

MACON COUNTY SHARED VISION

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June 5, 2006

Mr. Paul Osborne, Mayor
City of Decatur
One Gary Anderson Plaza
Decatur, Illinois 62521

Dear Paul,

The purpose of this letter is to encourage the Council to take action regarding the City's high level of health insurance costs. Our group believes that local tax levels that are higher than other communities diminish opportunities for economic growth and prosperity. We understand that tax reduction is better achieved when government costs can be reduced.

We appreciate the Council's public statements that health costs are high and solutions are needed. Yet, the recently adopted budget does not decrease expenditures for health benefits provided to city employees. We previously suggested that the Council form a citizens' budget commission to assist the Council in evaluating certain complex matters in the budget including health insurance costs. The Council's willingness to consider and discuss a commission on health costs should be applauded, but note that no commission has yet been formed. We believe that the Council can and should take action to curtail these costs.

As discussed later in this letter, and based upon advice of our counsel, **the City Council does have legal authority, the right and duty to address this matter currently.** Furthermore, a dialogue about these costs will not necessarily lead to a general reduction in health benefits for city employees. **There are numerous possible opportunities for cost reductions other than simply reducing benefits.** Since the Council's interest into this topic cannot reasonably be deemed an unfair labor practice, we encourage a comprehensive look at all issues effecting health care costs for employees in the City of Decatur.

We had previously raised this and other issues in our prepared statement to the Council on April 3, 2006. We would be pleased to provide another copy of this statement or you may also find it on our website. Our comments in this letter will focus on the following topics:

- Background on City Health Costs
- Effect of High Health Costs on City Budget and Taxes
- Possible Issues Contributing to High Health Insurance Costs
- Legal Authority for City Study and Evaluation of Health Costs
- Suggested Course of Action

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Background on City Health Costs

Based on the 2006/2007 Annual Budget, the city expects to incur health insurance expenses of \$8.1 million. This amount is approximately the equivalent of \$16,000 per city employee. Included in this expense is \$85,000 for City staff administration and \$200,000 of administrative expenses paid to the City's third party administrator - Consociate Group ("TPA"). These expenses are substantially higher than: i.) other government units in Macon County and Central Illinois, ii.) state employee health insurance plans, and, iii.) large and small private employer plans in Illinois. The relative low unit health care costs in Decatur¹ should lead to lower average costs and not higher costs.

<u>Item</u> ² (thousands)	<u>2004/05</u>	<u>2005/2006</u>	<u>2006/2007</u>
Claims	5,805	7,196	7,100
Claims reserves			400
Excess Insurance	207	252	299
TPA expense	168	177	200
Other	85	89	103
Total	6,266	7,715	8,102
Less -			
Employee payroll	47	202	300
Retiree contributions	702	715	685
Net Cost	<u>5,517</u>	<u>6,798</u>	<u>7,117</u>

The high health insurance costs have been well known for several years. In September 2004, city staff conducted a survey of other Central Illinois communities and realized that the City's health insurance expenditures were \$2,000 to \$5,000 higher than other communities.³ Also troubling was the City Manager's comment in the article that increasing the tax base and city revenues would be the "best answer" instead of decreasing benefits or employees. Some interpreted this remark to mean that increasing taxes would be preferable to aggressively managing these costs.

Staff has recently implemented health plan changes intended to reduce costs for non-bargaining unit employees. These changes only effect a small portion of City employees and the cost benefit to the City was fully offset by increased salaries for the effected employees. More importantly, the changes apparently would have little effect on aggregate health expenditures as the City did not reflect any reduction in health expenditures in the adopted budget for the fiscal period ending April 30, 2007.

Effect of High Health Costs on City Budget and Taxes

Over the last several years, the City has imposed tax increases on the community of several million dollars. The property tax levy for 2005, (due June 19, 2006), increased \$600,000 and is similar to property tax increases in prior years. While the City is only a portion of the property tax burden, The City of Decatur is the most visible government in Macon County and sets the tone for other taxing districts. Each \$1,000 of employee

¹ See "City's Medical Costs Shine – Decatur Fares Well"; Herald & Review; May 24, 2005

² Source: City of Decatur Annual Budget – City Web Site; Non-General Fund; Page 54 & 55

³ See "City Employees Have 'Cadillac' Insurance Health Plan"; Herald & Review; September 17, 2004.

