STATE OF DELAWARE
OFFICE OF MANAGEMENT AND BUDGET
DEPARTMENT OF FINANCE

EXECUTIVE ORDER NUMBER FOUR

PRELIMINARY RECOMMENDATIONS TO GOVERNOR AND JOINT FINANCE COMMITTEE FROM THE DIRECTOR OF OFFICE OF MANAGEMENT AND BUDGET AND SECRETARY OF FINANCE

MAY 1, 2017 (Revised May 17, 2017)

Executive Order #4, signed by Governor John Carney on February 16th, 2017, established the Government Efficiency and Accountability Review (GEAR) Board. GEAR is a response to the State's current budget shortfall and concerns that budget deficits will continue into the foreseeable future if long-term actions and structural solutions are not taken.

While GEAR is a long-term initiative, Executive Order #4 also directed the Director of the Office of Management and Budget (OMB) and the Secretary of Finance to issue to the Governor a report containing preliminary recommendations for the Joint Finance Committee (JFC) to review when considering the FY 2018 budget.

This preliminary report provides recommendations in the following areas of cost reduction:

- The Budget Reset
- Education
- Health Care
- Information Technology Centralization
- Establish Department of Human Resources
- Making Government More Efficient

BUDGET RESET RECOMMENDATIONS

On March 23rd, 2017, Governor Carney announced his budget reset, detailing proposals to address the budget gap for FY2018 that currently approaches $400 million. The Governor recommended a balanced approach that cuts spending and raises revenue through shared sacrifice. In addition to his proposals to raise revenues through increases in corporate franchise taxes and fees, personal income taxes and cigarette taxes, the Governor recommended the following major General Fund expenditure reductions (expressed in the thousands of dollars):

Reduction of health care costs for State employees and Medicaid participants ($18,684.0)

Reduction of education costs for school districts and the Department of Education ($38,926.9)

Reduction of costs for personnel, pensions and pass-through programs ($18,877.9)

Reductions to individual State agencies and other State-funded entities ($16,795.2)

In addition, Governor Carney's budget reset proposal identified $7.3 million of opportunities for switch funding of services from the General Fund to Special Funds.

Details of Governor Carney's budget reset proposals can be found at
http://governor.delaware.gov/budgetreset/

Subsequent to the Budget Reset announcement, the Office of Management and Budget has identified additional cost savings from fleet utilization that can be passed through to State agencies. These savings are possible through lower fuel costs, use of technology to manage greater asset to employee ratios, and avoidance of overinvesting in assets during their lifecycles through preventative maintenance and cycling out of inventory at the proper age.

In March 2017, the General Assembly enacted HB 105 authorizing the Director of the Office of Management and Budget in consultation with the Chairs of the Joint Finance Committee to deposit Special Fund balances into the General Fund as a measure to both control agency expenditures and clear out unused and underutilized appropriated balances. Thus far, OMB has deposited more than $7.1 million of Special Funds into the General Fund. Similar authority should be extended in subsequent fiscal years to enable the State to sweep unused and underutilized funding into the General Fund for further use.

EDUCATION RECOMMENDATIONS

The State should launch a comprehensive review of Delaware's school funding structure beginning later this year. The review should address the following core questions:

- Does the current school district funding system – the unit system – meet the requirements of today's fiscal environment?
- Can the State's current revenue structure continue to fund such a large percentage of public education without reform to the State's property tax system?
- Will increasing dependence on property tax funding at the State or local level improve or harm the stability of local school districts?
- Should the State's share of school district funding be altered and, if so, should districts be provided additional flexibility to raise property or other taxes?
- Should changes to the referendum process be made?

Background

The State's FY17 operating budget for School Districts and the Department of Education totals nearly $1.4 billion or 34% of the State's entire general fund budget – a 27% increase from a decade ago.

Public school enrollment has increased significantly over the last decade (from 123,000 in 2008 to 137,000 in the current school year) as a result of many factors. There has been a significant migration of students from non-public schools (private, parochial and homeschool) due to the 2008/2009 recession and the offering of increasingly attractive programs such as full day kindergarten, K-5 grade configurations, and specific instructional programming. Adding to the spending pressure from higher enrollment has been a dramatic increase in the number and identified severity of the State's special education students. Some of this is a result of migration into Delaware of families from neighboring states and some through greater identification of existing students into higher need categories.

