



## **MEMORANDUM**

**To:** Kurt Triplett, City Manager

**From:** George Dugdale, Financial Planning Manager  
Andrea Peterman, Senior Financial Analyst

**Date:** October 19, 2022

**Subject:** HEALTHCARE PROGRAM UPDATE

## **BACKGROUND**

In 2011, the City of Kirkland began self-insuring for healthcare due to rising costs and reduced benefits provided by the City's previous health care plan. Despite this significant step, healthcare costs continued to increase quickly and were a significant budget issue for the City. After three years of self-insurance three factors converged to lead staff and Council to develop a new and more sustainable healthcare plan.

1. Claims growth between 2011 and 2013 averaged 15% per year, although the City was able to keep premium growth to just under 9% in the same period this was an unsustainable trend.
2. Three years of aggregated claims data gave the City much better visibility into and understanding of our healthcare needs and experience, which made it possible to design a new program.
3. The "Cadillac Tax" on high cost healthcare plans, brought in as part of the Affordable Care Act (ACA) was intended to take effect in 2018. Early estimates were that this could cost the [City up to \\$1.5m per year](#).

Following significant staff, Council, and consultant time in April 2015, the City of Kirkland implemented 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 The "Cadillac Tax" was repealed in December 2019 and did not go into effect, nevertheless, the Healthy Kirkland Initiative has realized successes in improving employee health and managing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](#).

## **The Healthy Kirkland Initiative**

After assessment of a variety of options that placed different emphasis on the three goals described above the City opted for a “full systems approach” 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; and
- 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 had been implemented successfully somewhere in the United States. What differentiated the City’s approach was not so much the implementation of any element 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 approach, employees are given both a new economic exposure (the higher deductible) combined with a new financial incentive to save (the HRA VEBA contribution). 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 must complete a wellness incentive program. These activities include biometric screening and health risk assessment, visiting a health provider, and meeting with a health coach. The new framework provided an incentive to engage in healthy behavior and make more judicious decisions regarding the utilization of care.

<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>

### *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 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 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 CHANGES 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 increased 6% and the high deductible plan of the Association of Washington Cities (AWC), a similar plan to Kirkland's, increased 9.1%.

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

The 2017-2018 budget assumed no increase to the contribution to the health benefits fund in 2017 and a 2% increase in 2018, still well below both 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 budget assumptions recognized that the reserve maintained in the health benefits 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. In 2017, 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. The reserve balance in 2017 was drawn down while 2018 balance grew, indicating that costs rose at a slower rate than revenues. Note that a portion of the reserve drawdown in 2017 reflected the "runoff" of claims for IAFF members, or the total 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 2019-20 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. Actual results used \$296,484 in reserve balance in 2019, about \$327,000 better than forecast, and increased the reserve by \$419,929 in 2020. This outcome indicated that the 9.5% annual raises gained more ground relative to expenses than originally assumed.

In the 2021-22 budget process, the City used the conservative actuarial assumption of 6.7% for annual growth to set 2021-22 budget targets, continuing the plan to bring rates in line with actuarially forecasted growth and to draw down reserves. During the 2021 mid-biennial process, the 2022 rate increase was lowered based on the updated actuarial recommendation,

from the budgeted 6.7% increase to 2.35%. Actual results in 2021 increased the reserve balance by \$237,911, and it is expected to grow by \$478,924 by year end 2022. This outcome indicates a continued trend of annual rate increases outpacing actual expenses.

A portion of the reserve is a mandated 16-week minimum claims balance. This amount is estimated conservatively during the budget process by using the highest 16-week average from the prior year. For the 2023-24 budget, staff assumed 2021 as the baseline for the required 16-week claims reserve. As an additional check for conservative rate setting, staff analyzed the highest 16-week claims total from 2021-22 and created a secondary informational target of 16-week maximum liability. The 2023-24 rates maintained reserves above both the required and the assumed maximum 16-week claims levels.

