April. Locally, the industry laid off 37.2 percent of its workforce. Assuming the worst was over, Governor Abbott eased restrictions in early May, but the damage had already been done. Restaurants and bars lost more jobs than any other sector. The sector is unlikely to see significant job gains in the near term. Governor Abbott has scaled back from 75 percent to 50 percent the capacity that at which restaurants can operate. And according to Yelp, 80 percent of all businesses that were closed in March remained shuttered in June. As with arts and entertainment, full recovery won't occur until the virus is no longer a threat.

HOTELS & ACCOMMODATIONS

Hotel occupancy fell to the single digits during the early days of the pandemic. Typical occupancy is between 60 and 70 percent. Employers banned travel by their employees and consumers opted for staycations and daytrips. Some travel has resumed, but mainly among leisure travelers, who unlike business travelers spend less on hotels and air fares. The sector will continue to struggle until corporations lift travel bans. They may not recover even then as businesses realize they can accomplish as much through a webinar as they can in face-to-face meetings. As with other sectors, a full recovery won't occur until the virus is no longer a threat to public health.

OTHER SERVICES

The sector includes repair shops (automotive, electronic equipment, household appliances), personal care (barber and beauty shops, nail salons, weight loss centers), funeral parlors and cemeteries, dry cleaners and laundries, and membership organizations. The stay-at-home orders forced salons and barber shops to shutter completely during the height of the pandemic. Consumers, worried about exposure to the virus, reduced home repair and maintenance calls. And with no need to dress up while working from home, dry cleaners saw revenues drop. And companies often pare back business and professional memberships to conserve cash in a downturn. The sector will be one of the slowest to recover.

GOVERNMENT

Job losses in the public sector are overstated. Every June and July, the sector drops 20,000 to 25,000 jobs as school districts, community colleges and universities close for the summer. Outside of public education, the government sector appears to have shed about 4,000 jobs. The employment outlook for this sector will depend on how well tax collections hold up as the economy reopens.

The energy job losses layered on top of the pandemic losses have not made Houston worse off than other metros. In fact, Houston is faring better than many of its peers. Houston is the nation's fifth most populous metro. One might assume Houston would rank fifth or higher in jobs lost due to COVID shutdowns and the energy crunch. Houston actually ranks tenth among its peers, with fewer layoffs than less populous metros like Boston, Detroit, Miami, Philadelphia and San Francisco. Metro Houston has also recouped enough jobs to place it closer to its pre-pandemic peak than most of its peers. Houston ranks eighth out of 20 in that regard. Why is energy not a bigger drag? For one, going into the pandemic oil and gas jobs employment was already at its lowest level in 15 years. Second, sectors like finance and insurance, professional services, and health care have held up well, helping to mitigate the job losses in energy. The question for Houston and the other metros will be what jobs do come back when COVID is finally behind us?

The Houston region has received more than $9.4 billion in Paycheck Protection Program (PPP) Loan funding supporting more than 700,000 local jobs, according to an analysis of U.S. Treasury Department data by the Greater Houston Partnership. Restaurants, architecture and engineering firms, and building equipment contractors topped the list of recipients. Over half the loans were made to firms in Houston (8,441), with Spring a distance second (706), and Sugar Land third (466). Three-fourths of the loans (10,627) were made to firms in Harris County, with Fort Bend second (1,176) and Montgomery third (1,098). The analysis excluded loans of less than $150,000, which represents approximately 25 percent of the value of all loans made in metro Houston. The U.S. Treasury does not disclose data on loans below that level to the public.

Federal Reserve Economic Update

Nationally economic activity increased among most Districts, but gains were generally modest and activity remained well below levels prior to the COVID-19 pandemic. Manufacturing rose in most Districts, which coincided with increased activity at ports and among transportation and distribution firms. Consumer spending continued to pick up, sparked by strong vehicle sales and some improvements in tourism and retail sectors. But many Districts noted a slowing pace of growth in these areas, and total spending was still far below pre-pandemic levels. Commercial construction was down widely, and commercial real estate remained in contraction. Conversely, residential construction was a bright spot, showing growth and resilience in many Districts. Residential real estate sales were also notably higher, with prices continuing to rise along with demand and a shortage of inventory. In the banking sector, overall loan demand increased slightly, led by solid residential mortgage activity. Agricultural conditions continued to suffer from low prices, and energy activity was subdued at low levels, with little expectation of near-term improvement for either sector. While the overall outlook among contacts was modestly optimistic, a few Districts noted some pessimism. Continued uncertainty and volatility related to the pandemic, and its negative effect on consumer and business activity, was a theme echoed across the country.

