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February 3, 2014

Hon. Kamala D. Harris
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Ashley Johansson
Initiative Coordinator

Dear Attorney General Harris:

Pursuant to Elections Code Section 9005, we have reviewed the proposed initiative (A.G. File No. 13-0064) that would require certain home care organizations to spend at least 75 percent of their revenue on direct home care services versus administrative overhead.

Background

Private Home Care Industry. Private home care organizations employ home care aides to provide services to consumers who are unable to perform the activities on their own due to their age or disability. Because these private entities are not currently required to be licensed, it is difficult to determine the exact number of organizations currently in operation in California. (Chapter 790, Statutes of 2013 [AB 1217, Lowenthal], will require licensure of private home care organizations by the Department of Social Services [DSS] beginning in 2015.) Additionally, official data is not currently available on the annual revenue each home care organization is currently generating. However, in our research, we found estimates of between 1,200 and 2,500 private home care organizations in California with annual revenue ranging from $100,000 to over $5 million (based on a survey of a significant portion of the home care industry).

Services Provided by Private Home Care Organizations. These private home care organizations employ home care aides to provide services such as bathing, dressing, feeding, personal hygiene, transferring, ambulating, toileting, housekeeping, laundry, and transportation. Some home care organizations also operate home health and hospice services in addition to their home care services. Home care organizations that also provide home health services have their home health portion of their business licensed by the California Department of Public Health (DPH).

Proposal

This measure would require private home care entities to spend at least 75 percent of their annual revenue on direct services costs, file cost reports with state agencies, and incur penalties and be subject to other enforcement actions for failure to comply with the measure's provisions. Although the measure becomes effective upon enactment, home care organizations are not required to comply

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with the main provisions until January 2016 (or up to one year later if determined necessary by a specified state agency).

The measure states that it does not apply to certain home care entities, or to the provision of certain home care services, including, but not limited to: (1) individual home care aides who contract directly with consumers, (2) licensed hospice programs, (3) licensed health facilities, (4) services provided under the In-Home Supportive Services program, and (5) licensed residential care facilities for the elderly.

Places New Requirements on Private Home Care Industry

Defines Direct Home Care Costs and Administrative Overhead Costs. This measure defines "direct home care services" as the wages and benefits, payroll taxes, workers' compensation and unemployment insurance premiums, recruiting, training, orientation, and background checks for all home care aides and care managers. This measure defines "home care aide" as an individual who provides home care service to a consumer primarily in the consumer's home. The measure defines "administrative overhead costs" as all costs other than direct home care costs. Examples of administrative overhead costs include compensation and benefits for executives, profit, facility and office equipment costs, advertising costs, distribution to shareholders, and conference costs.

Establishes a Minimum Direct Home Care Service Cost Ratio. This measure would require home care organizations to spend at least 75 percent of their annual home care services revenue on direct home care services, and no more than 25 percent on administrative overhead costs.

Creates Process to Apply for an Adjustment to the Ratio. This measure allows home care organizations to apply for a retroactive or prospective adjustment to the minimum direct home care service cost ratio for one-year increments of time if such an adjustment is needed to allow the organization to continue to operate and maintain "financial integrity." Home care organizations may apply for this adjustment at any time, however, if a home care organization is notified that it is being investigated, the organization must submit the application for an adjustment within 60 days in order for such an adjustment to be relevant to the investigation.

Establishes Penalties for Organizations That Do Not Comply. Home care organizations that are out of compliance with this initiative may be subject to a civil penalty of between $1,000 and $10,000 annually for each violation.

Ties Licensure to Compliance With Ratio. If a home care organization is found to have violated the minimum direct home care service cost ratio, this measure requires the DSS to revoke the license of the organization (as previously noted, home care organizations will be required to be licensed beginning in 2015). Further, if the organization is also licensed as a home health agency, the measure requires the DPH to revoke their home health agency license if a violation of the ratio is identified. Finally, the measure gives DSS and DPH the permissive authority to deny a home care organization's application for licensure or licensure renewal for the violation of *any* of the requirements of this measure. However, as DPH is not responsible for reviewing or approving home care organizations' licensure or licensure renewal applications, it is unclear what authority this provision is intending to give to DPH. Any license revocation is stayed pending the completion of an administrative hearing.

Primarily Requires DSS to Administer and Enforce

This measure places several new implementation, oversight, and enforcement responsibilities with DSS. In some instances, DPH may also have a role in enforcement. Below, we summarize the major new responsibilities for the department.

Requires Home Care Organizations to Provide Cost Reports Annually. To ensure that home care organizations are in compliance with the minimum direct home care service cost ratio, this measure requires these entities to submit annual cost reports to DSS. These reports must specify the amount of home care services revenue, direct home care services costs, and administrative overhead costs. The DSS is required to make these reports available to the public upon request.

Requires DSS to Review Applications for Adjustments to the Ratio. The DSS would be responsible for developing the procedure through which a home care organization would apply for an adjustment to the minimum direct home care service cost ratio. In determining whether an organization is eligible for an adjustment, DSS is required to consider such things as whether the organization has (1) administrative overhead costs that are incurred for reasons beyond the control of the organization, (2) start-up costs for new organizations, and (3) higher costs associated with higher-cost geographic areas.

