TO:	**American Network of Community Options and Resources**
FROM:	**Avalere Health**
DATE:	**March 4, 2016**
RE:	**Estimated Impact of the Department of Labor Proposal on Community Providers Serving People with Intellectual and Developmental Disabilities**

SUMMARY

The American Network of Community Options and Resources (ANCOR) asked Avalere Health to estimate the first-year impact associated with the overtime pay exemption changes on community providers serving people with intellectual and developmental disabilities (I/DD). On July 6, 2015, the Department of Labor (DOL) proposed to set the standard salary level required for exemption from the overtime pay equal to the 40th percentile of earnings for full-time salaried workers (projected to be $970 per week, or $50,440 annually, in the first quarter of 2016). Currently, the standard salary level required for exemption is $455 a week ($23,660 annually).

Under cost impact Scenario 1, Avalere assumed that community providers serving individuals with I/DD will cover overtime for employees earning between $23,660 and $50,440 who will no longer be exempt at the estimated total cost to providers of over $1 billion. Under cost impact Scenario 2, Avalere assumed that community providers serving individuals with I/DD will increase salaries for affected employees in order to meet the new exemption level at the estimated total cost to providers of approximately $1.9 billion. We also estimated about $400-$850 million in potential increases in Medicaid spending due to individuals with I/DD losing access to services in the community setting and transitioning to the more expensive, institutionalized settings. Finally, we modeled alternative scenarios of the standard salary level required for exemption, which are below the 40th percentile of earnings for full-time salaried workers.

Cost Impact to Community Providers Serving Individuals with I/DD due to the DOL Proposal

	First-Year Cost Impact, in Millions of Dollars
Scenario 1: Total cost of covering overtime	$1,046
Scenario 2: Total cost of salary increases to meet new threshold	$1,862
Potential Increase in Medicaid Spending	$388-$856

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BACKGROUND

The Fair Labor Standards Act (FLSA) guarantees a minimum wage and overtime pay at a rate of not less than 1.5 times the employee's regular rate for hours worked over 40 in a workweek. While these protections extend to most workers, the FLSA does provide a number of exemptions. The standard salary level required for exemption is currently $455 a week ($23,660 annually) and was last updated in 2004. On July 6, 2015, the Department of Labor (DOL) published the Notice of Proposed Rulemaking (NPRM) with the public comment period through September 4, 2015.[1] In the NPRM, the DOL proposed to set the standard salary level required for exemption from the overtime pay equal to the 40th percentile of earnings for full-time salaried workers (projected by the DOL to be $970 per week, or $50,440 annually, in the first quarter of 2016). The Bureau of Labor Statistics (BLS) data used to set the salary level for the rulemaking consists of earnings for full-time (defined as at least 35 hours per week) non-hourly paid employees.[2] The DOL considers data representing compensation paid to non-hourly workers to be an appropriate proxy for compensation paid to salaried workers. Furthermore, in order to prevent the salary exemption levels from becoming outdated, the DOL proposed to include a mechanism to automatically update the salary and compensation thresholds on an annual basis using either a fixed percentile of wages or the Consumer Price Index, Urban (CPI-U).

The American Network of Community Options and Resources (ANCOR) is a national trade association representing more than 1,000 private providers of community living and employment services to individuals with intellectual and developmental disabilities (I/DD). The majority of funding for the services comes from Medicaid[3] that sets the reimbursement and private providers have no ability to negotiate the rates nor to pass on increased operating costs to the state or the individuals served. Community providers employ direct support professionals (DSPs) and other types of staff that currently are exempt from the overtime pay, i.e. earn over $23,660 annually. However, most of those employees earn below the proposed, new salary exemption threshold of $50,440, which means that the DOL proposed rule, if implemented, would result in additional costs for the providers associated with having to pay overtime or increasing salary levels in order to continue the exemption.