Employment increased overall among Districts, with gains in manufacturing cited most often. However, some Districts also reported slowing job growth and increased hiring volatility, particularly in service industries, with rising instances of furloughed workers being laid off permanently as demand remained soft. Firms continued to experience difficulty finding necessary labor, a matter compounded by day care availability, as well as uncertainty over the coming school year and jobless benefits. Wages were flat to slightly higher in most Districts, with greater pressure cited among lower-paying positions. Some firms also rescinded previous pay cuts. Others, however, have looked to roll back hazard pay for high-exposure jobs, though some have chosen not to do so for staff morale and recruitment purposes.

Overall U.S. Economy Is Recovering Faster Than Economists Expected

The U.S. economy and labor market are recovering from the coronavirus-related downturn more quickly than previously expected. Business and academic economists polled by The Wall Street Journal expect gross domestic product to increase at an annualized rate of 23.9% in the third quarter. That is up sharply from an expectation of an 18.3% growth rate in the previous survey. "I have been encouraged that many of the economic indicators have come in above consensus, perhaps suggesting that the U.S. economy is bouncing back stronger than expected," said Chad Moutray, chief economist for the National Association of Manufacturers. "With that said, there continue to be lingering challenges, especially in the labor market and with uncertainties surrounding Covid-19 outbreaks." A rebound in growth in the third and fourth quarters isn't expected to make up for ground lost earlier in the year. GDP shrank at a 31.7% annual rate in the second quarter and declined at a 5% pace in the first. The projected rebound for the third quarter would recoup about half of the output lost in the first half of the year. To return to the previous peak recorded in the final quarter of last year, the economy would need to grow at a roughly 24% rate again in the fourth quarter of this year. Economists see that as unlikely: Their forecast for fourth-quarter growth is for a 4.9% annual rate, suggesting the recovery will be protracted. The average forecast called for GDP to shrink 4.2% this year, measured from the fourth quarter of 2019, an improvement from the 5.3% contraction predicted in last month's survey. Nonetheless, the U.S. economy would still be on track to contract in 2020 by the most since contemporary records began in 1948, as measured from the fourth quarter of the prior year. By comparison, in the fourth quarter of 2008—during the financial crisis—GDP contracted just 2.8% from the prior year. Economists continue to believe that the economy is already in a recovery following a recession that the National Bureau of Economic Research determined began in February. Some 82.4% of economists said the recovery started in the second or third quarter of this year, broadly unchanged from last month's survey.

Economists also see faster improvement in the labor market, after employers added 1.37 million jobs to payrolls last month. The unemployment rate fell below 10% in August for the first time since March to 8.4%, and economists now expect the jobless rate to tick down to 8.1% in December. Last month, they expected a 9% unemployment rate at the end of this year. The more optimistic outlook came with caveats, however, many of them related to the outlook for containing Covid-19 and developing an effective vaccine. "A second wave of the coronavirus, escalating tensions with China, contested elections, civil unrest and insufficient fiscal stimulus could be a toxic cocktail that pushes the economy into a second dip" in the fourth quarter, said Philip Marey, senior U.S. strategist at Dutch lender Rabobank. One concern is that a recent reduction in federal jobless benefits could dent consumer spending in the months ahead. President Trump signed an executive action to provide an extra $300 a week in federally funded jobless benefits, less than the extra $600 a week payment that was in place from April through July. Nearly half of economists surveyed—49.1%—expect the reduction in jobless benefits to dent consumer spending and retail sales in September, while 27.3% expect to see the impact in data for August. Just 12.7% of economists expect the decreased benefits won't hurt consumer spending, although some said they expect the impact to be mild. An overwhelming majority of economists surveyed in August said the economic rewards of additional jobless benefits for laid-off workers outweighed concern that the extra payments could deter people from going back to work. Still, lawmakers are at odds over the size and content of another package of relief measures, such as additional jobless aid. Talks between Republicans and Democrats over fresh coronavirus aid remain at a standstill, as both parties blame the other for the lack of progress over the summer. The Wall Street Journal surveyed 62 economists from September 4-8, though not every economist answered every question.

