The Market Model for Vendor Rates

Home-Based Disability Support Services

These Services include the following:

Independent Living ◆ Personal Assistance ◆ Respite Care

Supported Employment ◆ Supported Living

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Introduction

Assembly Bill ABX 2-1 (2016) not only increased funding for developmental disability services; the bill requires the California State Department of Developmental Services ('The Department') to submit a rate study for agencies serving clients with developmental disabilities. The Bill requires the study to create rates that:

1. Provide adequate numbers of vendors throughout the State in all service categories
2. Ensure consumer choice through this ample supply of vendors, and
3. Improve consumer outcomes.[1]

The goals embrace the current market setup for services while acknowledging that our rate structure does not support the disability service marketplace. The goal is to strengthen this marketplace by improving the way rates are set for service agencies.

To create a valid rate study, we need the right benchmarks for rates. The State used to set rates through provider cost reports, but this practice ended long ago. ABX2-1 took a different approach to raising rates by instituting across-the-board increases without any cost reports. Burns and Associates, hired by The Department for the rate study, is collecting large amounts of cost report data through their Vendor Survey. Yet returning to cost reports for rate setting is problematic, as former Health and Human Services Secretary Diana Dooley stated in a 2017 DDS Stakeholder Meeting.

The vendor cost-report rate methodology is, in fact, fatally flawed because:

1. Setting rates from cost reports reward high-cost vendors and punish low-cost vendors regardless of quality and efficiency. If one vendor's cost is more than another vendor's, that vendor gets more money and is rewarded for spending more.
2. Averaging costs reports only tell you how much agencies spend on average. Averaging cost reports begs the question, 'Is the average cost too high, too low, or, just right?' The average doesn't tell us if the average rate is too low or too high.
3. If service provider cost reports are used to set service provider rates, service provider costs always equal service provider rates—regardless of the world in which they operate, the quality of service delivered, or their financial condition. The provider may be going broke, but a cost statement won't tell you that. The provider may deliver the worst service in the world, but a cost report won't tell you that. Vendor cost reports won't tell you if cost-report rate produces good or bad agencies.

[1] For the text of the rate study goals, see ABX2-1's Title 17 Section 2. § 4519.8 addition.

4. Using cost reports for rate setting won't allow you to evaluate the rate—you can't answer the question, 'Is that rate too high, too low, or just right?' because you only have the vendor cost report to evaluate the rate. If you can't evaluate the rate, then you can't really tell if the rate is right. You need an independent benchmark.

Vendor cost surveys are functionally irrelevant for rate setting. So how do we set rates?

Two other common alternatives are:

1. *Contract bidding* where the State choses vendors based on competing proposals.
2. *Competitive pricing* that allows people to choose from a variety of companies with different mixes of services. Prices are set by how much consumers are willing to pay for any given service.

Unfortunately, neither work for setting disability service rates.

The State can't use a contract bidding process because it is committed to creating a marketplace of many different vendors. Thousands of vendors submitting bids would be inefficient and would reward large service providers and squeeze out smaller ones. As the larger providers take over, the State would see competition erode and prices skyrocket—as we see in the health care and defense industries, among others.[2]

Competitive pricing won't work either. The State can't use consumer pricing for disability services because the State pays for the services instead of the consumer. Disability services are virtually free to people who qualify.

The State faces a dilemma: how should it set rates without vendor cost reports, without contract bidding, and without competitive pricing?

The answer to this rate-setting puzzle is located within the wider marketplace where disability service providers operate. Agencies hire talent, buy equipment, and retain professional assistance to deliver disability support services, purchasing these business resources from the marketplace in which they operate. We need a rate-setting method that captures the marketplace costs of delivering disability services.

[2] Hospital Monopolies: *The Biggest Driver of Health Costs that Nobody Talks About*, Forbes, https://www.forbes.com/sites/theapothecary/2011/08/22/hospital-monopolies-the-biggest-driver-of-health-costs-that-nobody-talks-about/#5c1219b62ce8 . Health and defense industries' consolidation through mergers and acquisitions are designed to counter competition to raise prices. Keeping a marketplace with set rates stops vendors from consolidating to force price increases. The State is wise to keep a service marketplace to hold down costs. But it needs to set prices so that the marketplace remains healthy, or it will be left with service providers who pretend to deliver quality services while the State pretends to pay them.

The following Market Rate Model identifies disability service cost components and methods for calculating these costs using the right data sources. The model's methods allow us to identify the costs of:

- Hiring personnel with the the appropriate skill sets
- Obtaining office space, service delivery space (if necessary), office equipment, and other physical resources
- Retaining professional services such as legal, tax, and financial advice for regulatory requirements; obtaining liability insurance

After the market costs are identified, the calculation methods are used to create a service rate. The rate can then determine if agencies are overfunded, underfunded, or adequately funded through cost reports. Once vendors have the same rates for the same services, these vendors will compete by delivering quality services instead of slashing costs. High-quality agencies will be popular and thrive. Low-quality service vendors will be unpopular and will leave the marketplace, or improve.

