



## **MEMORANDUM**

**To:** Kurt Triplett, City Manager

**From:** Kyle Butler, Financial Planning Supervisor

**Date:** October 10, 2020

**Subject:** HEALTHCARE PROGRAM UPDATE

## **BACKGROUND**

In April 2015, the City of Kirkland implemented an innovative employee healthcare program, the Healthy Kirkland Initiative. The objectives of the program were to improve employee health while mitigating the rising cost of health care and to avoid liability under the Affordable Care Act "Cadillac Tax". The "Cadillac Tax" is now fully repealed as of December 20, 2019 and will not go into effect, nevertheless, the Healthy Kirkland Initiative has realized successes in improving employee health and managing growth in health care costs. In December 2015, the City Council received a comprehensive briefing on the evolution of the City's program and this memorandum will summarize some of the highlights of that report and provide an update on the program's impact on the budget since that point in time. The full 2015 briefing (170 pages including attachments) is available on the City's website at: [https://www.kirklandwa.gov/Assets/City+Council/Council+Packets/120815+SpecMtg/3a\\_StudySession.pdf](https://www.kirklandwa.gov/Assets/City+Council/Council+Packets/120815+SpecMtg/3a_StudySession.pdf)

The background that follows is a description of the initiative and the plan design excerpted from the 2015 briefing:

### **The Healthy Kirkland Initiative**

The City opted for a "full systems approach" dubbed the Healthy Kirkland Initiative that included:

- 1) individual economic incentives to better empower individuals to make more informed medical decisions and improve the likelihood of health savings;
- 2) increased market transparency so employees could be more informed in those decisions;
- 3) unlimited primary care services, free to employees and qualified dependents, to promote proactive healthy behavior, and ensure participants had ample opportunity to get the critical on-demand primary care necessary to help ensure healthier lives.

Each element of the Initiative has been done successfully somewhere in the United States. What differentiated the City's new approach was not so much the implementation of any of these ideas separately as isolated efforts to improve care. Rather what was unique to the City's strategy was implementing each of these elements together, at the same time, as *interdependent* parts of a full health care delivery system.

## How Does the Healthy Kirkland Initiative Work?

### *High Deductible Health Plan*

First, the City moved to a high deductible health plan. Establishing a high deductible framework created the necessary structure to incorporate real economic decision making to everyone participating in the new plan. With a high deductible plan, participants are required to pay a much larger portion of their initial health costs, emphasizing the need to make informed decisions on nearly every element of their care.

### *HRA VEBA*

To offset the new financial exposure to employees, the City created an expansive Health Reimbursement Voluntary Employee Benefits Association (HRA VEBA) benefit contribution, essentially matching annually the cost of the entire deductible for both individuals and families. HRA VEBA's, unlike traditional HRA's, are savings accounts that stay with employees and eligible dependents and accumulated account balances roll over from year to year. With this new approach, employees are given both a new economic exposure (the higher deductible) combined with a new financial incentive to save (the HRA VEBA contribution). In order to fully match the annual cost of the high deductible as part of their HRA VEBA contribution, however, most employees and their spouses/domestic partners have to complete a wellness incentive program. These activities include a biometric screening, health risk assessment, visiting with a health provider and meeting with a health coach.

<b>Financial Exposure</b>		
	<b>Healthy Kirkland Plan</b>	
	<b>Employee Only</b>	<b>Family</b>
Deductible	1500	3000
<b>Out-Of Pocket Max</b>	<b>2500</b>	<b>5000</b>
VEBA Contribution	1200	2400
Wellness Contribution	600	600
<b>Total VEBA Contribution</b>	<b>1800</b>	<b>3000</b>
<b>Maximum Exposure</b>	<b>700</b>	<b>2000</b>

Thus, the new framework provides an incentive to engage in healthy behavior and make more judicious decisions regarding the utilization of care, supporting the notion put forth by economist Milton Friedman when he stated "nobody spends somebody else's money as carefully as they spend their own."