U.S. Unemployment Rate Fell to 8.4% in August as Hiring Continued

Unemployment fell sharply in August and hiring gains moderated, as the U.S. economy continued to recover from the steep downturn triggered by the coronavirus pandemic.
Employers added 1.4 million jobs last month, helping push down the unemployment rate to 8.4% from 10.2% in July, Friday's Labor Department report said. The jobless rate's decline—it has dropped from near 15% in April at the beginning of the pandemic—put it below the peak from the 2007-2009 recession. That puts unemployment in line with past major recessions, though it is significantly higher than pre-pandemic levels. The jobless rate stood at 3.5% in February, a half-century low, just ahead of the coronavirus crisis.
State re-openings of their economies helped boost employment this summer, but the gains have cooled in recent months. The economy is operating with about 11.5 million fewer jobs than in February. Economists expect the initial hiring spurt from business re-openings to ease as state restrictions are lifted at a slower pace than earlier in the summer. Further, the number of unemployed individuals saying their layoffs are permanent rose last month to 3.4 million, a headwind to the pace of recovery in future months. Still, the number of unemployed individuals saying their layoffs were temporary declined to 6.2 million in August from 9.2 million in July, indicating many employers are bringing back workers. Retail and government hiring helped drive August's jobs gains. Super centers and home improvement stores have seen employment increase during the pandemic, and other types of retailers, including department and furniture stores, are seeing a rebound after a deep decline. Meanwhile, Census hiring boosted federal jobs while state and local employment has held up relatively well as the school year gets under way. Financial markets were mixed. U.S. Treasury yields rose after the better-than-expected jobs news, while stocks continued a selloff in a volatile session. Federal Reserve Chairman Jerome Powell said Friday's report was good news but that the economy was likely to require low interest rates for years. Unemployment rates for Black, Hispanic and white workers fell in August, while holding steady for Asian workers, the Labor Department said. Joblessness is lowest among white Americans—7.3%—and remained above 10% for Black, Hispanic and Asian workers, pointing to divergent economic outcomes from the pandemic. The unemployment rate for those without a high-school diploma was 12.6%, while workers with a bachelor's degree or higher were unemployed at a 5.3% rate.
The share of Americans working or seeking work rose in August to 61.7% from 61.4% in July and a pandemic low of 60.2% in April. More individuals looking for work bodes well for job growth and the broader economic recovery. Several large companies have warned of job cuts in recent days, a sign the labor market could face uneven performance this fall.
United Airlines Holdings Inc. said Wednesday it plans to cut 16,370 staff amid a pandemic-driven slump in passenger demand. Coca-Cola Co. said last week it plans to lay off some employees. Economists say new company layoffs reflect a shift in employers' mentality from earlier in the crisis, when many expected shutdowns would be over in a matter of weeks. Some companies that reopened in late spring and early summer hired back a portion of their furloughed workers but aren't seeing enough demand to bring employment back to precrisis levels.

Job Cuts in 2020 Surpassed 2001

Job cuts announced by U.S.-based employers in August totaled 115,762, 116% higher than the August 2019 total of 53,480, according to a monthly report released by global outplacement and business and executive coaching firm Challenger, Gray & Christmas, Inc. August's total is 56% lower than the 262,649 job cuts announced in July. It is the highest total in August since 2002, when 118,067 job cuts were announced. So far this year, employers have announced 1,963,458 cuts, 231% higher than the 592,556 cuts tracked in January-August of 2019. Announced job cuts in 2020 have surpassed the previous record annual total of 1,956,876 recorded in 2001. "The leading sector for job cuts last month was Transportation, as airlines begin to make staffing decisions in the wake of decreased travel and uncertain federal intervention. An increasing number of companies that initially had temporary job cuts or furloughs are now making them permanent," said Andrew Challenger, Senior Vice President of Challenger, Gray & Christmas, Inc. Transportation companies announced 26,545 cuts in August. Although this was 59% lower than the 65,093 cuts announced in July, it is 647% higher than the 3,554 cuts announced in August 2019. So far this year, the sector has cut 131,571 jobs, a 482% increase over the 22,593 cuts announced in January-August 2019. Entertainment/Leisure companies, including bars, restaurants, hotels, and amusement parks, posted the second-highest number in August, with 17,271 job cuts, bringing the year-to-date total in that industry to 799,051. That is 8,128% higher than the 9,711 cuts reported in January-August 2019. Retail companies posted job cuts through August at 168,403, 194% higher than the 57,226 cuts through August 2019. Companies announced 160,411 hiring plans in August. Entertainment/Leisure led with 45,575 hires, followed by Construction, which plans to add 31,052 jobs. "The employment landscape is dealing with a host of burdens that reach beyond job cuts. COVID-19 and the recession continue to cause volatile conditions in many industries," said Challenger. "Both companies and workers are grappling with increasing uncertainty due to stalled economic relief, the approaching election, and child care and education concerns. This is undoubtedly impacting talent management concerns," said Challenger. "Many employees hesitate to return to the job force out of fear of exposure to COVID. Parents are trying to determine if they can safely send their children back to school or daycare, or if they need to facilitate remote learning. In some cases, working parents do not have a choice," he added.