Delaware public schools receive 59% of their funding from the State, 31% from local property taxes, and 10% from the federal government as follows:

State funding is allocated through a variety of formulas, most of which are based on student enrollment/unit count. Specifically, the majority of State funds are earned through so-called "Division Funding" which account for approximately 80% of the State revenue to local school districts.

- Division I – Personnel Costs, authorizes local school districts to hire and compensate staff in accordance with state salary schedules. Staffing funds account for approximately 67% percent of allocations. Increased enrollment has translated into increasing staff entitlements from 7,700 Division I units in 2005 to 9,700 in the current school year.
- Division II - Fixed per unit amount for general operations.
- Division III- Equalization, offsets variations in property wealth among districts.

In addition to the unit funding outlined above, the State provides resources for various programs such as transportation, professional development, technology, academic excellence, driver's education maintenance and educational sustainment, which range from being prescriptive in nature to being as flexible legally as local funds.

Local funding is primarily raised through property taxes. There are four individual components to the tax rates assessed by each local school district, which includes current expense, tuition, debt service and match. Funds raised in each component must be used for the specified purpose.

- Current expense revenues generate the largest portion of local school district collections, and also provide the most discretion in support of operating expenses. The current expense rate cannot be raised beyond a maximum amount approved by local taxpayers.
- Tuition Tax is assessed to support the mandatory payments to receiving school districts when students attend a school in a non-resident district or to support eligible students or statewide programs within districts. Tuition Tax can be raised by action of the local school board but can only be used for eligible and approved expenses.
- Debt Service is collected to repay the local share of major capital project debt obligations.
- Match Tax generates revenue to provide local school district contributions if required through any State appropriation and/or permitted by statute.

Federal funding is tied to specific entitlement programs and must be used in accordance with federal law and regulations.

Delaware's state funded contribution to overall public education spending is relatively high. For example, Pennsylvania and New Jersey both provide approximately 36% and Maryland 42% with a significantly higher share provided by local property tax collections. Notably, Delaware is ranked 46th in the country in property tax burden as a percentage of personal income.

Over the past three decades, more than a dozen reports and studies have been generated about the Delaware school finance system. They have often repeatedly addressed the same issues, (1) property tax reform, including the need for regular reassessment and recommendations around allowing current expenses to be raised on a limited and proscribed basis by action of local school boards; (2) the core of the unit system, which provides stability, predictability and a relative degree of equity but can limit local flexibility around the allocation of resources; (3) the role of the tuition tax in raising local resources for high needs students; (4) the lack of a state funding stream for low income and English Learner students; (5) the perceived merits and challenges of school district consolidation , and (6) the specific challenges of education in the City of Wilmington. Despite all of these reports, very little has actually changed.

What has become clear in recent years is that the current expenditure structure and revenue portfolio supporting public education in Delaware is no longer adequate to the task at hand. Put simply, we can no longer continue to kick this can down the road. It is time to create a process that will actually result in the implementation of funding solutions for public education that are simpler, more cost effective and more sustainable.

HEALTH CARE RECOMMENDATIONS

There are two approaches to curbing the rise of State health care costs. One approach strictly focuses on cutting the growth of public sector health care costs by changing spending, eligibility or allocation of costs within public sector plans such as Medicaid and the State Group Health Insurance Program (GHIP) that serves state employees and retirees. But this approach on its own, could well result in the reallocation of Delaware's rising health care provider costs to the commercial sector including private and non-profit employees and businesses as well as those who purchase insurance on the health care exchange. A systemic approach would focus on establishing goals and objectives for reducing public and private healthcare expenditures and developing cooperative Performance Improvement Plans with providers that are not curbing that growth.

The combination of both approaches makes the most sense for Delaware. We recommend approval of the various reforms to Medicaid and the GHIP included in the Budget Reset recommendations. The State should also enact legislation this year modeling the work of other states that are setting annual benchmarks for health care cost growth and requiring collaborative Performance Improvement Plans for healthcare providers that exceed those benchmarks.

