Government of the District of Columbia
Office of the Chief Financial Officer

Jeffrey S. DeWitt
Chief Financial Officer

MEMORANDUM

TO:	**The Honorable Phil Mendelson** **Chairman, Council of the District of Columbia**
FROM:	**Jeffrey S. DeWitt** **Chief Financial Officer**
DATE:	**December 2, 2016**
SUBJECT:	**Fiscal Impact Statement – "Universal Paid Leave Amendment Act of 2016"**
REFERENCE:	**Bill 21-415, Committee Print given to the Office of Revenue Analysis on November 29, 2016**

Jeffrey S. DeWitt

Conclusion

Funds are not sufficient in the fiscal year 2017 through fiscal year 2020 budget and financial plan to implement the bill. Although the tax rate is estimated to be sufficient to cover the benefits of the program and a reserve requirement and shut-off provisions have been included to safeguard the District in the event that the tax is not sufficient in any given year to cover the benefits, adequate resources have not been fully identified nor appropriated to cover the start-up and system implementation costs.

The bill establishes a $238 million per year parental and family care benefit program funded by a 0.62% payroll tax on District employers. On the basis of information provided by the Office of the Chief Technology Officer and the evaluation of comparable projects, the total cost for the IT system could be as high as $80 million. For the bill to be fiscally sufficient, a $40 million capital project must be established in an approved budget and financial plan before the project commences to ensure completion of Phase I of the project. Phase I includes specification development, system design, procurement, software licensing, staffing and programming through the payroll tax collection function. The remaining cost to develop the benefits functions of the system, and $18 million for ongoing personnel and administrative expenses can be funded from the revenues generated by the payroll tax after the Phase I of the IT system is completed.

This is a significant bill proposing benefits more generous than other existing state programs. As a result, it presents multiple risk factors that may impact timeline and cost. These factors relate to implementation, enforcement and participation levels resulting from higher wage replacement relative to other programs (55% wage replacement in California and Rhode Island, and 66% in New Jersey, versus the 90% for those earning up to 150% of minimum wage as outlined in the bill). The bill also leaves many details to be determined, and requires the Mayor to establish rules and regulations for the administration of the program.

As noted above, the major risk factors are:

- Very high wage replacement levels relative to other states making the estimation of benefits difficult, particularly for family leave. Even a small change in participation levels could impact the solvency of the program
- Undefined regulations (to be determined by the Mayor) causing enforcement and administrative uncertainties
- Determining the timeframe for the technology without an established agency or defined regulatory requirements
- Potential timing mismatch of revenue flows and benefit claims
- Changing demographics in the long term may result in unexpected increases in participation rates in the future
- Technology costs exceeding the estimate would result in a delay in the payment of benefits.

Background

The bill requires the Mayor to establish a paid family and parental leave program that allows covered employees[1] in the District to receive a paid benefit when taking leave from their job for a qualifying family leave or parental leave event. A qualifying parental leave event includes the birth of a child, adoption of a child, or placement of a child for whom the individual assumes parental responsibility. A qualifying family leave event is the diagnosis of a serious health condition[2] of a family member[3] of a covered employee.

The program will be funded by a 0.62% payroll tax on covered employers, which includes any entity that employs an individual and is required to pay unemployment insurance[4], except the United States Government, the District of Columbia Government or any employer the District is not authorized to tax. Self-employed individuals can opt into the program, and if they do, must contribute 0.62% of annual income. The revenue will be deposited in a Paid Family and Parental Leave Fund ("Fund") from which benefits and administration costs will be paid. Administration costs cannot exceed 5% of the funds deposited. (Please note, the forecast estimates these costs will exceed 7%, requiring this part of the bill to be addressed.)

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[1] Covered employees are anyone who spends more than 50% of his or her time working in the District for any District employer required to pay unemployment insurance. Covered employers do not include the U.S. Government, the Government of the District of Columbia, or any other employer that the District is not authorized to tax.

[2] Serious health condition is defined as a physical or mental illness, injury, or impairment that requires inpatient care in a hospital, hospice, or residential health care facility, or continuing treatment or supervision at home by a health care provider or other competent individual. Section 101(18) of the bill further defines incapacity, treatment, inpatient care, and continuing treatment.