### *Vera Whole Health Near Site Primary Care Clinic*

The final element of the full systems approach was the creation of a near site primary care health center, free to employees and qualified dependents. The City chose Vera Whole Health Services as the operator of the health center. The Kirkland Vera clinic is located in the Totem Lake area, just a short drive from the Evergreen Hospital Emergency Room. Parking at the facility is free, and it is open to employees and their family members who are enrolled in the City's health plan. The health center provides preventative and same day

acute care (immunizations, check-ups, limited prescriptions, etc.) along with behavioral and lifestyle health coaching, all at no cost to the employee. The health professionals at the clinic provide care that includes both coaching and education, so employees can schedule appointments for a variety of preventative and acute services, as well as wellness and nutritional consultations. Finally, Vera was chosen as the clinic provider because it provides reciprocity among its clinics. Kirkland employees and qualified dependents can visit any Vera clinic for free. Currently there are several clinics in Seattle and a clinic in Everett in addition to the Kirkland location and as more clinics are added, access for Kirkland employees and their families to high quality, free health care will only increase.

The health center is a critical component of the entire system. The reasons for this are several. First, because primary care is free to employees and convenient, employees and qualified dependents have a powerful financial incentive to use the clinic to save their HRA VEBA balances and be more active in maintaining their health. Second, because the operation of the clinic is informed by an employee advisory group, the quality and availability of care is part of a participatory process that encourages employee engagement and oversight. Finally, because the Vera model involves unlimited free access to a health coach, the clinic could become a catalyst for cultural change at the City that promotes more healthy proactive living as part of the employment experience.

Each element of the Healthy Kirkland Initiative taken alone would likely be an important improvement to an existing health care plan. Taken together and implemented as part of a comprehensive system however, each element is enhanced to realize much more of its full potential providing entirely new opportunities for participants to improve health, increase savings and enjoy a better quality of life.”

## **PROGRAM UPDATE SINCE 2015**

Initially, the City’s AFSCME, PSEU, and Teamster bargaining units and Management and Confidential staff joined the program in 2015 and subsequently the remaining Police bargaining units joined as well. Effective in 2017, the firefighter’s union (IAFF) opted to participate in a plan outside the City’s system sponsored by the LEOFF Trust PFP for which the City pays the premiums.

Initial results from the Healthy Kirkland Initiative were promising. The 2016 recommended contribution to the self-insurance fund for the program decreased 4.5% at a time that the national average for health care costs was a 6% increase and the Association of Washington Cities increase for its high deductible plan similar to the City’s increased 9.1%.

The 2015-2016 Budget assumed zero percent growth in the health benefits fund as a result of higher than expected health cash reserves from the early results of the program and in anticipation of continued success of the Healthy Kirkland Plan.

The 2017-2018 Budget assumed no increase to the contribution to the health care fund in 2017 and a 2% increase in 2018, still well below the national average and AWC plan increases (AWC’s HDHP premium increased 13.2% from 2017 to 2018). The premiums paid to LEOFF Trust in 2018 increased 13%.

The 2017-2018 assumptions recognized that the reserve maintained in the health care fund was substantially above the state required minimum of 16-weeks of claims data. This balance was the result of several dynamics:

- By diverting claims to the clinic, the 16-week rolling average of claims was substantially lowered.
- The amount set aside for claims is based on an actuarial analysis. In the early years of the program, claims performed better than the calculated actuarial result.
- A \$1 million contingency had been added to the reserve in the beginning of the City's self-insurance program as a hedge against higher than expected claims growth, which has proven to be unnecessary after the first year of self-insurance in 2011. This amount was reallocated to help fund the replacement of the City's core financial and human resources system.

To begin to draw down the reserve balances, the 2017-2018 rates were set below the actuarial recommendation which in fact did draw down the balance in 2017 while 2018 balances grew, indicating that costs rose at a slower rate than revenues. Note that a portion of the reserve draw down in 2017 reflects the "run off" of claims for IAFF members, which is the amount of claims incurred in 2016, but paid out in 2017 when they were no longer part of the City's plan.

Rate assumptions made in the 2019-2020 budget began a multi-year plan to raise rates to bring them in line with actuarially forecasted cost growth, with annual increases of 9.5% and a planned use of reserves as rates were brought in line with expenses over several years. Actual results in 2019 resulted in a use of \$443,476 in reserve balance, which was about \$180,000 better than forecast, while the 2020 projections are on pace to use \$242,446 of reserve balance, about \$247,000 better than the forecast. This outcome indicates that the 9.5% annual raises had gained more ground relative to expenses than originally assumed, allowing Kirkland more flexibility in setting rate growth at a lower level for 2021-2022.