Category	Actuals					Projected					
	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Starting Reserve Balance	7,130,429	5,172,161	5,772,934	5,476,450	5,896,379	6,170,290	6,649,214	7,246,045	7,520,415	7,414,045	6,859,822
Use/Addition to Reserves	(958,269)	600,773	(296,484)	419,929	273,911	478,924	596,832	274,369	(106,369)	(554,223)	(1,079,385)
Contingency Reserve*	(1,000,000)										
Ending Reserve Balance	5,172,161	5,772,934	5,476,450	5,896,379	6,170,290	6,649,214	7,246,045	7,520,415	7,414,045	6,859,822	5,780,437
16-Week Requirement (Average)	1,868,942	1,298,074	1,477,168	1,465,453	1,443,715	1,334,336	1,437,080	1,547,735	1,666,911	1,795,263	1,933,498
16 Week Worst Case (Above Average)	215,963	758,418	277,890	635,013	270,130	257,530	277,360	298,716	321,717	346,490	373,169
16 Week Total Maximum Liability	2,084,905	2,056,492	1,755,058	2,100,466	1,713,845	1,591,866	1,714,440	1,846,451	1,988,628	2,141,753	2,306,668

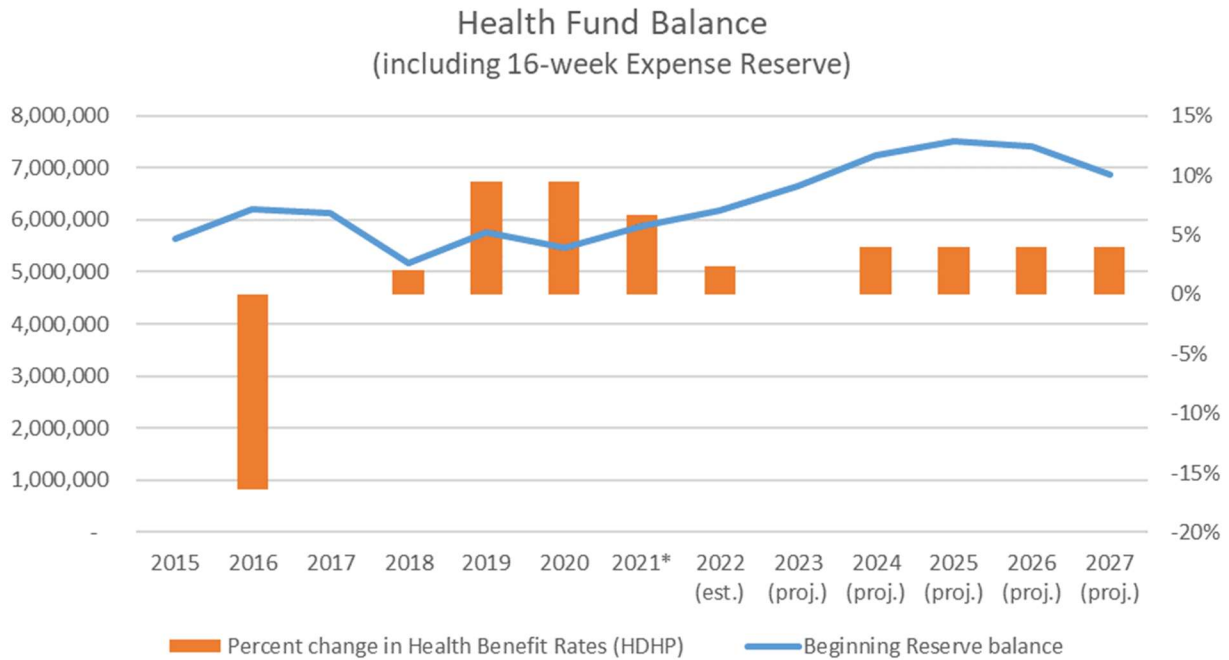
\*Contingency was transferred to the Finance System Replacement CIP project

Looking forward to the 2023-24 budget and beyond, the most recent actuarial analysis indicates that a cumulative five-year increase of approximately 41% (approximately 9% 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. In 2020, medical claims were down by 5.6%, possibly due to the impact of the COVID-19 pandemic and quarantine measures, which delayed many medical procedures and reduced visits to healthcare providers. Actual claims in 2021 increased by 2.1%. Total medical claims through July of 2022 are trending significantly lower than 2021, down 21.2% due to a lack of inpatient utilization. This decrease is likely to be an anomaly and claims are expected to return to 2021 levels in future years. Given that the current reserve is well over the required minimum, staff has laid out a plan to raise claims-related premiums in line with projected costs covered by those premiums while drawing down on reserves in future years. This approach still maintains balances above the required 16-week minimum claims balance.