[3] Family member is defined as a biological, adopted or foster son, daughter, parent, parent-in-law, step-parent, legal guardian, stepson or stepdaughter, legal ward, son or daughter of a domestic partner, or person to whom an eligible individual stands in loco parentis.

[4] Per D.C. Official Code Section 51-101 et seq.

Following a one-week waiting period, covered employees who experience a qualifying event may claim a paid benefit for up to 11 weeks of parental leave and 8 weeks of family care leave[5]. They may claim only one qualifying event in a 52 week period. The amount of the benefit cannot exceed $1,000 per week and is calculated in two parts:

1) On wages earned up to 150% of the District's minimum wage, the claimant will receive 90% of the claimant's average weekly wage[6]
2) On wages earned above 150% of the District's minimum wage, the claimant will also receive 50% of the claimant's average weekly wage

Self-employed individuals who opt into the program will remain enrolled continuously until they expressly opt out during a designated open enrollment period. Individuals who opt in, after having previously opted out, will not be eligible to receive benefits in their first year. If a self-employed individual opts out two or more times, he or she cannot enroll for five years from the date of the last withdrawal.

Upon passage of the bill, the Mayor must issue rules within 180 days and submit the rules to Council for a 45-day review period. The bill requires the Mayor to establish reasonable procedures for filing a claim, including rules regarding supporting documentation to claim benefits and proof of a serious health condition to determine appropriate leave lengths. It requires the Mayor to notify employers within 5 business days of a claim being filed. Within 10 business days after an individual files a claim, the claimant must be notified as to the determination of benefits, and their right to appeal the determination with the Office of Administrative Hearings. Once eligibility is determined, payment must be made within 10 business days. The Mayor must provide covered employers a notice explaining the rights of employees under the Act, and the employers in turn must notify the employees of their rights.

The bill requires that the Mayor create a "user-friendly, online portal" for submitting claim forms and supporting documentation. It must be privacy-protected, searchable, and provide relevant information to claimants, employers and the public. The bill requires that the software utilized be able to handle any expansion of benefits in the future.

The bill requires the Mayor to conduct a public education campaign to be paid out of the Fund, but not to exceed 0.25% of the annual fund revenue. Within 180 days of the effective date of the bill, the Mayor must provide notice to covered employees how contributions into the Fund can be made, and by March 1, 2019, the Mayor must begin to collect the payroll tax revenue from employers and self-employed individuals who have opted into the program.

The bill requires eligible individuals to provide written notice to an employer as to when they intend to utilize parental or family leave benefits under the bill. The notice must be given at least 10 days in advance, when it is foreseeable. If the leave taken is eligible leave pursuant to the Family and Medical Leave Act or the District of Columbia Family and Medical Leave Act, then the leaves must run concurrently. There are no additional job protections provided by the bill beyond what is

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[5] The bill requires that the International Classification of Diseases by the World Health Organization be used to determine how many weeks an individual may take to care for a family member, based on the type of serious health condition being experienced by that family member.

[6] The Average Weekly Wage is defined as the total wages subject to taxation by a covered employer during four out of five quarters immediately preceding the qualifying event, divided by 52.

entitled by the FMLA laws. There is also no prohibition on employers providing additional parental and family benefits, provided they will not interfere with the benefits provided under the bill.

The bill prohibits individuals from receiving the benefit while simultaneously receiving long-term disability payments, unemployment insurance payments, or self-employment income.

Claimants may appeal benefit determinations to the Office of Administrative Hearings no later than 60 days after a determination has been made. Individuals who make false statements or misrepresentations to obtain a benefit will be barred for three years from receiving benefits under the bill. If benefits are received erroneously, the Mayor must seek repayment of benefits from the recipient.

The Office of the Chief Financial Officer is required to certify the balance of the Fund quarterly beginning on October 1, 2017, and by December 1, 2017 provide a report to the Council as to the funds that have been deposited and the expected timeline for beginning to make benefit payments. Claims cannot be paid until at least one year after the effective date of the Act and after the OCFO certifies solvency of the fund.

