



MEMORANDUM

To: Kurt Triplett, City Manager

From: Andrea Peterman, Interim Financial Planning Supervisor

Date: October 2, 2024

Subject: **Healthcare Program Update – Healthy Kirkland Initiative**

RECOMMENDATION:

Staff recommends City Council reviews the Healthcare Program issue paper for the 2025-2026 budget as it provides the context and background for healthcare cost assumptions and drivers.

EXECUTIVE SUMMARY:

- Council is asked to review the Healthcare Program issue paper for the 2025-2026 budget for a summary of the program's history, its components, and healthcare cost assumptions and drivers.
- The City began self-insuring for healthcare in 2011 and launched the Healthy Kirkland Initiative in 2015 to improve outcomes in the face of continued healthcare cost growth.
- The early success of the Healthy Kirkland Initiative reduced health cost increases and health cash reserves grew at a higher than projected rate. Beginning in 2017, annual healthcare rates were set with the aim of spending down the health fund reserve balances which allowed the City to moderate healthcare rate increases.
- While the reserves decreased in some years, overall, the period from 2017 to 2022 saw annual rate increases outpacing claims expenses. This was in part due to the COVID-19 pandemic impacts, which resulted in a decrease of healthcare usage in 2021-2022.
- The 2023-2024 budget again set rates to draw down the reserves. However, actual experience in 2023 and 2024 has been impacted by higher inflation, increased healthcare usage and significant high-cost claims. As a result, the City has drawn down on its reserves faster than anticipated.
- The 2025-2026 budget sets higher rates more in line with current healthcare cost experiences, but still less than actuarial projections. Actual outcomes will be closely monitored, and changes may be implemented in the mid-biennial budget process and in future budgets as needed.
- The City Manager, HR and Finance are evaluating immediate changes to the Stop Loss program and alternatives to rare/expensive prescription drugs to identify cost savings.

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 healthcare 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. The City's claims growth averaged 15% per year between 2011 and 2013. 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 its 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 showed this could cost the City up to [\\$1.5 million 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 healthcare 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 healthcare costs.

In December 2015, the City Council received a comprehensive briefing on the evolution of the City's program. Highlights from that report are summarized below, followed by an update on the program's impact on the budget since that time. The full 2015 briefing (170 pages including attachments) is available on the City's [website](#).

DISCUSSION/ANALYSIS:

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 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 the implementation of each element separately as an isolated effort to improve care but implementing the elements simultaneously as interdependent parts of a full healthcare 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 care.

HRA VEBA

To offset the new financial exposure to employees, the City created an expansive Health Reimbursement Arrangement Voluntary Employee Benefits Association (HRA VEBA) benefit contribution, essentially matching annually the cost of the entire deductible for both individuals and families. Unlike traditional HRAs, HRA VEBAs are savings accounts that stay with employees and eligible dependents and the 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 visiting a health provider, meeting with a health coach, and receiving a biometric screening and health risk assessment. The new framework provided an incentive to engage in healthy behavior and make more judicious decisions regarding the utilization of care.

Employee Financial Exposure Limits

	Employee Only	Family
Deductible	1,500	3,000
Out-of-Pocket Cost Limit	2,500	5,000
VEBA Contribution	1,200	2,400
Wellness Contribution	600	600
Total VEBA Contribution	1,800	3,000
Maximum Employee Exposure (Out-of-Pocket Limit less VEBA)	700	2,000

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 for many reasons. The Kirkland facility is in the Totem Lake area, just a short drive from the Evergreen Hospital Emergency Room, and parking is free, and it is open to employees and their family members who are enrolled in the City’s health plans. 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. Employees can schedule appointments for a variety of preventative and acute services, as well as wellness and nutritional consultations. Because Vera provides reciprocity among its clinics, Kirkland employees and qualified dependents can visit any Vera clinic for free. In addition to the Kirkland location, there are six other clinics in the region, including a new Tacoma location that opened in 2024. 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 for several reasons. Because primary care is convenient and free to employees, employees and qualified dependents have a

powerful financial incentive to use the clinic to save their HRA VEBA balances and to be active in maintaining their health. 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 may act as 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 healthcare plan. Taken together and implemented as part of a comprehensive system, each element is enhanced 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 (MAC) 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 healthcare 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 (0%) growth in the health benefits fund due to higher than expected 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:

- The 16-week rolling average of claims was substantially lowered by diverting claims to the clinic.
- The amount set aside for claims was based on an actuarial analysis. In the early years of the program, claims performed better than the calculated actuarial result.
- A \$1 million contingency was added to the reserve in the beginning of the City's self-insurance program as a hedge against higher than expected claims growth, which proved 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.

Starting in 2017, the City has set annual healthcare rates with the aim of spending down the reserve balances, which helped to smooth out rate increases. Premium increases during this period averaged 5.25% per year, in line with the national average.