We are partnering with Armanino LLP, a national accounting firm, to use these principles for calculating market rates for home-based disability support services throughout California. We hope our research will inform The Department's rate study. Burns and Associates, hired to perform the rate study, has requested additional data from vendors. We will be using our market model to collect this data and deliver it; hopefully our data will be the basis of a dialogue on rates that fulfill the mandated rate study goals. It is time to get real about rates—people with developmental disabilities' lives depend on it.

1. Methodology

Three Cost Centers	1. *Follow HCBS and Burns & Associates categories of Direct Support Provider (DSP), Program Support, and Administration cost areas.[3]:* • *DSPs.* Staff who deliver direct care in the client's home and community. [4] • *Program Support.* Staff who supervise, train, provide client relationship services, and other DSP support. As well as wages and benefits, program support includes equipment, their office space, and pro-rated liability insurance & business resource costs. • *Administration.* Executive leadership, accounting, general insurance, and other business resource costs, including admin office space.

[3] HCBS and Burns and Associates both use the term 'direct support staff' which is equivalent to 'DSP'.

[4] We follow California common usage for whom Burns & Associates calls "direct care workers" and "direct support staff', to avoid any reader confusion. The terms are interchangeable.

Use Market Cost Components	2. *Calculate Rates using Cost Components.* The rate of a service provider is based on costs for each component of service. For example, a DSP's wage is a cost component of the overall cost of delivering service. So are business resources—office, software, insurance, legal advice, etc. All cost components need to be included in the rates. The cost of a component is the price of that component in the agency's local marketplace. For example, car insurance may be more expensive in urban areas than in rural areas. DSP wages are more expensive in San Francisco than Redding.
Create Uniform Rates	3. *Create uniform agency rates where the same service is provided in the same geographical area.* We assume that rates for the same service provided in the same area must be uniform—agencies will compete based on service quality, instead of prices. These rates must also be uniformly increased for clients with intensive behavior and medical needs.
Allow Reserve Creation	4. *Allow Agencies to create and retain reserves.* The State has learned that creating reserves is crucial for its operation, and has put billions of dollars into their rainy-day fund. Agencies must do the same, since they are independent organizations just like the State. Any organization without reserves is unstable and cannot weather unexpected expenses, delays in reimbursement, and improve consumer service through innovation. Generating reserves can be done through donations, equity investments, and running operations at lower costs than the rate provided. All three avenues are legitimate and should be encouraged. With healthy competition through adequate and uniform rates, different combinations of reserve generation will achieve different consumer outcomes. Client choice will drive the quality and pick the best providers through healthy agency competition.
Rate Formula	5. *DSP costs are calculated using the methods listed below.* The Program Support wage & benefit costs are calculated by marking up the DSP wage and benefit costs. Program Support costs are then calculated based on the program support time plus other program support costs. (DSP Cost) + (Program Support Cost) + (Admin Cost) = Service Rate

Adjust Rates Every Year	6. *Adjust rates yearly based on a previous quarter look-back period.* Market costs rise every year, especially in high-cost areas. Minimum wages at both the local and the State level go up every year. Health care has risen 470% in thirty years. Business resource costs increase rapidly in unpredictable ways. We need annual recalculations that would use a small number of market data points to adjust rates.

2. DSP Cost

Wages	1. *Calculate DSP wage allocations by marking up the local minimum wage in each geographical area.* Set the DSP labor cost as a percentage markup of the minimum wage in each area. For example, a 30% markup from a $12.00 minimum would allocate $15.60 for wage costs, including any future raises over the starting wage. Disability service positions require higher-level skills and are more demanding jobs than nearly all other minimum wage jobs. Agencies need wages that compete with other businesses that hire workers who have the skills needed for disability service work—those companies pay more than the minimum wage. The markup represents amount over the minimum agencies can use for starting wages as well as any raises given to senior staff.
	2. *Use local wage and benefit costs of competing occupations to determine the minimum wage markup.* We will identify competing occupations, establish their market rates in different areas, and propose minimum wage markups based on these labor market comparisons. The cost allocation for DSP, and Program Support Staff, wages needs to include the entire employment cycle—starting wage and seniority wage increases over the average time spent at an agency. Markups must be significantly higher than starting and perhaps higher than average wages of competing occupations. Competing occupations are not only those jobs that have similar skill sets. DSP positions compete with occupations such as fast food, fast casual, and casual dining positions—entry level jobs that are easier to get to because they are not at people's homes, and need less skills than disability services. One cannot ignore these positions because they have a different skill set. Entry level jobs that are less demanding and which pay more are more attractive to workers with DSP skill sets even when those DSP skill sets are not required for those jobs.