Category	Actuals					Projected					
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Starting Reserve Balance	6,639,981	7,214,986	7,130,429	5,172,161	5,772,934	5,329,458	5,087,011	5,166,712	5,156,671	5,066,950	4,918,309
Use/Addition to Reserves	575,005	(84,557)	(958,269)	600,773	(443,476)	(242,446)	79,701	(10,041)	(89,722)	(148,641)	(220,854)
Contingency Reserve*			(1,000,000)								
Ending Reserve Balance	7,214,986	7,130,429	5,172,161	5,772,934	5,329,458	5,087,011	5,166,712	5,156,671	5,066,950	4,918,309	4,697,454
16-Week Requirement (Average)	2,239,440	1,945,999	1,868,942	1,298,074	1,477,168	1,691,952	1,805,313	1,926,269	2,055,329	2,193,036	2,339,969
16 Week Total "Max" Liability	2,444,125	2,348,502	2,084,905	2,056,492	1,755,058	2,100,466	2,241,197	2,391,357	2,551,578	2,722,534	2,904,944

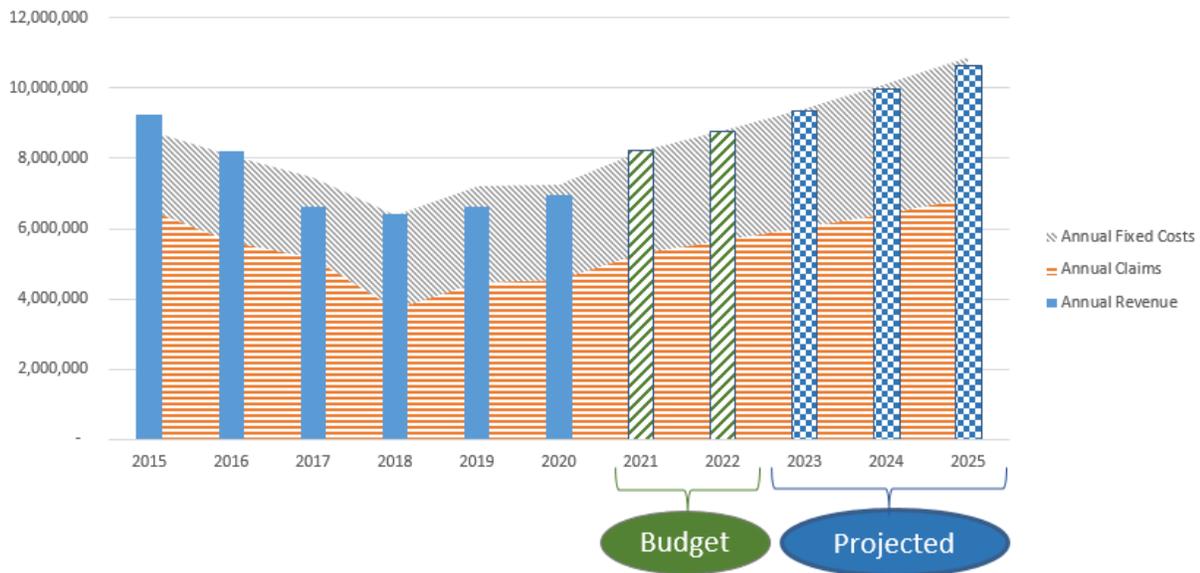
\*Contingency was transferred to the Finance System Replacement CIP project

A portion of the reserve is a mandated 16-week minimum claims balance. This amount is estimated as part of the budgeting process, it declined in recent budget cycles due to the Healthy Kirkland Initiative's successes and the withdrawal of the IAFF union members from this plan. Staff is now assuming that 2019 is the baseline for the reserve.. In order to ensure conservative budgeting practices, staff has assumed that the 16-week minimum reserve requirement is estimated to grow by the actuarial claim's growth percentage of 6.7% annually, which was used in setting the 2021-2022 budget targets. As an additional check for conservative rate setting, staff analyzed the highest 16 week claims total from 2019-20 and created a secondary informational target of 16 week "Max" liability to keep the five year projected ending reserve balance above, the current rate proposal maintains reserves above both the required and the assumed "Max" 16-week claims levels.