For the 2021-2022 budget, the City used the actuarial assumption of 6.7% for annual growth to set budget targets, continuing the plan to bring rates in line with actuarially forecasted growth and to draw down reserves. However, the impact of the COVID-19 pandemic significantly altered the patterns of healthcare usage. Claims costs declined during the acute phase of the pandemic as participants deferred medical appointments, a reduction in accidents caused healthcare usage to fall, and inflation was low. Consequently, during the 2021 mid-biennial process, the 2022 rate increase was lowered to 2.35% based on the updated actuarial recommendation. The fund balance at the end of 2022 was \$6.65 million, close to \$5 million above the mandated 16-week minimum claims balance.

During the 2023-2024 budget process, staff once again 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. Because actual claims were lower than projected in 2021-2022, staff assumed the recommended zero percent (0%) growth in 2023, deferring the next rate increase to 4% in 2024. Rate increases of 4% were planned from 2025 to 2027 to draw down the reserve gradually to reach the target of \$2.3 million above the estimated 16-week maximum liability for 2027. Actual experience in 2023-2024 has again been different than actuarial projections, with higher inflation, increases in claims, and a rise in high claimants. As a result, the reserve balance is projected to drop \$1.82M in 2023-24.

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 2025-2026 budget, staff assumed 2023 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 2023-2024 and created a secondary informational target of 16-week maximum liability. The 2025-2026 rates maintain reserves above both the required and the assumed maximum 16-week claims levels.

Category	Actuals					Projected					
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
Starting Reserve Balance	5,772,934	5,476,450	5,896,379	6,170,290	6,649,214	6,406,308	4,829,127	4,434,157	3,881,451	3,612,747	3,672,117
Use/Addition to Reserves	(296,484)	419,929	273,911	478,924	(242,906)	(1,577,181)	(394,970)	(552,706)	(268,704)	59,370	435,688
Ending Reserve Balance	5,476,450	5,896,379	6,170,290	6,649,214	6,406,308	4,829,127	4,434,157	3,881,451	3,612,747	3,672,117	4,107,805
16-Week Requirement (Average)	1,477,168	1,465,453	1,443,715	1,323,782	1,721,341	1,943,400	2,215,476	2,437,024	2,680,726	2,948,799	3,243,679
16 Week Worst Case (Above Average)	277,890	635,013	270,130	356,354	406,244	463,118	527,954	580,750	638,825	702,707	772,978
16 Week Total Maximum Liability	1,755,058	2,100,466	1,713,845	1,680,136	2,089,477	2,406,518	2,743,430	3,017,774	3,319,551	3,651,506	4,016,657

As the reserve balance dropped significantly in 2023-2024, the most recent actuarial analysis indicates that a cumulative five-year increase of approximately 91% (approximately 18.2% per year) in the claims-related premium contribution might be necessary to bring the premiums in line with costs. Kirkland's actual claims experience in past years has been lower than actuarial projections have forecast, but that trend has not continued this biennium. Actual results in 2023 decreased the reserve by \$242,906 as medical claims grew 47.8%. This steep increase compared to 2022 was in part due to the relatively low claims in 2022. However, claims have remained high and are expected to end 2024 8.5% higher than 2023. The increased claims experienced by the City have been driven in large part by rising pharmaceutical costs and large claimants impacting a relatively small plan. The increase in claims will draw down the reserve an additional \$1.5 million in 2024. As mentioned above, this drawdown of the reserves was planned, but has happened much faster than projected.

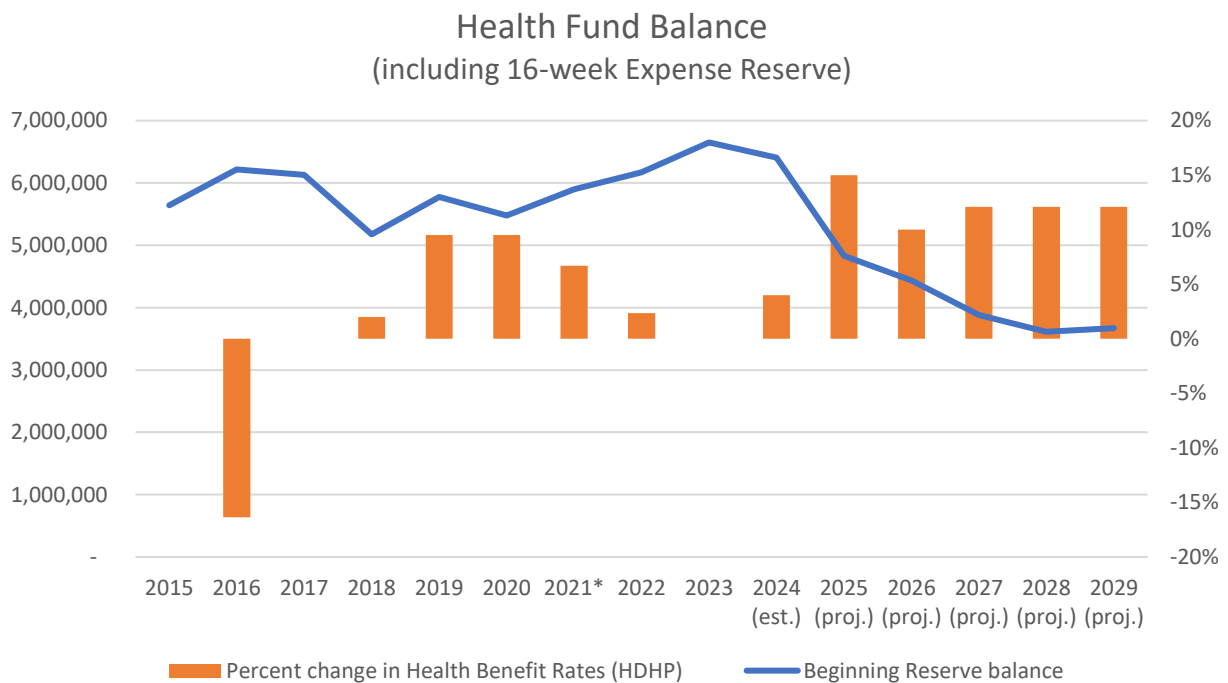
The preliminary 2025-2026 budget reflects premium increases in line with actuarial projections for cost growth, with annual increases of 15% in 2025 and 10% in 2026 and a continued use of