<u>Background</u>

Health care costs account for well over 25 percent of Delaware's general fund budget and more than $2 billion in annual state and federal expenditures. Health care costs in Delaware are growing more than 6% annually – far outpacing general inflation and population growth and more than double the rate of growth of state revenues. Federal and state funding of health care supports over half of Delaware's population including 20% through Medicare, 23% through Medicaid, and 12% through the State GHIP. Given the significant extent to which State government pays directly for health care, it is incumbent on the State to use its purchasing power to stem the rate of growth in health care costs.

Employee and Retiree Health Care Costs in the State GHIP have risen almost 50% since the start of the decade. If expenditures continue as projected, the plan will grow to $1 billion by FY 2022.

To address this problem, the State Employee Benefits Committee (SEBC) over the past year has refocused its mission to provide group members with adequate access to high quality healthcare that produces good outcomes at an affordable cost, promotes healthy lifestyles and helps members become engaged consumers. To achieve this mission, the SEBC has undertaken the following initiatives:

- For FY17, the State awarded new health plan administration contracts to Highmark Delaware and Aetna Third Party Administrators (TPAs) with a focus on 1) improving the health of the GHIP population through the use of technology, information sharing, and advanced care management models; 2) having TPAs provide innovative cost containment features such as using Accountable Care Organization payment methodologies, implementing value-based care delivery strategies, and providing meaningful trend and cost guarantees that include risk sharing; and 3) establishing goals reduce spending growth rates 2% and enroll 25% of the GHIP population in consumer-driven or value-based plans by the end of FY20.

- For FY18, the SEBC has 1) reduced administrative fees by $1.5 million; 2) added value-based care models through Aetna and Highmark expected to save $1.6 million; 3) implemented a savings program through Aetna to encourage use of lower cost providers of high-tech imaging; 3) adopted an enhanced Clinical Management Program through Highmark; and 4) made efforts to lower cost by an estimated $4.4 million by helping employees become better health care consumers during the 2017 Open Enrollment process with the implementation of the myBenefitsMentor® Consumer Decision Tool, access to new Educational mini-videos, and an Interactive Benefits Guide.

The SEBC is also discussing a second enrollment period for January 1, 2018 to continue promoting consumerism, better quality and lower cost options – many of which would require legislation including:

1) implementing and/or modifying deductibles and replacing copays with coinsurance;

2) broader use of Centers of Excellence and other value-based care delivery models (estimated savings of $1.5 million to $12.2 million);

3) addressing plan inequities such as Double State Share and no premium cost sharing for Special Medicfill pensioners (estimated savings of $9 million);

4) increasing the overall employee cost sharing target from 10% to 15% ($26 million of savings);

5) introducing a Health Savings plan and redesigning the existing health plan offerings available to active/non-Medicare retirees to provide meaningful choice/differentiation between options and promote shared responsibility and employee accountability (initial savings estimate of $3M dependent upon migration of employee enrollment); and,

6) implementing a surcharge for tobacco users (estimated net savings of $3 million or more).

Medicaid and Other State Health Services Costs have also risen dramatically as eligibility increased from 175,000 in FY 2010 to nearly 235,000 in the current year. The Budget Reset recommendations include $9 million of cost savings proposals including 1) reducing by 14% Delaware's highest-in-the-nation Medicaid reimbursements rates for dental services; 2) leveraging federal Medicaid reimbursement for certain state agency health services programs; 3) implementing utilization efficiencies in Medicaid non-emergency transportation and 4) eliminating the Delaware Prescription Assistance Program. The Delaware Division of Medicaid and Medical Assistance (DMMA) in the Department of Health and Social Services (DHSS) is working on a multi-year statewide transformation of its payment and care delivery model including implementation of a global budget target and new payment models.

Overall Healthcare Affordability in Delaware is threatened by a variety of factors impacting Medicaid, the State GHIP, and commercial health care markets. Delaware's population and workforce is older, aging faster, and generally less healthy than the average state. The hospital landscape is more concentrated in Delaware with just six acute care hospital systems across the State and most populations relying on a single hospital for their care. Rising demand for healthcare in combination with supply inefficiencies have led to 25% greater historical spend per capita in Delaware than the U.S. as a whole. And while Delawareans generally spend more on care, these investments do not always lead to better health or outcomes.