FINDINGS

Avalere assumed nearly 4,000 community providers serving people with I/DD will be affected by the DOL proposal.[4] This reflects providers who are members of state associations, not just ANCOR. On average, community providers employ 62 full-time salaried employees, for a total of ~242,000.[5] Majority of those full-time salaried employees (95 percent or ~230,000) are currently exempt from the overtime pay.[6] Of those currently exempt, 67 percent (or ~ 154,000) earn between $23,660 and $50,440 and will lose their exemption under the DOL proposal.[7] We assumed the majority (90 percent or ~139,000) work overtime;

[1] Proposed Rule, Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees, 80 FR 38515 or http://www.regulations.gov/#!documentDetail;D=WHD-2015-0001-0001

[2] Bureau of Labor Statistics, Research series on deciles of usual weekly earnings of non-hourly full-time workers, http://www.bls.gov/cps/research_nonhourly_earnings_2015q1.htm

[3] National Core Indicators. Chart Generator 2013-14. National Association of State Directors of Developmental Disabilities Services and Human Services Research Institute, http://www.nationalcoreindicators.org/charts/

[4] ANCOR's 2015 internal data on community providers serving people with I/DD.

[5] ANCOR's 2015 internal survey of 258 members.

[6] Ibid.

[7] Ibid.

35 employees per provider.[8] This will be the number of employees directly affected by the DOL proposed rule.

Provider Cost Impact Scenarios

Avalere assumed the average salary for non-exempt employees under the DOL proposed rule to be $37,050 which is the mid-point in the $23,660 and $50,440 and also aligns with the average salary for the affected employee reported by ANCOR members interviewed.[9] We assumed weekly overtime worked by an exempt employee to be 5 hours. Surveyed providers reported an average of 14 percent of hours worked by exempt employees in excess of the 40-hour week.[10] The resulting overtime pay per hour is $26.72 which is 1.5 times the hourly rate ($17.81) estimated based on the annual salary of $37,050.

Under Scenario 1, the total cost of covering 5 hours/week of overtime for 139,000 employees who will no longer be exempt is over $1.05 billion, or ~$266,000 per provider. Those costs are higher as the estimate of weekly overtime hours increases. Under Scenario 2, the total cost of increasing annual salary by over $13,000 for each of the 139,000 affected employees in order to meet the new exemption level is $1.86 billion, or nearly ~$474,000 per provider. This estimate does not include additional costs associated with payroll taxes and employer contributions to retirement accounts, which will likely increase due to higher salaries.

The DOL proposed rule impact under both, Scenario 1 and 2, will result in a large financial burden for many community providers who do not have margins to absorb cost increases associated with the rule implementation. Nor will they receive additional funding from Medicaid to help them mitigate additional costs. As a result, providers will likely have to employ a mix of different strategies in response to the rule.

ANCOR survey indicates that 34 percent of providers might increase salaries to meet the new exemption threshold and 76 percent of providers might turn the currently exempt employees into hourly workers to continue employee exemption status.[11] The latter strategy might prove to be cost-neutral or possibly introduce savings due to lower or no benefits offered to hourly employees. Some providers might restructure their staffing, wages, and benefits. For instance, 37 percent of providers indicate that they would lay off higher-paid employees who will be non-exempt under the proposed rule. Nearly one third or 28 percent of providers would hire more lower-paid workers to eliminate/reduce overtime among affected employees.[12] Some providers, especially smaller ones who have no other areas for finding cost offsets, might need to reduce wages and/or eliminate future wage increases for direct support professionals (DSPs) who account for the core staff serving individuals with I/DD and are currently not exempt from the overtime pay, earning less than $23,660.[13] [14] Overall, the mixed strategy approach in order to absorb new costs could bring the total cost down to under $1 billion for the community providers affected by the DOL proposal.