Looking forward to the 2021-2022 budget and beyond, the most recent actuarial analysis indicates that a cumulative five-year increase of approximately 40% (approximately 8% per year) in the claims-related premium contribution might be necessary to bring the premiums in line with costs. However, Kirkland’s actual claims experience and trends have so far indicated lower costs than actuarial projections have forecast. Given that the current reserve is still in excess of the required minimum, and wider budget considerations due to the economic challenges of the COVID-19 pandemic staff has laid out a plan to raise those premiums in line with projected costs covered by those premiums in 2021-2022 while beginning to draw down on reserves in future years. This approach still maintains balances above the required 16-week minimum claims balance.

The preliminary 2021-2022 budget reflects a 6.7% premium increase that closes the current gap between claims and fixed costs and medical premiums for 2021-2022, but does project to collect slightly less revenues than expenses in future years if continued at 6.7% rate growth as illustrated in the table above and the following graphic. This assumption can be revisited and adjusted as necessary in the 2023-2024 budget process to react to trends observed in 2021-2022. Reserve balances are projected to remain above the 16-week minimum claims balance through the end of 2025 even assuming this draw down.

2015-2025 Premium Revenues vs Expenses Paid from Premiums



To put these figures into context, the 6.7% increase does not relate to all healthcare expenses, just those tied to claims-related costs. It excludes costs such as the clinic and HRA/VEBA related to the Healthy Kirkland Plan that represent relatively fixed costs. The cost growth assumptions in the overall Healthy Kirkland plan is summarized in the table below.

### Healthy Kirkland Plan Components

Assumptions for 2021-2022		
Category	% Increase	
	2021	2022
Fully Insured Equivalent (Medical Claims)	6.7%	6.7%
Vera Clinic	4.5%	4.5%
HRA/VEBA	0.0%	0.0%
Third Party Administration/Stop Loss	12.0%	12.0%
<b>Overall Increase to Self Insurance Budget</b>	<b>7.1%</b>	<b>7.2%</b>

Further, the City’s overall healthcare expenditures includes premiums associated with the Kaiser managed care plan offered by the City, the LEOFF PFP plan costs, dental benefits, and internal staff costs associated with administering the program. The table below summarizes the increase in overall healthcare expenditures reflected in the preliminary budget (note that the LEOFF PFP increase is an estimate as the plan has not yet published its 2021 rates). The average benefit costs per FTE increase approximately 4.4% in 2021 and 4.8% in 2022, excluding pension costs which are not discussed in this issue paper. The one-time decrease in Kaiser rates represents an overall rate reduction from that insurer across the board. Note that the 2022 factors are the best estimates available at this time and will be refined as part of the mid-biennial budget update in the Fall of 2021.

Overall Healthcare Expenditure Changes		
	2021	2022
<b>Premiums and Premium Equivalent</b>		
HDP	6.7%	6.7%
Kaiser	-5.0%	8.0%
IAFF PFP	8.0%	8.0%
Willamette	0.0%	3.8%
Delta Dental	0.0%	3.8%
Vision	0.0%	2.0%
<b>Other Fees</b>		
HRA/VEBA	0.0%	0.0%
Clinic Fee	4.5%	4.5%
Other Costs	1.0%	1.0%
Workers Compensation	0.0%	0.0%
<b>Avg. Change Per FTE from Prior Year</b>	<b>4.4%</b>	<b>4.8%</b>

### CONCLUSION

The Healthy Kirkland Initiative has been successful in working toward all three objectives – economic incentives to promote informed health care choices, market transparency and promotion of health behaviors. While it is difficult to judge the overall health of the employee population, participation in the clinic and wellness incentive programs is the highest that the providers have experienced. We have “bent the trend” in healthcare cost growth and these measures to control costs allowed the City significant flexibility when setting rates for 2021-

2022 to help alleviate cost pressures on operating fund budgets that were facing reduced revenue budgets due to the economic effects of the COVID-19 pandemic. Another illustration of the success of the strategy is that the employee balances in their HRA/VEBA accounts are in excess of \$3.6 million as of June 2020. This gives employees and their families a financial buffer against unexpected medical costs that was not possible prior to the Healthy Kirkland Initiative.

Phasing in the claims-related premium increase should still maintain a healthy reserve and allows the decisions in future budget cycles to recognize actual claims trends. The five-year strategy would result in a planned reserve drawdown illustrated below. The projected reserve above the minimum also acts as a hedge against worse than expected performance or the need to increase the reserve in the event that the IAFF returns to the City's plan.