Financial Plan Impact

The bill establishes a $238 million per year parental and family care benefit program funded by a 0.62% payroll tax on District employers. On the basis of information provided by the Office of the Chief Technology Officer and the evaluation of comparable projects, the total cost for the IT system could be as high as $80 million. For the bill to be fiscally sufficient, a $40 million capital project must be established in an approved budget and financial plan before the project commences to ensure completion of Phase I of the project. Phase I includes specification development, system design, procurement, software licensing, staffing and programming through the payroll tax collection function. The remaining cost to develop the benefits functions of the system, and $18 million for ongoing personnel and administrative expenses can be funded from the revenues generated by the payroll tax after the Phase I of the IT system is completed.

I. <u>Estimating the Revenue</u>

The bill requires each covered employer to contribute 0.62% of a covered employee's salary to the Fund. Covered employers include nearly every employer in the District, except the federal government, the District government, and other employers the District is not authorized to tax under federal law or treaty.

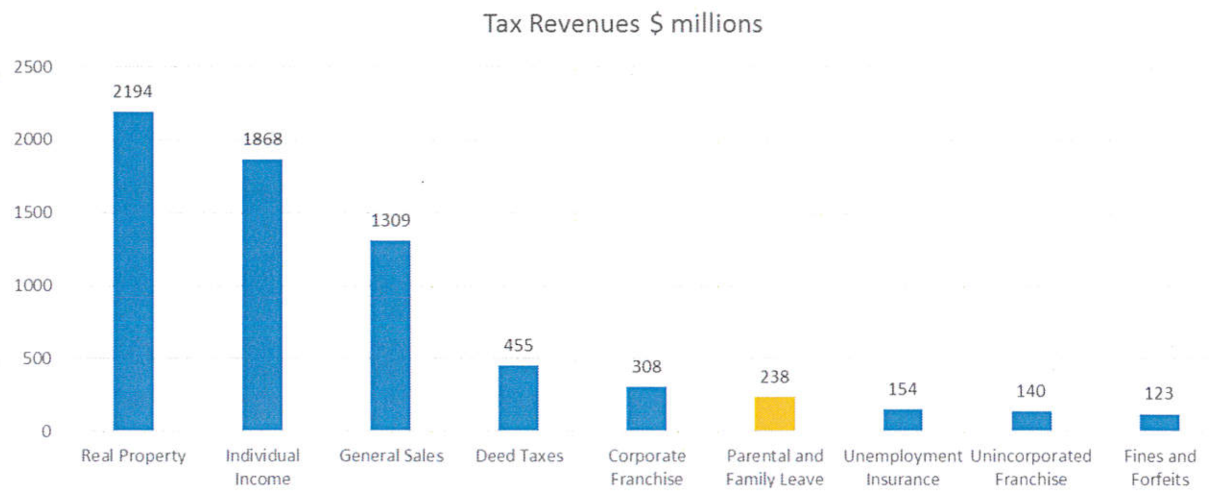
The number of employees fitting the broad criteria of this definition is approximately 541,376 people (36% reside in the District, 39% reside in Maryland, and 25% reside in Virginia)[7] with a total wage base of $39.7 billion. This figure includes self-employed individuals who, under the bill, are eligible to opt out. From this base, we expect total annual revenue capacity of approximately $238 million in year one (the table below reflects annual growth rate at 2% per year. No revenue will be collected for the first eighteen months while Phase I of the system is being developed. See Section IV for more details.).

[7] 2015 American Community Survey data for Maryland, Virginia and the District.

Estimated revenue generation based on 0.62% payroll tax First four years of program – based on assumed implementation timeline					
	Year 1	**Year 2***	**Year 3***	**Year 4***	**Four year Total**
0.62% payroll tax collections**		$125,626,838	$253,766,213	$258,841,537	**$638,234,587**

*assumes 2 % annual growth in wage base
**Chart reflects assumed timeline of program implementation discussed in Section IV below

The payroll tax on District employers will generate $238 million in revenue. See the chart below for comparison to other District taxes and fees based on the lasted available actual data (FY2015).