reserves. Implementing 12.1% increases from 2027 to 2029 will draw down the reserve to just above the required 16-week claims reserve (the estimated 16-week maximum liability for 2029).

Revenues are projected to collect less than expenses in future years if continued at the assumed rate growth as illustrated in the table above and in the following graphic. Though reserve balances are projected to remain above the 16-week minimum claims balance through the end of 2029 even assuming this draw down, it would be prudent to evaluate options for creating a sustainable long-term plan. Over the 2025-2026 biennium, staff will carefully track how assumptions have materialized and if necessary, will present proposed adjustments as part of the 2025 mid-biennial process.

Stop Loss Insurance Revisited

Additionally, it is important to note that as the City has stop loss insurance that caps individual claims at \$125,000 per year, and the overall plan at \$9.583 million per year. The City Manager, HR and Finance, working with the City’s healthcare advisor, are evaluating changing stop loss carriers and insurance levels to reduce costs. The same team is also evaluating alternatives to how the City supports those who require rare and expensive prescription drugs. It is worth noting that if significant plan design changes beyond these steps are considered, the City would need to educate, inform, and involve the labor unions.



The assumed increase in 2025-2026 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 2025-2026**

Category	% Increase	
	2025	2026
Fully Insured Equivalent (Medical Claims)	14.0%	10.0%
Vera Clinic	7.0%	0.0%
HRA/VEBA	0.0%	0.0%
Third Party Administration/Stop Loss	23.0%	16.8%
Overall Increase to Self Insurance Budget	31.8%	5.5%

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 as 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 2025 rates). The average medical benefit cost per subscriber will increase approximately 10% in both 2025 and 2026. Note that the 2026 factors are the best estimates available at this time and will be refined as part of the mid-biennial budget update in 2025.

Overall Healthcare Expenditure Changes

	2025	2026
Premiums and Premium Equivalent:		
HDP	15.0%	10.0%
Kaiser	2.1%	8.0%
IAFF PFP	10.0%	10.0%
Willamette Dental	9.9%	3.5%
Delta Dental	3.9%	3.5%
Vision	4.6%	2.8%
Other Fees:		
HRA/VEBA	0.0%	0.0%
Clinic Fee	7.0%	0.0%
Other Costs	1.0%	1.0%
Workers Compensation	4.9%	4.9%
Average Change per Subscriber from Prior Year (Medical Premiums)	11.3%	9.5%

CONCLUSION

For years, Kirkland has experienced lower healthcare costs than actuarial projections forecast, but during the current biennium, the number of claims, as well as claimant costs, have

increased. In response, the City has adjusted the fund forecast and planned higher claims-related premium increases. The five-year strategy of higher rate increases would continue the planned reserve drawdown while avoiding major changes to the plan. The projected reserve balance above the minimum allows for decisions in the next budget cycle to recognize actual claims trends and make modifications as needed. The projected reserve also acts as a hedge against worse than expected performance in the future.

In general, the overall health of the employee population is positive and participation in the clinic and wellness incentive programs remains high. Kirkland's rate of preventative visits per year continues to be well above business benchmarks. The success of the strategy is also illustrated by employee balances in HRA/VEBA accounts, which are more than \$8.3 million as of June 2024. These accounts, which were implemented with Healthy Kirkland Initiative, give employees and their families a financial buffer against unexpected medical costs.

NEXT STEPS:

Staff will closely monitor healthcare costs during the 2025-2026 biennium and evaluate program options as needed for the 2026 plan renewal. Staff will consider changes to stop loss insurance and how the plan supports those on rare prescription medications. If significant plan changes are considered for the next biennium, the City will engage with the labor unions.

ATTACHMENTS:

None.