[8] Avalere's assumption based on conversations with ANCOR members.
[9] Avalere's assumption based on conversations with ANCOR members.
[10] ANCOR's 2015 internal survey of 258 members.
[11] ibid.
[12] Avalere's assumption based on conversations with ANCOR members.
[13] Ibid.
[14] Staff Stability Survey Report 2014, http://www.nationalcoreindicators.org/upload/aidd/2014_Staff_Stability_Report_11_13_15.pdf

Medicaid Impact

We also assessed the impact on individuals with I/DD served by community providers who will no longer be able to access services in the community setting due to provider closures and/or service reductions and will transition to the more expensive, institutionalized settings resulting in increased cost to Medicaid. ANCOR survey indicates that 21 percent of providers might reduce services in response to the DOL proposed rule. [15]

There were nearly 5 million individuals with I/DD in FY 2013, of whom 1.5 million received services.[16] Majority of individuals (95 percent or 1.4 million) received services in the community setting, which includes residential facilities (max. 15 people), supported living, family support, and supported employment. A small portion (5 percent or ~73,000) received services in the institutionalized setting, which includes nursing facilities, state-operated institutions, and privately operated institutions (16+ people). Avalere assumed a 10 percent reduction in the number of individuals who will be able to access services from the community providers (~143,000). We further estimated that 5 percent (or ~7,000) of individuals who will lose access to community services will seek services in the more expensive institutionalized settings such as large state-run or private nursing facilities. This assumption reflects current rate of institutional care[17] and assumes most of individuals who might lose access to their services will be able to receive care from other community providers.

We assessed differences between annual Medicaid spending per person receiving services in the community versus institutional setting. We found that the low-end estimate of Medicaid spending difference is ~$55,000 per person per year. This is based on the reported $61.5 billion in total public spending on I/DD services in FY2013 of which $8 billion was spent on institutionalized care and $53.5 billion on community-based services. [18] Medicaid accounts for 78 percent of total public spending on I/DD services. [19] The resulting spending ~$29,000 per person per year for services in the community setting and ~$84,000 per person per year for services in institutionalized setting.

We found that the high-end estimate of spending difference is ~$122,000 per person per year. This is based on the reported average annual cost of care in state-operated 16 + person I/DD institutions of nearly $200,000 per person and between $51,000 and $101,000 per person average annual cost of care in 7-15 person Intermediate Care Facilities for Intellectual Disabilities (ICF/ID) and other group settings as well as 6 or fewer person ICF, group, host, and foster homes.[20]

[15] ANCOR's 2015 internal survey of 258 members.
[16] Braddock et al., Coleman Institute and Department of Psychiatry, University of Colorado, 2014, http://www.stateofthestates.org/documents/UnitedStates.pdf
[17] Ibid.
[18] Ibid.
[19] Ibid.
[20] Data Charts for Fiscal year 2013, The State of the States in Developmental Disabilities, University of Colorado, Department of Psychiatry, http://www.stateofthestates.org/index.php/intellectualdevelopmental-disabilities/interactive-charts#chartControls

Alternative Cost Impact Options

Avalere modeled alternative scenarios of the standard salary level required for exemption which are below the 40th percentile of earnings for full-time salaried workers. We used the 67 percent estimate of currently exempt employees who earn between $23,660 and $50,440 to approximate the share of employees at different salary levels that could be used by the DOL as alternative exemption thresholds. We then assessed the changes in the overall cost impact to community providers.

Alternative Cost Impact to Community Providers Serving Individuals with I/DD due to the DOL Proposal

Upper limit of:	Salary exemption threshold: Projected Q1 2016 annual earnings of non-hourly full-time workers	Estimated percentage of currently exempt employees making between $23,660 and salary exemption threshold	Scenario 1: Total cost of covering overtime, in Millions	Scenario 2: Total cost of salary increases to meet new threshold, in Millions
10th percentile	$26,467	7%	$110	$195
15th percentile	$30,896	18%	$283	$503
20th percentile	$35,325	29%	$456	$811
30th percentile	$43,334	50%	$768	$1,368
40th percentile	**$50,440**	**67%**	**$1,046**	**$1,862**