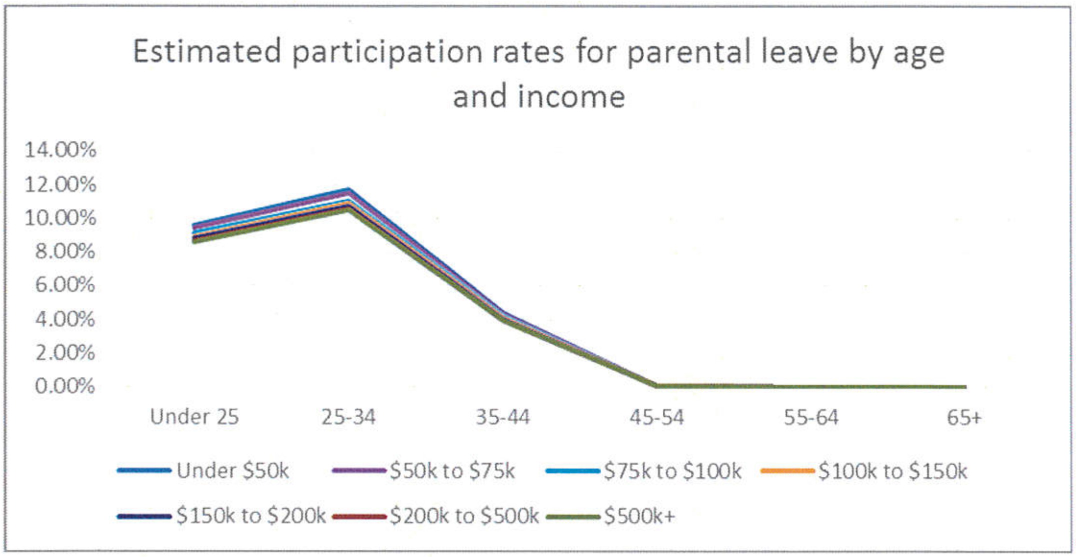


II. <u>Estimating the Cost of the Benefit</u>

The bill provides wage replacement for eligible individuals taking parental leave for the birth, adoption or legal placement of a child, or caring for a family member with a serious health condition. Individuals will receive 90% of their wages up to 150% of the minimum wage, and 50% of wages over that amount, to a maximum of $1,000 per week. Based on the distribution of salaries for District employment, approximately 48% of eligible employees would receive 90% wage replacement, driving District participation levels above those of other state programs. Individuals will be entitled to 11 weeks within a 52-week period for parental leave, or 8 weeks within a 52-week period when caring for a family member.

Using fertility rate data from the Centers for Disease Control National Vital Statistics[8], on the number of births per 1,000 women, we calculate the percentage of eligible workers likely to have a baby in each age group of the workforce. The chart below shows how participation rates vary by age. The rate is reduced as the wage of the worker increases, because we assume that participation decreases as wage replacement decreases.[9]

[8] National Vital Statistics Report, 2014. (www.cdc.gov/nchs/data/nvsr/nvsr64/nvsr64_12.pdf).
[9] The rate of decrease is based on a regression equation estimated using participation data by income level provided by the State of Rhode Island for its paid family leave program.



We apply the same methodology to determine participation rates for men. It is important to note that unlike other states with a Paid Family Leave benefit, many spouses and partners of District male workers live outside of the District, in jurisdictions without paid family leave benefits. This makes it more likely that males in the workforce will take the District's bonding benefit. Using these participation assumptions, we estimate that 23,878 (or 4.4% of the workforce) individuals will take leave annually for bonding with a child.

The data available to calculate the participation rate for family leave is not as reliable as fertility rates from the National Vital Statistics Report used to estimate participation rates for parental leave. There are no similar reliable data sources available to determine expected participation rates for care of a family member. Furthermore, there are several reasons why the participation rates observed in nearby states will not apply to the District. First, the wage replacement rate in this bill is much higher than in other states (55% wage replacement in California and Rhode Island and 66% in New Jersey, versus 90% for those earning up to 150% of minimum wage in the District as outlined in the bill). Second, other states with this benefit also have short-term or temporary disability benefits, which in certain circumstances may lessen the need for a family care benefit. Third, the ability of workers to take leave to care for relatives living in other nearby states could affect participation rates in the District.