The good news is that new technologies are providing Delaware policymakers with unprecedented access to aggregated health care cost and outcome information. Using this information along with its purchasing power and regulatory authority, the State can incentivize adoption of total cost of care payment models across all segments of the health care market, enabling the State and providers to establish new models for health care delivery focused on better outcomes at lower costs. The State will be able to set targets and work with high cost providers to incentivize improved performance where necessary. While it will take a multi-year effort to implement systemic changes, the ability to bend Delaware's health care cost curve to at or below national averages is within reach.

INFORMATION TECHNOLOGY CENTRALIZATION RECOMMENDATION

In order to more aggressively realize the many benefits of Information Technology Centralization (ITC), it is recommended that Executive Order 20 from the previous administration be revised and reissued by Governor Carney. The new ITC executive order should require an analysis be conducted for the remaining agencies. The results of the analysis should outline the current state of technology, a centralization plan that defines the delivery strategy for commoditized services and identifies how agency-specific needs will be addressed; cost savings, efficiencies, timelines and a plan for fiscal and employee resources. Executive agency participation in the process should be required including specific milestones and deadlines. Significant executive level support will be necessary to navigate this transformational change that will serve as the underpinnings for many State priorities and initiatives.

ESTABLISH DEPARTMENT OF HUMAN RESOURCES

It is proposed that a Department of Human Resources be created to ensure consistent application of all human resources policies, procedures, benefits, leave administration and diversity objectives across the State of Delaware. A new chapter in Code-Title 29 Chapter 90D is required to establish the new department. Authority previously held by the Director, OMB, for the Human Resource Management (HRM) and Statewide Benefits Office (SBO) will be moved to the new Secretary.

The proposed changes will:

- Create a new Division of Diversity and Inclusion headed by a Chief Diversity Officer
- Create the Division of Labor Relations
- Give the Secretary the authority to sign collective bargaining agreements
- Give the Secretary the authority over agency HR staff, subject to service-level agreements

By elevating Human Resources to the cabinet level, greater focus can be paid to the issues of workforce development, and better defining career paths for -- and ensuring the best performance from -- employees. The new Division of Diversity and Inclusion will be positioned to oversee the state's efforts to create a workforce that reflects the diversity of the populace, and appropriately accommodates the needs and sensitivities of all its employees. Finally, the inclusion of Statewide Benefits in the scope of change enables cost control management to be integrated within the overall strategy for talent acquisition and retention.

MAKING GOVERNMENT MORE EFFICIENT

The Executive Branch of State government has periodically undertaken top to bottom reviews of State spending and collaborates every year with the Delaware General Assembly to create the annual operating and capital budget. But the State has not previously instituted a permanent and ongoing program to continuously identify, monitor, and implement programs, policies and processes that bend rising cost curves, boost efficiency and cut costs within State government. GEAR was created to address this gap.

GEAR seeks to identify opportunities for cost savings through greater state government efficiency and establishing best practices for continuous improvement. It will identify, support, and promote the realization of tangible cost savings from streamlining government processes, finding opportunities to share services between agencies, and promoting a sustainable culture of continuous improvement. Specifically, the GEAR team will:

- Discover potential shared services that can be leveraged across multiple agencies, thereby reducing the State's investment in redundant backroom systems and processes;
- Engage State agency leadership to identify which continuous improvement methodologies and sources of quality expertise have been used to greatest effect;
- Recommend changes to the Government Accountability Act to improve the strategic planning and performance management processes of all agencies;
- Recommend changes to the State personnel system to support the hiring, training, and retention of employees who will create and sustain a culture of continuous improvement; and
- Develop a communication platform to regularly inform State employees and the public of all GEAR-related government process efficiency initiatives

Program activities since GEAR's inception in mid-February have included the:

- Hiring of a GEAR Program Director by the Secretary of Finance;
- Holding of an inaugural Board meeting on March 24th and establishing a schedule for remaining meetings throughout the year;
- Conduct of multiple deep-dive working sessions with certain GEAR Board and Cabinet members and senior staff to identify GEAR-related projects either planned or currently in flight; and
- Working with GEAR Board members to gather input on first year priorities including some outlined in this report.

The full GEAR Board will provide annual recommendations for the Governor and General Assembly each December 1st.