U.S. Job Openings and Labor Turnover

The number of job openings increased to 6.6 million on the last business day of July, the U.S. Bureau of Labor Statistics reported. Hires decreased to 5.8 million in July. Total separations were little changed at 5.0 million. Within separations, the quits rate rose to 2.1 percent while the layoffs and discharges rate decreased to 1.2 percent. These changes in the labor market reflected an ongoing resumption of economic activity that had been curtailed due to the coronavirus (COVID-19) pandemic and efforts to contain it.

Job Openings - On the last business day of July, the number and rate of job openings increased to 6.6 million (+617,000) and 4.5 percent, respectively. Job openings rose in a number of industries, with the largest increases in retail trade (+172,000), health care and social assistance (+146,000), and construction (+90,000). The number of job openings increased in the South and Midwest regions.

Hires - In July, the number and rate of hires decreased to 5.8 million (-1,183,000) and 4.1 percent, respectively. Over the year, the hires level was little changed. Hires decreased in a number of industries, with the largest fall in accommodation and food services (-599,000), followed by other services (-143,000), and health care and social assistance (-137,000). Hires increased in federal government (+33,000), largely because of Census hiring. Hires also increased in real estate and rental and leasing (+26,000).

Separations - Total separations includes quits, layoffs and discharges, and other separations. Quits are generally voluntary separations initiated by the employee. Layoffs and discharges are involuntary separations initiated by the employer. Other separations includes separations due to retirement, death, disability, and transfers to other locations of the same firm. In July, the number and rate of total separations was little changed at 5.0 million and 3.6 percent, respectively. Total separations increased in retail trade (+112,000) and in state and local government education (+49,000). The number of total separations decreased in durable goods manufacturing (-44,000). Total separations were little changed in all four regions. In July, the number and rate of quits increased to 2.9 million (+344,000) and 2.1 percent, respectively. Quits increased in retail trade (+152,000), professional and business services (+98,000), and state and local government education (+35,000). The number of quits increased in the Midwest and West regions. The number and rate of layoffs and discharges decreased to 1.7 million (-274,000) and 1.2 percent, respectively in July. The layoffs and discharges level decreased in durable goods manufacturing (-40,000), transportation, warehousing, and utilities (-40,000), and wholesale trade (-21,000). The number of layoffs and discharges decreased in the Northeast and South regions. The number of other separations were little changed in July at 337,000. Other separations increased in a few industries, with the largest increases in transportation, warehousing, and utilities (+35,000) and state and local government education (+16,000). Other separations decreased in health care and social assistance (-22,000). Other separations were little changed in all four regions.

Net Change in Employment - Over the 12 months ending in July, hires totaled 70.2 million and separations totaled 78.5 million, yielding a net employment loss of 8.2 million. These totals include workers who may have been hired and separated more than once during the year.

Benefits & Compensation Considerations When Rehiring

As many employers are on the way to normalizing their business practices and re-engaging their employees, they should not overlook the many potential pitfalls in the administration of their retirement, health and welfare plans and their executive compensation arrangements. The risks of missteps are high, and include loss of tax-qualification of retirement plans, penalty taxes in connection with the Affordable Care Act's (ACA) employer mandate rules, other IRS penalties, employee lawsuits and Department of Labor enforcement actions. The following summarizes key employee benefits and executive compensation considerations as employers reopen and rehire during the COVID-19 pandemic.

Ensure Eligibility Determinations under Retirement and Health & Welfare Plans are Correctly Implemented - When employers started to put employees on furlough, many employers desired to continue benefits for these individuals. Before doing so, employers should have made certain that their coverage of these employees was consistent with the provisions contained in their plan documents. This is equally true for the reinstatement of these individuals to active employment. *This means that the official plan document must provide clear rules on eligibility but so too should ancillary documents* such as benefits guides, summary plan descriptions and other employee communications.