The preliminary 2023-24 budget reflects premium increases that close the current gap between claims and costs for 2023-24. Because actual claims have been lower than projected during the current biennium, staff assumed the recommended zero percent growth in 2023, deferring the next rate increase to 2024. Implementing 4% increases from 2024 to 2027 will draw down the reserve gradually to reach the target of \$2.3 million above the required 16-week claims reserve, which represents the estimated 16-week maximum liability for 2027.

Revenues are projected to collect slightly less than expenses in future years if continued at the 4% rate growth as illustrated in the table above and in the following graphic. This assumption can be revisited and adjusted as necessary in future mid-biennial and full budget processes, which has been the City's approach in prior years. Reserve balances are projected to remain

significantly above the 16-week minimum claims balance through the end of 2027 even assuming this draw down.



The assumed increase in 2023-24 premium rates described above does not relate to all healthcare expenses, only those tied to claims-related costs. It excludes costs related to the Healthy Kirkland Plan, including the Vera Clinic and HRA/VEBA, which are relatively fixed. The table below summarizes the growth assumptions for claims costs in the overall Healthy Kirkland Plan.

### Healthy Kirkland Plan Components

#### Assumptions for 2023-2024

Category	% Increase	
	2023	2024
Fully Insured Equivalent (Medical Claims)	7.7%	7.7%
Vera Clinic	0.0%	3.0%
HRA/VEBA	0.0%	0.0%
Third Party Administration/Stop Loss	12.6%	16.6%
<b>Overall Increase to Self Insurance Budget</b>	<b>7.3%</b>	<b>8.7%</b>

### HEALTHCARE COSTS BEYOND THE HIGH DEDUCTIBLE PLAN

In addition to the high deductible plan, City of Kirkland employees are eligible for a range of other health plans, depending on their bargaining unit, as well dental and vision plans.

Therefore, the City’s overall healthcare expenditures include 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 2023 rates). The average medical benefit cost per subscriber will increase approximately 1.9% in 2023 and 5.5% in 2024. Note that the 2024 factors are the best estimates available at this time and will be refined as part of the mid-biennial budget update in 2023.

**Overall Healthcare Expenditure Changes**

	<b>2023</b>	<b>2024</b>
<b>Premiums and Premium Equivalent:</b>		
HDP	0.0%	4.0%
Kaiser	5.2%	8.0%
IAFF PFP	5.2%	8.0%
Willamette	0.0%	3.8%
Delta Dental	2.3%	3.8%
Vision	-15.1%	2.0%
<b>Other Fees:</b>		
HRA/VEBA	0.0%	0.0%
Clinic Fee	0.0%	3.0%
Other Costs	1.0%	1.0%
Workers Compensation	4.8%	4.8%

**CONCLUSION**

Kirkland continues to experience lower healthcare costs than actuarial projections have forecast. The plan to phase in claims-related premium increases should still maintain a healthy reserve and allow the decisions in future budget cycles to recognize actual claims trends. The five-year strategy of moderate 4% rate increases would result in a planned reserve drawdown while avoiding steep changes. The projected reserve above the minimum also acts as a hedge against worse than expected performance or the need to increase the reserve if the IAFF returns to the City’s plan.

The overall trend in lower than projected claims is an indicator of the success of the Healthy Kirkland Initiative. While it is difficult to judge the overall health of the employee population, participation in the clinic and wellness incentive programs remains high. Although there was a drop in participation during 2020 due to the pandemic, rates stayed well above business benchmarks, and participation in 2021 returned to pre-pandemic levels. The success of the strategy is also illustrated by employee balances in HRA/VEBA accounts, which are over \$6.1 million as of June 2022. These accounts, which were implemented with Healthy Kirkland Initiative, give employees and their families a financial buffer against unexpected medical costs.