Requires DSS to Enforce Compliance With the Measure. This measure gives DSS the authority to verify that home care organizations are in compliance with this measure through investigations, inspections, and audits. The DSS is required to provide home care organizations with reasonable written notice that it is conducting an investigation. When the department has identified a violation, it is required to notify the organization of the violation in writing. This notification is required to contain information about assessed penalties, licensing actions, and the organization's right to request a hearing held by DSS.

Requires DSS to Make Oversight Information Publicly Available. In addition to receiving the annual cost reports, DSS would be required to make information regarding complaints, citations, findings of violations, assessments of penalties and fines, and other enforcement actions reasonably available to the public. The measure also requires the department to establish a public registry of home care organizations. This measure would require the registry to indicate which home care organization had violated the requirements of this measure and the nature of the violation.

Authorizes DSS to Establish Fees to Cover Implementation and Enforcement Costs. In order to cover the costs incurred by DSS and DPH to administer and enforce the measure, this measure gives DSS the authority to assess fees on home care organizations. It should be noted that, under this measure, these fees would count towards a home care organization's administrative overhead costs.

Establishes the Home Care Enforcement Fund. All fees, fines, and penalties collected as a result of this measure would be deposited into the Home Care Enforcement Fund established by the measure to be used by DSS for implementation and enforcement. Additionally, if the resources in the fund are more than is needed for implementation and oversight, DSS has the ability to use the remaining funds to further other department purposes.

FISCAL EFFECTS

Apart from state agency administrative costs, the fiscal impact of the measure on state and local governments depends largely on the behavioral responses of home care organizations subject to the measure, as discussed below.

State Agency Administrative Costs

The measure imposes new administrative, oversight, and workload responsibilities on DSS and DPH. Although the cost to comply with these administrative duties is likely in the range of $8 million to $11 million annually, the measure gives DSS the authority to establish a fee to be paid by home care organizations to cover these costs. Should DSS exercise this authority, there would be no state General Fund cost associated with the new requirements the measure places on DSS and DPH.

Potential Behavioral Responses Could Vary Widely

At this time, the number of home care organizations that are not in compliance with the minimum direct home care service cost ratio is unknown. Therefore, it is unknown how many home care organizations would be required to take action in order to comply with the measure's requirements. Further, if there are organizations that are not currently spending at least 75 percent of their revenue on direct services, there is no data available to tell us how close they are to meeting the ratio requirement or what their annual revenue is today. As a result of this measure, there are various behavioral responses that could occur across the private home care industry for organizations that are not spending at least 75 percent of their revenue on direct home care costs. Below, we provide a listing of the primary potential behavioral responses, the deployment of which depend on the unique circumstances of each home care organization (discussed further below).

- ***Apply for an Adjustment to the Ratio.*** In order to be in compliance with this measure, some home care organizations may decide to exercise the option to apply for an adjustment to the minimum direct home care service cost ratio. The purpose of the provision of the measure that allows home care organizations to apply for this adjustment is to permit organizations to continue to operate and maintain financial integrity.

- ***Redistribute Expenditures Within Existing Revenue.*** Some home care organizations may decide to redistribute their costs within their existing revenue stream in order to comply with the required cost ratio. For example, an organization with $1 million in annual revenue that is currently spending only $650,000 on direct services and $350,000 on administrative overhead may try to find a way to shift $100,000 from administration to direct services. An example of this would be an organization that decides to reduce its profit or administrative costs and increase the home care worker hourly wage.

- ***Increase Total Annual Revenue.*** In order to comply with the ratio, a home care organization could decide to increase its total annual revenue so as to rebalance the proportion of revenues going for direct services costs versus administrative costs. An example of this behavior would be an organization that currently has $1 million in annual revenue, of which $650,000 (65 percent) is spent on direct services. This organization could increase what they charge recipients for services so that their annual revenue increases to $1.45 million. If the additional $450,000 that is generated is used for direct service costs (such as pay increases for home care workers), the organization would now be in compliance with the ratio ($1.1 million direct costs/$1.45 million total revenue).

- ***Go Out of Business.*** If a home care organization is not able or willing to apply for an adjustment to the required cost ratio or find a way to be in compliance with the ratio, it may decide to go out of business. Additionally, a home care organization that has its license revoked for not complying with the measure, may also ultimately go out of business if it is unsuccessful in attempts to regain licensure.

Response to Measure Will Likely Vary Across the Private Home Care Industry. Private home care organizations may implement one or a combination of strategies identified above (or others that we have not identified in this analysis) in response to meeting the requirements of this measure. Strategies will likely vary based on the unique fiscal and operational characteristics of each individual organization. Some of the relevant characteristics include:

- ***How Close the Organization Is to Meeting the Ratio.*** A home care organization that is very close to meeting the ratio requirement may react very differently than an organization that would have to make significant changes to its business to become compliant with the measure. If a home care organization is significantly far from meeting the ratio, there could be practical barriers to business actions that can be taken to comply with the cost ratio. In such circumstances, if the home care organization would decide to go out of business if the cost ratio were not otherwise adjusted, we assume that it is likely that the home care organization would apply for an adjustment to the cost ratio if such an adjustment would allow it to continue operations and maintain financial integrity.