The estimate of the participation rates for family care makes two assumptions: older people will be more likely to care for a family member than younger people, and those making above $75,000 will participate at the lower rates experienced by other states because of lower wage replacement. For those making less than 150% of minimum wage, whose wage replacement will be closest to those seen under the District government paid family leave program, we apply a range of participation rates based on age. We apply the District government experience rate of approximately 5% for the oldest workers, and scale down to 1% for the youngest workers. For high-wage workers whose wage replacement rates more closely reflect benefit levels seen in California, Rhode Island, and New Jersey, we use those participation rates. Based on these assumptions, we estimate that a total of 10,972 (or 2% of the eligible workers) employees will claim the benefit each year to care for an ailing family member.

Based on the experience of other states, we assume that men will take 25% fewer weeks than women. To estimate the benefit by income groups, we multiply the number of people in each income group who will receive the benefit[10] by the number of weeks they are expected to take the benefit. We then sum across the cost of the benefit for each income group to get the total cost of the benefit. The resulting cost is shown in the chart below.

Estimated Annual Benefit Cost					
	Year 1	**Year 2**	**Year 3***	**Year 4***	**Four year Total**
Parental Leave Benefits			$88,965,183	$179,709,671	$268,674,854
Family Care Benefits			$29,577,465	$59,746,479	$89,323,944
TOTAL	**$0**	**$0**	**$118,547,648**	**$239,456,150**	**$357,998,798**

*assumes 2% annual growth
**Chart reflects expected timeline of program implementation discussed in Section IV below.

III. Estimated Administrative Costs

The two main areas of administrative costs are information technology, and the personnel required to administer the Family and Parental Paid leave program. While some data exist on systems throughout the District, a new integrated information technology system must be developed to accomplish the specific needs of this program. It must accomplish many tasks including, but not limited to:

- Collecting the payroll tax from all eligible employers – perhaps as many as 40,000 - currently withholding taxes
- Collecting taxes separately from self-employed workers
- Tracking the history of wages and payments from employers as well as the paid benefits that are associated with their employees
- Linking with systems throughout the District including SOAR (the OCFO system of financial management and accounting), DOES unemployment records, and perhaps other program databases to ensure there is no overlapping of benefits
- Establishing separate web portals for tax administrators, employers, claimants, and physicians (for submitting documentation to confirm eligibility)
- Issuing checks and/or bank transfers to claimants
- Ensuring that proper tax withholding is made and appropriate annual 1099 forms issued to claimants, since these are taxable benefits

The precise cost of the system will be dependent on the specifications required by rules and regulations and programmatic needs that arise during design and development. There are complexities around each phase of a large-scale information technology project. In design, the core requirements and interfaces will need to be determined. Additionally, complexities could arise with the integration of other District systems.

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[10] We make calculations by income group so that we can apply different participation rates to different income groups and also calculate the likely weekly benefit payment they will receive.

Other states with paid family leave programs built their systems on top of existing short-term disability program systems. The District does not have a short-term disability program and must build a new information technology system, which makes direct cost comparisons unreliable. We can look at similar-sized information technology projects in the last decade such as the District's Medicare system, the OCFO's new tax information system, and the health benefit exchange system – all cost well in excess of $40 million. When the state of Massachusetts upgraded its unemployment insurance system, they were able to use existing source code for free from the state of Minnesota, and the system still cost approximately $50 million.

Based on these comparisons and the complexities and uncertainties previously discussed, the system could cost as much as $80 million. However, in discussions with the Chief Technology Officer $40 million is adequate to ensure completion of all upfront costs, which include specification, design, procurement, licensing, staffing, and programming through development of revenue collection. If the project costs go to the higher estimate, tax collection from the initial phase can be used to complete the project. However, costs above $40 million would delay the implementation of benefits.