Qualified Retirement Plans - *401(k), 403(b) and Defined Benefit Plans*. Generally speaking, an employee on a furlough will be treated as though they are on an unpaid leave. Thus, when returning to work, there will be no break in participation under a qualified retirement plan. With respect to a terminated employee, if the employee was a participant before their termination they must be eligible to participate on the date of their rehire. In either case, the plan may have rules relating to service crediting, however, that could limit the service that is credited to employees for periods they are not working. Significantly, there could be a plan rule that might cause a "break in service" to occur in a year in which less than 500 hours of service is credited to a participant.

> *Automatic Enrollment* - Generally, absent plan language to the contrary, an eligible rehired employee will be automatically enrolled at the plan's default deferral percentage if an affirmative election is not made on a timely basis.
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> *Loans* - Employers should review their payroll systems to ensure that loan repayments properly continue for employees returning from furlough. Loan payments may have been suspended during the furlough period but these payments should re-commence on return to work. This is especially important because the Coronavirus Aid, Relief, and Economic Security (CARES) Act permits employees to suspend loan repayments until December 31, 2020.

Equity Incentive Plans - Many employers provide their executive employees with equity-based compensation in the form of restricted stock or restricted stock units, stock options, stock appreciation rights and other grants or awards where the employer's stock is either granted or is used to determine the value of the awards. Typically, such grants or awards will have vesting provisions that can be time-based or performance-based, but in most cases will have a provision that calls for the termination or forfeiture of the grant or award at the time the grantee's employment terminates if the award is not vested at that time, and may also provide for termination (particularly in the case of options) at some specified date following termination of employment, even if the award is already vested.
While these type of compensation arrangements are subject to some regulatory schemes, and may (as in the case of options that are meant to be "incentive stock options") also be subject to varied tax treatment that is linked to the grantee's status as an employee, there is a great deal of latitude in how these types of grants and awards

can be handled with respect to furloughed employees. A critical issue to consider is whether the plan under which these grants or awards are issued has provisions that are relevant specifically to a furlough or temporary leave of absence. Equity compensation plans generally have provisions relating to terminations of employment with different provisions applicable based on the type of termination (*e.g.*, for cause, without cause, death or disability). The plan may not, however, speak to how furloughs and temporary leaves are treated. It is, therefore, very important for employers to review their plans and the award documents to determine if the treatment of these grants and awards is consistent with what would make the most sense, would preserve the purposes of the plan as part of the employer's overall compensation program and promote the employer's best interests in light of the circumstances the COVID-19 pandemic has created. If the provisions of the plan or award documents would lead to a result that is undesirable, there may be (and typically there are) provisions in the plan that permit amendments to the plan itself or to award agreements that may be helpful and appropriate. Considerations for an employer in this situation would include the following:

- What happens to vesting provisions during a leave of absence, and is a COVID-19 furlough within the scope of such provisions.
- If amendment of the plan is desirable, who must amend, and are there any requirements (such as shareholder approval) that must be met.
- Who has the authority to amend specific award agreements, and could the amendment cause the award to be treated differently for tax purposes – such as triggering concerns under Section 409A of the Internal Revenue Code, or causing an "incentive stock option" to be treated as a nonqualified stock option.

Health & Welfare Plans

Employees Terminated from Employment

- If the employee is rehired within 13 consecutive weeks from their termination of employment, and the employee was participating in the medical plan before their employment was terminated, the ACA mandates that the employee be re-enrolled in the plan on the date of their rehire.
- If the employee is rehired after a 13-week absence, the employee is treated as a new employee, and their eligibility will be determined by the terms of the plan document. However, note that, if on the date of rehire the employee is reasonably expected to average 30 or more hours per week, the employee must be eligible for the medical plan no later than 90 days following the date of rehire.

Furloughed Employees

- If the employee is a full-time employee on their date of rehire, the employee will likely be eligible to participate in most, if not all, health and welfare plans with no waiting period.

Determination of Full-Time Status - An employer may use either a "monthly measurement method" or a "lookback" method to determine whether an employee is classified as a full-time employee for ACA purposes. If the lookback method is used, this means that the employer measures an employee's hours for a particular period and if the hours justify full-time status, then the employee retains that status throughout a subsequent "stability period" (which most commonly is a plan year). For this reason, where an employer uses a lookback measurement period to determine eligibility under the *medical plan*, provided the employee was in a stability period at the time they were furloughed (during which they were considered to be a *full-time employee*), the ACA stipulates that the employee should have retained their full-time status during the furlough period, even if the employee was not paid during this period. In other words, if the full-time employee was enrolled in coverage on the date they were furloughed, they should have continued to be enrolled in coverage during the furlough period (assuming all applicable premiums were timely paid). Such an employee will continue to be enrolled in coverage following their rehire until at least the end of the current stability period. If the employer does not use a "lookback" method but instead measures full-time status for plan purposes on a monthly basis, then the employer would have had more flexibility to consider furloughed employees eligible or ineligible for benefits during the furlough period. Upon a return to work, if working a full-time schedule, the returning employee should be offered medical benefits.