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health costs equates to \$500,000 in additional taxes taken out of taxpayers pockets. The effect is to create a "deadweight loss" on the local economy that slows economic growth and decreases the value of real estate.⁴ **One estimate would allow for a twenty-five percent reduction in City of Decatur property taxes, or eliminate all increases in property taxes over the last five years.**

The effect of high health costs does not necessarily equate to better health care for city employees. High health costs may be the result of excessive use of health care by a few, overly generous reimbursements to health care service providers⁵, or excess revenues to TPA's and insurers. **Accordingly, reducing health care costs may not have an adverse effect on employee health or health care benefits.**

If health insurance costs were to be reduced by \$5,000 per employee, the property tax levy for the City of Decatur could be reduced by over twenty-five percent. Private sector property values would increase by \$25 million to \$40 million within the City of Decatur.⁶ It is possible that the reduction in health insurance expenditures could exceed \$5,000 per employee if all aspects of the health plans were scrutinized and competitively bid. The City's efforts to lower expenses and decrease taxes could lead to increasing public pressure on all Macon County governments to effectively control government expenditures and reduce taxes.

Possible Issues Contributing to High Health Insurance Costs

A comprehensive study and evaluation of the City's health expenditures is warranted based on the expenditure levels and the ever-increasing costs. The cause of high costs are unknown by the public and the Council. At a minimum, the Council should have a greater knowledge to make effective legislative decisions on employee contracts, city expenditures and tax levies. Absent meaningful information, the Council and taxpayers are left to speculate as to the causes of the high expenditures. Fortunately, the approach to understanding and managing health care costs are well known in the private sector. The key areas for inquiry are:

1. *Are the health benefits provided to city employees both reasonable and competitive?*

Health benefit coverage refers to the scope and extent of health care services covered by the health plan. These benefits should be clearly defined and compared to typical coverages to identify whether excessive costs could be explained by atypical benefit coverages.⁷ A survey of benefit practices by other government and private sector employers should be completed at least every two years.

⁴ A deadweight loss is an economic phenomenon that refers to the decrease in economic activity that results from avoidable tax increases. Based on real estate cap rates, each additional and avoidable \$1 of local taxation has the effect of decreasing real estate values by \$10.

⁵ I.e. Hospitals, labs, pharmaceutical companies, doctors and other providers.

⁶ Applying cap rates of 7 to 10 to reduced property taxes of \$2.75 million.

⁷ Examples of atypical benefits may include: bariatric procedures, cosmetic surgery, extended counseling services, growth hormone therapy or laser eye surgery.

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2. Are Benefit Claims paid in accordance with Health Plan documents?

A common challenge in self-funded health plans is the careful management of claims payments by the employer and TPA. Claims payments by the TPA should only be made in strict accordance with the defined benefits plan documents. If any health claims paid are exceptions to defined benefits, excessive costs could be incurred. Because of the "self insured" character of the plan, such exceptions would lead directly to excessive costs for the City and taxpayers. The internal controls that would prevent or detect such "exceptions" should be identified, tested and evaluated. The Contract with the TPA should require maintenance of adequate controls and reporting of exceptions.

3. Are medical service unit prices reasonable and competitive with other medical service networks?

The unit health prices and discounts should be evaluated for competitiveness to other health networks. Larger health networks than the City uses may have better unit health prices. Smaller networks typically don't realize the same competitive discounts as larger networks.⁸

4. Are employee contribution and cost sharing practices reasonable and competitive?

Competitive employee cost sharing of health costs are known to be less in the City's plan than other plans. There are various techniques for sharing costs with employees. Cost sharing may take the form of employee deductibles, co-pays, or employee contributions. Generally, the more that employees share in the cost of services provided, the more discriminating they are in over-utilizing health services. High dollar deductible plans (HSA's) are gaining in popularity. Other government unit and private sector plans should be surveyed to determine what are typical practices.

5. Are administrative costs reasonable and competitive?

For large TPA's and insurance companies, the administrative costs are approximately one percent of the cost of the plan. The City's plan appears to have administrative costs of 2.5 percent and if adjusted for high claims costs it could be as high as 4.0 percent. These amounts do not include the separate City staff costs allocated to medical costs in the financial accounts. While worthy of attention, neither of these administrative costs are significant relative to the overall costs.