Estimated Information Technology Costs - Startup					
	Year 1	**Year 2**	**Year 3**	**Year 4**	**Four year Total**
IT Development startup	$40,000,000	$0	$0	$0	**$40,000,000**

Personnel costs were estimated by looking at the claim to staff ratio for unemployment insurance. Based on an assumed ratio of claims to employee,[11] we estimate approximately 113 FTEs will be required including – claims specialists, customer service, medical/insurance experts, management, administrative law judges, and tax processers. Real estate costs involve obtaining office space for the new agency that will administer this program (estimated at 22,000 square feet at $52 per square foot). IT costs include fees for annual software licenses and IT support. (Please note, the forecast estimates that administrative costs will exceed 7%, which will exceed the 5% limitation in the bill as written.)

Estimated Personnel and Administration Costs For the New Program					
	Year 1	**Year 2**	**Year 3***	**Year 4***	**Four-year Total**
Salaries for 113 FTEs		$5,428,500	$11,073,000	$11,296,000	**$27,797,500**
Real Estate		$1,376,000	$1,194,000	$1,218,000	**$3,788,000**
Ongoing IT maintenance and licensing fees		$0	$4,097,653	$6,573,410	**$10,671,063**
TOTAL		**$6,804,500**	**$16,364,653**	**$19,087,410**	**$42,256,563**

*assumes 2% annual growth
**Chart reflects expected timeline of program implementation discussed in Section IV of this letter

[11] Claims to staff ratios in states vary from approximately 400 claims per staff member to 700. We assume 500 claims, and then add managers, experts in medical and insurance fields, attorneys, and administrative law judges to handle appeals.

IV. Assumed Timeline

The figures used in this estimate assume the following timeline:

Year 1: Information Technology System is developed to collect revenue from employers.
Year 2: Midway through year 2, revenue begins to be collected when the system is finalized. Half a year of revenue will be collected.
Year 3: Midway through year 3, a one-year reserve is set aside, and benefits can begin to be paid.

V. Program Fund Reserve and Shut-down Procedures

As discussed previously, the bill requires a one-year reserve equal to the expected benefits. If reserves drop below what is required to cover nine months of expected benefits, the bill requires the Office of the Chief Financial Officer to propose changes to make the program solvent. If a reserve levels drop to only six months of total expected benefits, then benefit payments will cease. Because of the many uncertainties and risk factors discussed above, this element of the bill is the most essential in our determination of the fiscal viability of this program. The program must be self-sustaining on an ongoing basis. These provisions are required to ensure that the program is self-sustaining and does not adversely affect the District's other programs and financial position.

VI. Sources and Uses

Below is a summary of revenues and costs that reflects the expected timeline of the program - including development of an information technology system to process revenue collections and claims, and the need to build a one-year reserve prior to issuing benefits.

Fiscal Impact of Bill 21-415 Universal Paid Leave Act of 2016 FY 2017 – FY 2020					
	Year 1	**Year 2**	**Year 3**	**Year 4**	**Four year Total**
Revenue (0.62% payroll tax)		$125,626,838	$253,766,213	$258,841,537	**$638,234,587**
TOTAL SOURCES		**$125,626,838**	**$253,766,213**	**$258,841,537**	**$638,234,587**
Expected Benefits			$118,542,648	$239,456,150	**$357,998,798**
Technology Startup Costs	$40,000,000*				**$40,000,000**
Personnel costs* assumes 50% in year 2 and 100% in year 3		$5,428,500	$11,073,000	$11,296,000	**$27,797,500**
Real Estate for new Administration (est. 22k sq ft $52 per sq ft)		$1,376,000	$1,194,000	$1,218,000	**$3,788,000**
Information Technology Maintenance and License Fees			$4,097,000	$6,573,410	**$10,671,063**
Public Education Campaign Requirement		$297,976	$297,976	$297,976	**$893,928**
Required Reserve Funding		$118,524,362	$118,560,935	$0	**$237,085,297**
TOTAL USES	**$0**	**$125,626,838**	**$253,766,212**	**$258,841,537**	**$678,234,587**
Surplus / (Deficit)	**($40,000,000)**	**$0**	**$0**	**$0**	**($40,000,000)**

*Currently, $20,039,000 has been placed in a reserve designated for universal paid leave, but has not yet been appropriated in a formal budget process and, therefore, is not available for use.