Plan Document Controls - Notwithstanding the above-mentioned ACA rules, the plan document determines when an employee is eligible to participate in the plan. Employers should consider amending their health and welfare plans to achieve desired results for rehired employees.

New Rules for Cafeteria Plan Elections - IRS Notice 2020-29 suspended long-standing federal regulations that limit when an employee can make mid-year changes to employer-sponsored health coverage. The new rules allow employers to amend their Section 125 plans (known as flexible benefits plans or cafeteria plans) to permit mid-year changes to coverage for the 2020 plan year, regardless of whether the change is permitted under the existing IRS regulations.

How to Appropriately Report Furloughed and Laid-off Workers to IRS on Forms 1094-C and 1095-C for ACA Purposes - Many employers will likely incorrectly report the status of furloughed workers on their Forms 1094-C and 1095-C—and the IRS penalties can be significant. Generally, furloughed employees are *not* considered terminated during their furlough. This means that code '2B' (employee was not a full-time employee), and not code '2A' (employee was not employed during the month), should be used on Form 1095-C, line 16, in each month of the furlough during which the employee was not offered healthcare coverage. However, where the employer uses a lookback measurement period to determine eligibility, and the employee was considered a full-time employee during the furlough period, employers should use the applicable safe harbor code on Form 1095-C, line 16, in each month of the furlough period. There are many exceptions to the reporting rules stated above. For that reason, employers should consult legal counsel when preparing ACA Forms for 2020.

Other Service Crediting Issues for Re-Engaged Workers - Employers must pay close attention to the vesting and benefit accrual language in their retirement plan documents as it relates to rehires and those returning from a furlough. For example, if vesting and/or benefits accrue on an elapsed time basis, and the furloughed employee did *not* incur a break in service during the furlough period, then the furlough period will be counted towards vesting for that individual. With respect to breaks in service, a furloughed or terminated employee may have incurred a break in service under the retirement plan during their absence. For example, many retirement plans state that a participant incurs a break in service if the participant is credited with less than 500 hours of service during the plan year. If the participant incurred a one-year break in service, that may impact the participant's ability to accrue benefits or an additional year of vesting under the plan.

The Impact of New COBRA Rules for Returning Workers - The DOL issued guidance that suspends election and payment deadlines through the "outbreak period." This period lasts from March 1 through the 60th day following the expiration of the national emergency declaration. Claims should not be denied during these periods, but employers are permitted to pay them retroactively when coverage is elected and paid for. Different insurance companies and third-party administrators of health plans construe these rules differently, with some allowing claims to be "pended" (neither approved nor denied) during periods of non-payment. COBRA notices revised by the DOL after it issued this guidance do not address these suspension issues. Therefore, plan fiduciaries should provide additional notices to COBRA beneficiaries. Avoiding 409A Penalty Taxes in Connection with an Arrangement that includes Separation from Service Provisions Under Code Section 409A, there is no separation from service on account of bona fide leave of absence if the period of such leave does not exceed six months, or if longer, so long as the individual retains a right to reemployment with the employer under an applicable statute or by contract. Furloughs create an odd situation as there is often an intention to re-employ workers but no right to re-employment. Therefore, if an employee is on a furlough that exceeds six months, the 409A rules may require that the employee is considered to be separated from service, which could trigger a plan payout.

Necessary Retirement, Health and Welfare Plan Amendments - In order to meet an employer's business needs, it may be necessary for employers to amend their retirement and health and welfare plan documents. The following are a few examples of when an amendment is necessary:

- If an employer does not want to credit service for purposes of retirement plan vesting or benefit accrual during a period of furlough;
- If an employer wants its group health plans to cover "return-to-work" COVID-19 screenings;
- If an employer wants to amend its cafeteria plan to reflect the aforementioned changes set forth in Notice 2020-29 (note: plan sponsors that adopt any of these new rules must amend their plans to reflect the temporary relief, which is only available during 2020. The amendment must be adopted by Dec. 31, 2021, and may be retroactive to Jan. 1, 2020); or
- If an employer wants to reduce employee benefit plan benefits, including 401(k) match benefits. Note that many special considerations apply when considering whether to reduce benefits under a retirement plan, especially if the employer wants to reduce or eliminate an employer matching contribution midyear.