6. Are health plan benefits effectively bid on a competitive and regular basis?

In the private sector, effective bidding strategies are essential to evaluate, control and manage health costs. All bidders must be provided essential and reasonable information (so that no bidder has an informational advantage). All

⁸ Unit health prices refer to the cost of specific health procedures (i.e. tests, x-rays, doctor visits, room charges, surgical procedures.) The differences could easily be in the range of five to ten percent of health costs.

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bidders should be fairly considered. The complexity of the information and bidding process requires multiple iterations of information requests and submissions. The goal of the process should be to have at least five quality alternatives presented and available. The bidding process should be repeated on a regular basis.

An essential step in a sound bidding process is accumulating historical claims data so that a competitive bidder fully understands the claims history of the plan. Failure to provide bidders good historical claims data will cause bidders to either withdraw or over-estimating prospective claims.

Another key element of effective bidding is to be sure that all credible health benefit providers are allowed to present proposals. This may require "protecting" local insurance agents that present a specific provider for consideration.

7. Is the City fully utilizing health management practices that encourage employees to adopt healthy lifestyles and limit use of health benefits?

The private sector has been aggressively employing healthy lifestyle practices to encourage employees to avoid expensive health care needs. The City should survey these techniques and implement them to lower costs.

Legal Authority for City Study and Evaluation of Health Costs

The Council has been advised (and admonished) by staff that any study or evaluation of health costs would be an Unfair Labor Practice ("ULP") under the Illinois Labor Relations Act due to pending negotiations with employee bargaining units. This admonition was made even though several bargaining units openly encouraged the City to investigate the reason for high health costs.

While we are not lawyers, but our common sense suggested that the Council had a duty to understand these costs before or during negotiations. **Furthermore, we believed that the legal advice given the Council was incorrect and forced the Council to make important negotiating decisions without material and relevant information on an important element of the negotiations.**

We retained a highly reputable Illinois law firm to research this issue and provide legal advice on whether the Council would be committing a ULP by engaging in a study of health costs. The written opinion was consistent with our judgment. In summary, it states that:

- The Council has the right if not duty to investigate these costs either before or during the negotiation process.
- The establishment of a commission, or conducting any other form of information gathering **would not** constitute an ULP.
- The Council should not use the information or process of gathering the information for any reason other than informing itself on health costs. It should avoid public discussions that might seem to be bargaining directly with City employees away from the designated bargaining representative.

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- Any information developed for or gathered by the Council could be used to develop strategies for presenting proposals in the bargaining process.

We would be pleased to provide a copy of this letter to the Council if requested to do so. We would encourage the Council to ask for and obtain its own **independent** legal opinion on this important issue.

Suggested Course of Action

1. Seek an independent legal opinion related to the legal implications of the Council to authorize, organize, request or conduct its own evaluation of the reasons for high health costs and possible strategies to reduce those costs.
2. Organize a group to gather information on the City's health costs with the goal of providing the Council independent information and advice as to the cause of high costs and possible strategies to reduce those costs.
3. Because the activities in Suggestion Two above are not an Unfair Labor Practice, the study should be conducted openly and thoroughly. There should be no limits on the scope or goals of the study and results should be fully shared with the press and community.
4. Develop a consensus in the Council to ask the staff to adopt effective bidding practices related to the health care coverage and costs.

Paul, we are providing these ideas with the goal of assisting the Council with a very important concern to the community. We sincerely believe that Decatur can embark on a path of meaningful economic growth and prosperity if all government units are fiscally conservative and responsible. With ongoing vigilance towards all costs of government, we then can consider appropriate and needed reductions in local taxes.

We would respectfully request that you fully consider the ideas and suggestions in this letter. More importantly, it is time for the Council to take effective legislative and oversight action. We believe that you should limit undue reliance on staff that has seemed restrained in effectively controlling these costs. We would be pleased to meet with you or any other Council members, or staff, to fully discuss the matters in this letter. Per your previous suggestion, this letter is only for the use of you, the Council and members of our group. We look forward to hearing from you.

Very truly yours,

Stephen D. Daniels

Stephen D. Daniels
Macon County Shared Vision

Cc: City Council Members
Macon County Shared Vision - Members