- ***Existing Prices Charged.*** As we point out, one reaction a home care organization may have to come into compliance with this measure is to charge more for services. We note that if an organization is already charging more than other competing organizations for services, it would be less likely to increase its prices to a level that would make it difficult for them to compete for clients.

- ***Amount of Annual Profit.*** A home care organization that is currently able to secure a large portion of its revenue as profit would likely have a different reaction than an organization that has a very small portion of its annual revenue going towards profit. This is because organizations that have more profit may have more ability to redirect some of the profit (considered to be administrative overhead costs under the measure) towards direct services than an organization with very little profit available to redirect.

- ***Size of Organization.*** The size of an organization may impact how it reacts to this measure. A small organization may have fixed costs associated with rent and necessary overhead that may make it more difficult for them to reduce administrative costs than a larger organization.

Fiscal Impact of Potential Behavioral Responses

Some Responses to Measure Would Have Little, if Any, Impact on State or Local Finances. The ability to receive an adjustment to the required cost ratio could potentially allow home care organizations receiving the adjustment to continue to operate largely as they currently do. In such cases, there would likely be little, if any, fiscal impact on state and local governments. Similarly, to the extent organizations are able to shift costs from administrative overhead to direct services without changing their overall annual revenue, there could be little, if any, impact on state and local government finances.

Some Responses Could Result in Uncertain Revenue Impacts. As we discuss above, a potential reaction to this measure may be for a home care organization to increase its annual revenue. To the extent an organization increases the price of its services (using the price increase to increase the wages of its home care aides), there could be an increase in state revenues in the form of higher personal income taxes paid by home care aides (if these home care aides are earning enough to be required to pay annual income taxes).

Under the scenario where a home care organization does not apply for or is not granted an adjustment to the cost ratio and accordingly goes out of business, there could be lost tax revenue to the state if another organization does not pick up the clients that were previously being served by the organization that went out of business. This is because the organization that went out of business would no longer be paying taxes on its business income and some of the home care aides of the former business may no longer be working and paying income taxes. (On the other hand, it is possible that the organization may stop operating a home care business, but decide to operate a home health or referral agency instead, thus continuing to generate tax revenue to the state.)

Overall Fiscal Impact Depends on the Mix of Behavioral Responses. The net fiscal impact of this measure (beyond the relatively certain state agency administrative costs) will depend on how each private home care organization will respond to the measure. Since how an organization responds to the measure will vary based on the individual characteristics of that organization, the initiative's fiscal impact on state and local governments could vary by home care organization. For example, a home care organization that raises revenue and wages for aides to become compliant with this measure could have a positive effect on state finances through potentially higher income taxes. However, this positive effect on state revenues could be offset to some degree if another organization goes out of business and an organization that stays in business does not assume its prior clients.

Most Likely Responses Have Little to No Net Fiscal Impact. Although we have pointed out various responses home care organizations may exercise as a result of this measure, and have noted the uncertainty surrounding the response that each individual home care organization would make to the measure, we consider the most likely responses to be ones that result in, at most, a minor net fiscal impact on state and local governments. We assume that DSS will administer the application for an adjustment to the ratio in a reasonable manner that would not discourage home care organizations that could benefit from the adjustment from applying. If the adjustment is administered reasonably, we consider it to be likely that an organization, prior to potentially going out of business, would apply for an adjustment to the cost ratio to permit it to continue to operate. As discussed above, an adjustment could potentially allow the home care organization to operate similarly to its current operations, such that there would be a minor, if any, impact on state and local finances. We also think that organizations that are close to meeting the ratio requirement would likely manage to adjust their costs within their existing revenue to become compliant, again resulting in little to no impact on state and local finances.

Finally, even if organizations go out of business as a result of not being able to comply with this measure, we consider it unlikely that they would not be at least substantially replaced by new or existing organizations that are able to operate within the requirements of this measure. Such a market adjustment would, on net, result in a minor impact on state and local finances. Although we consider it to be unlikely, to the extent a portion of the current home care organizations go out of business and are not replaced by other organizations, the lost revenue to the state would come in the form of less taxable business income and less personal income taxes paid by home care aides. Such a fiscal impact would likely be short-term in nature (until the market adjusts) and, at most, in the low millions of dollars annually. In summary, we find that the most likely responses to the component of this measure subjecting home care organizations to a prescribed cost ratio are those that have, at most, a minor net impact on state and local finances.

Summary of Fiscal Effects

We estimate that the measure would have the following significant fiscal impact:

- State administrative costs of between $8 million and $11 million annually, with the authority to fully recover these costs from fees levied on certain home care organizations.

Sincerely,

for Mac Taylor
Legislative Analyst

for Michael Cohen
Director of Finance