Expense Reimbursement Amidst the New Work-From-Home Normal

In Mid-March, much of the nation's workforce began working from home due to the COVID-19 pandemic. With this unprecedented shift in working habits, employers may be overlooking business-related expenses being incurred by their employees. For example, employees may now (and for the foreseeable future) be incurring expenses related to printer paper, pencils, pens, cell phone expenses, home internet bills, etc. These are not typical expenses that employers would reimburse. However, because of the "new normal" of working from home, employers must vigilantly analyze the types of expenses their employees are incurring for business-related purposes and provide reimbursement accordingly. Employers should also reassess their employee reimbursement policies in order to ensure they remain compliant. Expense reimbursement lawsuits were already commonplace before the pandemic, and with no end in sight to the pandemic and employees working from home, employers can expect additional lawsuits to be filed.

Where does an employer's obligation to reimburse employees working from home come from? Under the Fair Labor Standards Act ("FLSA"), an employee is entitled to reimbursement of expenses incurred on the employer's behalf if that expense brings the earnings of an employee below the federal minimum wage. Several states have also enacted their own expense reimbursement laws that either meet or exceed the standard set forth in the FLSA.

Which states have employee expense reimbursement type laws separate from the FLSA?
Alaska, California, Illinois, Indiana, Iowa, Kentucky, Massachusetts, Michigan, Minnesota, Montana, New Hampshire, New York, North Dakota, Pennsylvania, South Dakota, and Washington, DC all have enacted statutes which bear on expense reimbursement. Some states (like California, Illinois, and Montana) have more robust reimbursement laws in that employers are required to reimburse employees for all "necessary expenditures or losses" or "business expenses" incurred by the employee in direct consequence or discharge of his or her duties. Other states (like Alaska and Arkansas) require reimbursement only if equipment purchased by employees for work-related purposes "cannot be used during normal social activities of the employee" or if the purchase/expense would bring the employees compensation "below minimum wage."

Does an employer have to reimburse an employee that is not required to work from home but chooses to do so? No, an employer is not typically required to reimburse an employee for business-related expenses when they are neither required nor encouraged to work from home. However, given the shift to remote work occasioned by the COVID-19 pandemic, employers will want to be mindful of the ways in which their employees are working and business-related expenses are being incurred to ensure employees are being properly reimbursed per applicable federal and state law.

What types of expenses should employers be reimbursing that they might not have before COVID-19? With employees having historically worked in an office environment, many of the supplies and resources they utilized to complete their job duties were provided for by the employer (i.e., printer paper, pens/pencils, computers, electricity, computer monitors, internet, phones, etc.) Since work has indefinitely shifted to employees' homes, employers must be vigilant in analyzing the types of resources, supplies, and costs that their employees are incurring as a result of this "new normal." Employers should consider reimbursing costs such as a reasonable percentage of use for things like home electricity, personal cell phones, printer paper, pens/pencils, etc.

What constitutes a reasonable reimbursement amount? An employer is likely not responsible for the entire personal cell phone bill of an employee simply because that employee uses his/her personal cell phone for work purposes. Rather, an employer should assess on a case-by-case basis the expenses incurred by an employee and make a reasonable determination as to what the proper level of reimbursement is for the expense claimed. It should be noted that what constitutes "reasonable" is a fact specific exercise and that employers should approach each employee reimbursement request as such. An employer will want to maintain records as to reimbursements made to employees and the rationale behind those reimbursement amounts.

Can an employer pay a flat sum per month to employees for reimbursement of business-related expenses? The safest way to monitor employee reimbursements is to provide them on a request-by-request basis. However, there are some costs that employers know employees will incur on a monthly basis and so it may make sense to provide a reimbursement on a more periodic basis. If an employer knows that an employee will regularly incur a certain business-related/work-related expense, it can choose to increase that employee's salary to cover the costs of those expenses. This can be tricky, however, as the employer must be sure to document/identify the amount of compensation attributable to the expense actually incurred. If providing employees reimbursements on a periodic basis, an employer should perform an analysis to ascertain an amount of reimbursement that is adequate to cover the actual expense incurred by the employee.