3. *Set minimum wage areas using the highest local minimum wage for a major city in that geographic area.* In California, geographical areas can span regions adjacent to higher minimum wage districts. Most companies in these areas tend to base their salary offers on the highest minimum wage in their area, since many qualified job applicants are drawn towards the higher wage. We propose creating geographical minimum wage areas, tying the wage floor to the highest minimum wage (for a major city) in the region. We have identified six minimum wage areas, where the going minimum rate of pay is higher than that of the State: San Francisco, SF East Bay, Los Angeles County, Sacramento, San Diego, and San Jose. We may need to add new minimum wage areas as other municipalities create additional minimum wage ordinances. We will use the State minimum wage as a base outside of geographical areas.

4. *Set different markups for different services.* Some services require direct support staff to have higher-level skills and are more difficult to perform than others. Respite, Supported Living, and Independent Living services should have increasing markups due to the increased skill and work demands of those services.

5. *Markup DSP wages an additional percentage for client ratios, behavioral, and medical needs.* When DSPs support more than one client at a time, or are supporting individuals with intensive behavioral needs as well as those who are medically fragile, the additional responsibilities and skill sets require higher compensation.

6. *Calculate the overtime cost component as a markup cost from direct care staff's wages and benefits equal to the current 5.82% add-on.* The State provided a 5.82% cost increase for paying and managing overtime, and this increase should remain a part of our rate. Calculating this cost as a markup on DSP's wages requires a higher percentage rate to get to 5.82% rate increase.[5]

Benefits

7. *Calculate sick leave as a replacement cost.* When a DSP is sick and is paid sick leave, the agency must replace that worker, incurring double cost for that shift. The sick leave needs to include replacement costs.

8. *Use agency Affordable Care Act (ACA) costs to calculate their component.* The ACA is a government mandate and must be included in agency rates. Each agency should be reimbursed for their costs because the cost variance is due to the age of the worker. Any independent benchmark would pressure agencies to hire younger staff, resulting in age discrimination.

Reimburse-ments	9. *Add transportation costs for all Home and Community-Based services.* The State has a legal responsibility for Respite Care mileage reimbursement according to Title 17, Section 3, §58130 6. The State must begin reimbursing all Respite Care DSPs throughout the state. Independent Living Skills Instruction has the same schedule challenges, and should also be reimbursed for mileage, as is currently the case. Personal assistance has the same structural challenges, and needs transportation reimbursement. Given the small shifts, relatively low-pay, and the inaccessibility of many homes via public transit, we believe this reimbursement to DSPs is essential to retaining staff. Since mileage is highly variable, we suggest a pass-through on mileage reimbursement rates with a per-visit cap that varies by geographical area. Reimbursements should be at the annual IRS mileage rate.[7]
	10. *Include productivity adjustments for non-billable time.* Training wages, paperwork, staff discussions around service delivery and other costs often can't be billed as part of a direct service unit, and is not related to administrative nor program support costs. Time lost due to missed appointments by clients must also be included. These hours must be factored in, and we follow HCBS' productivity markup method, as does Burns & Associates.

[5] In our rate model, we use a 7.35% markup to keep the OT rate at a 5.82% markup for the entire rate.

[6] Title 17 generally requires transportation reimbursement for DSPs going to and from homes, and for any transportation costs they incur during the visit. We need to make this consistent across all five service codes.

[7] Supported Living: Title 17, § 58661 Direct Service Rates. Independent Living: ILS Programs are defined in Title 17 Section 56742(b)(3) and (b)(4), and are considered to fall under the regulations for "Adult Day Programs." The allowable cost components for all Community-Based Day Programs are listed in Title 17, Section 57434. Respite: Title 17 CA Code of Regulations, Article 3 - Supplemental Rate for Respite Worker Travel Costs, §58130. Supplemental Rate for Respite Worker Travel Costs.

3. Program Support Cost

1. *Set the Program Support wage allocation by marking up the DSP wage allocation*. The additional skill set qualifications and their associated market value require higher wages for program support staff. The amount of increased wages over DSPs depends on the occupational competition in the agency's area. For example, the program support wage allocation should depend on what other companies paying supervisors and trainers in that geographical area. The program support staff wage allocation should be calculated by marking up the DSP wage. The amount of the markup should be based on the market wage for similar positions in the area. For example, the program support staff wage allocation could be 175% of the DSP wage cost allocation. If a minimum wage area's base wage is $12.00, the DSP wage allocation would be $15.60 per hour, and the program support allocation would be $27.30. The markups address wage compaction. When only DSP wages are raised, and program support staff stay the same, the result is wage compaction: the declining wage difference between two classes of employees. Since program support positions require a premium over the DSP staff, the pay ratios need to be maintained. Competing supervisory occupations must be compared when calculating the markup. A program support markup will keep those ratios the same and allow agencies to compete with other companies for qualified staff. Where program support oversees services delivered in languages other than English, additional compensation via higher markup will be required.
2. *Calculate program support rates using the program support ratio.* Program support costs are the program support personnel's wages & benefits, plus any additional costs incurred in delivering program supports, such as CPR certificate costs, training space, computers, etc. We propose calculating program support costs as a ratio to billed service units, following HCBS methodology. The ratio is:

$$\frac{\text{Program Support Costs}}{\text{Billed Service Units}}$$

This ratio gives us a dollar amount for the program support cost component.