Can an employer require employees to submit reimbursement requests within a certain timeframe? Employers should have a written reimbursement policy that requires employees to submit reimbursement requests by a certain deadline after the expense is incurred. This will help combat employees sitting on reimbursement requests for months or years, but ultimately the deadline to submit a reimbursement request will depend on state specific laws where they exist. For example, California allows an employee up to three years to submit a reimbursement request.
The employee never told us about the expense, am I still required to provide a reimbursement? Generally, the burden is on the employer to make sure employees are getting reimbursed for business-related expenses.

What should I be doing as an employer with regard to employee expense reimbursement amidst the COVID-19 pandemic? Given that many employees have shifted to working from home, employers should establish or revamp their reimbursement policies and make sure that their employees are aware that they can secure reimbursement of their expenses. Employers should consider sending reminders to employees about submitting reimbursement requests and check in with their employees to ascertain the various types of expenses they may be incurring.

Mandatory COVID-19 Vaccines: Coming to a Workplace Near You?

Six months into the COVID-19 pandemic in the United States, everyone is looking for hopeful signs that life can return to "normal" on any level. Encouraging news reports indicate that the race to develop a COVID vaccine is progressing, with hopes that one will receive approval and become commercially available by early in 2021. With a vaccine comes some difficult questions for employers. Can employers mandate a vaccine as a condition of employment? Even if they can do so legally, should they? Can employers mandate a vaccine? Probably, but with exceptions. Private employers likely have the legal right to require employees to obtain a COVID vaccine as a condition of employment. For years, many employers in high-risk workplaces (e.g., hospitals and nursing homes) have required their employees to obtain an annual flu vaccine. This does not pose problems in the ordinary course. Given the estimated 180,000+ Americans who have died from COVID, it seems unlikely that lawmakers will enact legislation that would preclude employers generally from mandating a COVID vaccine. With that said, employers may also have a legal duty under the Americans with Disabilities Act to allow certain employees to opt out of the vaccine. For example, given the speed with which the vaccine candidates are moving through clinical trials, employees in high-risk categories may receive advice from their health care providers not to receive the vaccine at least initially until the complications are better understood. Alternatively, perhaps young, healthy employees who are at relatively low risk from COVID may obtain notes indicating that the vaccine is not necessary for their own health. If employees request an accommodation from an employer's COVID vaccine mandate, the employer will need to determine whether the accommodation is a reasonable one and whether it imposes an undue burden on operations and on the health and safety of coworkers. As with all ADA accommodation requests, employers will need to carefully consider the facts on a case-by-case basis. Additionally, employees may object to the vaccine on religious grounds. Again, employers must balance employees' right to be free from religious discrimination against the burden that the accommodation would create in the workplace. (Note that the Supreme Court has stated that employers have less obligation to accommodate employees' religious objections than their medical needs. In religious discrimination cases, the employer can deny the request if it imposes more than a minimal burden on the business.) Should employers mandate a vaccine? It depends. As the legal rules above suggest, implementing a mandatory vaccine program will likely require employers to devote considerable time and energy to the program. In addition to dealing with accommodation requests, employers will need to decide questions such as:

- Who pays for the vaccine? (Many employers and insurers subsidize employee flu shots and provide them on-site to minimize the burden on employees. However, it remains to be seen how expensive a COVID vaccine will be and whether the government will issue any rules on how it is allocated in the early going.)
- How should employees prove they received the vaccine?
- Assuming the vaccine eventually wears off, how frequently will employees be required to get the vaccine?
- Do remote-work employees need to get vaccinated?

In addition, employers who mandate a vaccine will need to consider the potential liability that arises from doing so. What happens if an employee has a severe reaction to the vaccine and then argues that he would not have gotten the vaccine except that his employer required it? Could the employer be held liable because of the mandatory vaccine policy? It's difficult to say right now, but employers cannot simply ignore this possibility. Ultimately, this will likely involve risk balancing. For employers that cannot effectively socially distance and those who work with high-risk populations, a mandate probably makes sense to minimize the risk of a COVID outbreak. (For example, imagine a nursing home not requiring a vaccine and then experiencing a spread of COVID through its elderly population. Hindsight being 20/20, it would be easy to say that the employer should have mandated a COVID vaccine.) For other employers, the risks may outweigh the benefits, especially in the first few months after a vaccine is released.

Sources: Littler; Houston Chronicle; Greater Houston Partnership; Wall Street Journal; Associated General Contractors of America; Federal Reserve; IHS Markit; Reuters; Houston Business Journal; U.S. Bureau of Labor Statistics; Challenger, Gray, & Christmas; Washington Post; Salary.com; Hunton, Andrews, Kurth; National Law Review; Baker Hostetler