4. Admin Cost

Keep Admin at 15% of Rate

Retain administration costs as 15% of revenue. Administration staff wages and business resource expenses allocations will increase with other allocations when the 15% administration cost allocation is maintained. A 15% admin rate is less than the rates at which similar businesses operate in the marketplace. Vendors need 15% to obtain the administrative resources needed for service delivery. Higher rates based on increased DSP and Program Support costs components will raise the overall rate. The 15% allocation will increase due to the overall rate increase, providing revenue to cover admin salary increases and increased business resource costs. The Department's current rate for administration is 15%, and this percentage needs to remain at 15% for three reasons:

a. *Recruitment and retention of qualified management and administrative staff require higher wages in proportion to DSP and Program Support Staff wages.* Executive leadership, accounting managers, and human resource staff must be recruited from the same pool of people that health care, senior care, and other service companies draw from. Increasing DSP wages without increasing income for service administration completely ignores market conditions.
b. *Quality management is necessary for quality service.* Hiring qualified administrators is just as important as hiring qualified DSPs and program support staff. Delivering a service requires more than a DSP showing up at a client's doorstep; organizational leadership brings all the resources together so that a qualified DSP with field support provides the right service for that client. Good DSPs and program support staff don't want to work for poorly run agencies. Poorly managed agencies deliver poor service to their clients.
c. *Business resource costs increase at similar rates to labor costs*. Service delivery depends on training, payroll, office space for administration, software, computers, billing systems, and the like. Many agencies must provide audits or financial reviews to The Department of Developmental Services. Agencies also need extensive legal advice for monitoring and incorporating changes in personnel law, as well as updating service provision practices for quality control and assurance purposes. General liability, employment practice, directors' and officers' insurance must be purchased and renewed annually. No service is delivered without these resources in place, and many are required for vendorization. Business resource costs often increase faster than minimum wages. For example, Oakland office rents rose 34% in one year—seven times faster than the increase in minimum wage.[8]

5. Conclusion

What if the State thinks the rates are too high?

There will undoubtedly be objections that the rates under this model are too high. Such a response begs the question, "Too high according to what standard?" If the rates are too high because vendor surveys show costs are much lower, we can only answer that the vendors are being underpaid, resulting in operating losses. Many programs are closing due to low rates and many vendors refuse to provide certain services because the rates are too low. If one claims rates are too high because they are higher than other states' rates, such a comparison only shows California rates need to be higher to successfully deliver services in California markets.

The State Must Choose

Market rates are the right criteria to calculate vendor rates because agencies must operate within their local markets and pay local market rates for every resource they need to deliver services. Claiming market rates are too high is a comment about the high cost of California markets, not the rates service providers need to operate in those markets.

Continuing to provide rates lower than marketplace costs will not achieve ABX 2-1 goals of consumer-driven choice and quality of services. The State will have to choose: on the one hand, the State can pay appropriate rates, enabling consumer choice, creating consumer-driven quality standards, and providing the basic availability of services. On the other hand, the State can arbitrarily set lower rates with the attendant negative consequences outlined in this paper. As Burns & Associates states, the study is to determine *appropriate* rates—what the State does with these market rates is up to the State.

Achieving ABX 2-1 Goals Through the Market Rate Model

In hearing after hearing, in conversations at association meetings, in desperate testimonies as agencies close their doors, we hear the same theme from service providers: "We can't hire workers, we can't pay the rent, we can't afford our insurance, we can't retain competent managers." We also hear from State officials claiming there is no crisis, the Department of Developmental Services is a financial black hole, and for every agency that closes its doors, another one takes its place.

Our preliminary data indicates there is indeed a funding crisis, and we show why this crisis exists. We also show how to fix it using the Market Rate Model for setting agency reimbursement rates. It is time to adopt a clear methodology and gather the right data for creating rates that support providers and create consumer choice. The mandated Rate Study has provided us with an opportunity; it's time to heed the call using the right model.

[8] https://www.bizjournals.com/sanfrancisco/blog/real-estate/2016/03/oakland-office-rents-uber-pandora-jll-shorenstein.html ; Oaklands minimum wage went from #12.25 to $12.86, a 5% increase