

Agenda and pre-reading fact base

November 15th Meeting – 3 pm to 6 pm

Ritz-Carlton Hotel, Cleveland

For information on this meeting or the Tribute Dinner for Senator Voinovich later in the evening at the Rock and Roll Hall of Fame, please contact Richard Stoff or Erin Harper at 614-469-1044

Introduction

Members, Friends and Colleagues of the Ohio Business Roundtable ...

We are pleased that you will be joining us on November 15 for our all-hands business leadership meeting. We look forward to reviewing and discussing with you not only the BRT's work on the state budget crisis but the important work undertaken by our chamber of commerce colleagues on governance and productivity.

You will enjoy the process we use for sharing this analysis with you but more importantly engaging you, as CEOs, in dialogue on how we make the change happen and what it means for our state's competitiveness.

As noted on the Agenda, following this page, at the outset of our meeting, we will very briefly review the information in this pre-read and some more data as well, especially on the deep-dives in Medicaid and Education. From there we will get you up out of your chairs and move into an interactive Gallery Walk (yes, it literally is a "walk-around") in which small groups of CEOs and their deputies, for the better part of an hour or so, will visit and rotate through five stations that capture the data, analysis and opportunities on colorful oversized boards with charts and graphs. The stations will be manned by members of our project team and Steering Committee, who will be ready to engage you in small group dialogue so the CEOs are primed for the larger interactive session (on "what does it all mean and where do we go from here?") when we all get back around the table for the last hour of the meeting. The BRT and our McKinsey team and our colleagues at the chambers of commerce have invested time, effort and resources in assembling a wealth of data and information to move the state forward in the face of the most difficult budget in 50 years. We want to take full advantage of the fact that we will have the state's business leadership in one room on November 15.

In preparation for the 15th, our team has drawn together this fact base on the budget and the areas investigated by the BRT. We have purposefully chosen to save our synthesis of findings to discuss in person with you on the 15th, but these materials will provide valuable context for the challenges and opportunities to eliminate the \$8 billion budget gap and reposition Ohio for future success.

Overall Agenda for the November 15th Meeting

- | | |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------|
| I. Objectives | 3:00 pm |
| II. Briefing | 3:10 pm |
| III. Gallery Walk | 3:30 pm |
| Station 1: Overall Budget Picture
Station 2: Medicaid and Healthcare Financing Deep Dive
Station 3: K-12 Education and School Funding Deep Dive
Station 4: Other areas, e.g., Corrections, Higher-ed, Pensions, etc.
Station 5: Chambers' governance/productivity recommendations | |
| IV. Discussion | 4:45 pm |
| V. Adjourn | 6:00 pm |

Business Leadership Tribute Dinner for Senator George Voinovich beginning at 6:30 pm at the Rock and Roll Hall of Fame – Vans will leave the Ritz-Carlton every 10 minutes to the event.

Contents of the Fact Base

Ohio revenue and expenditure fact base

Medicaid and health care financing fact base

K-12 Education fact base

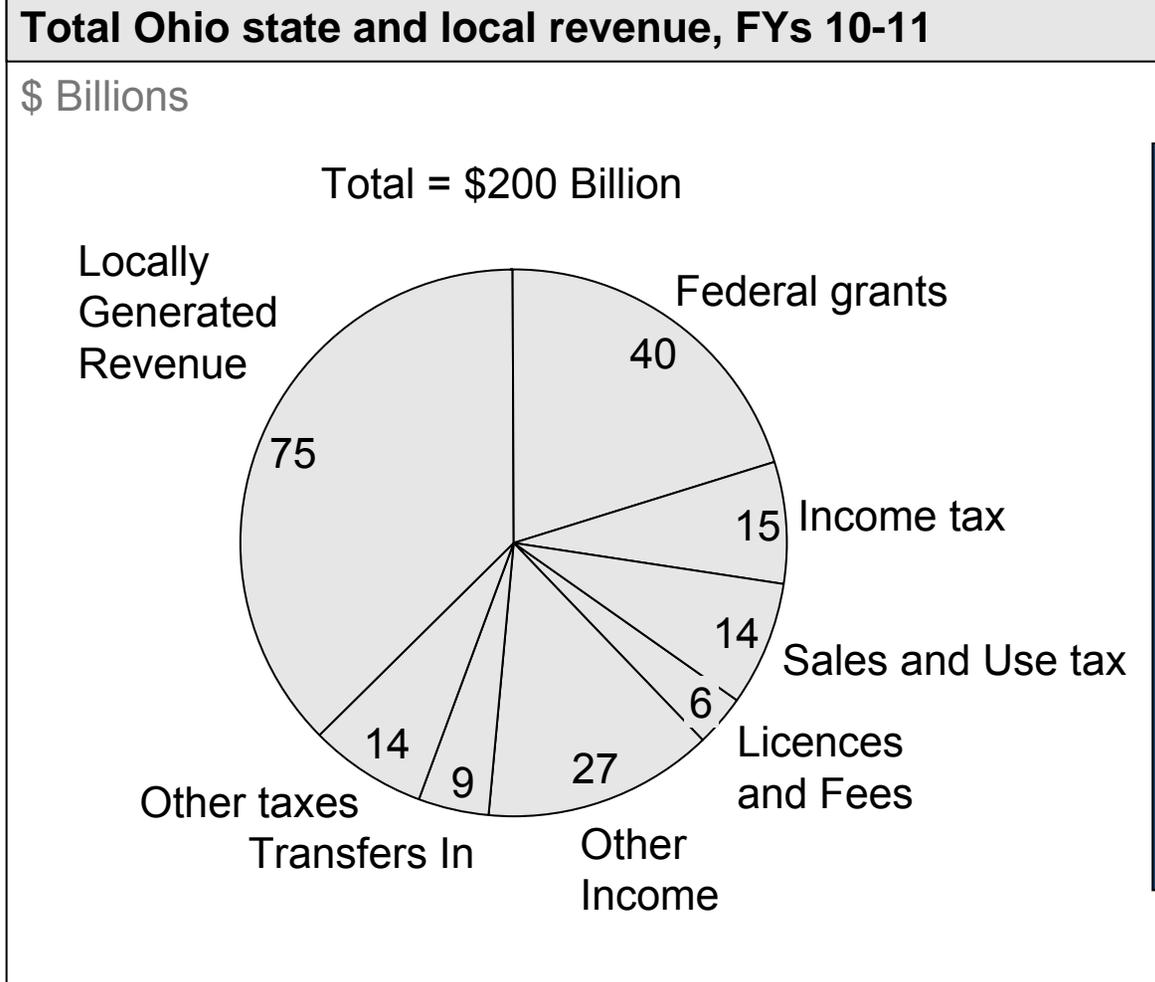
Corrections fact base

Higher education fact base

State pensions and benefits fact base

Ohio total revenue (state and local) derives from multiple sources

ROUGH ESTIMATES



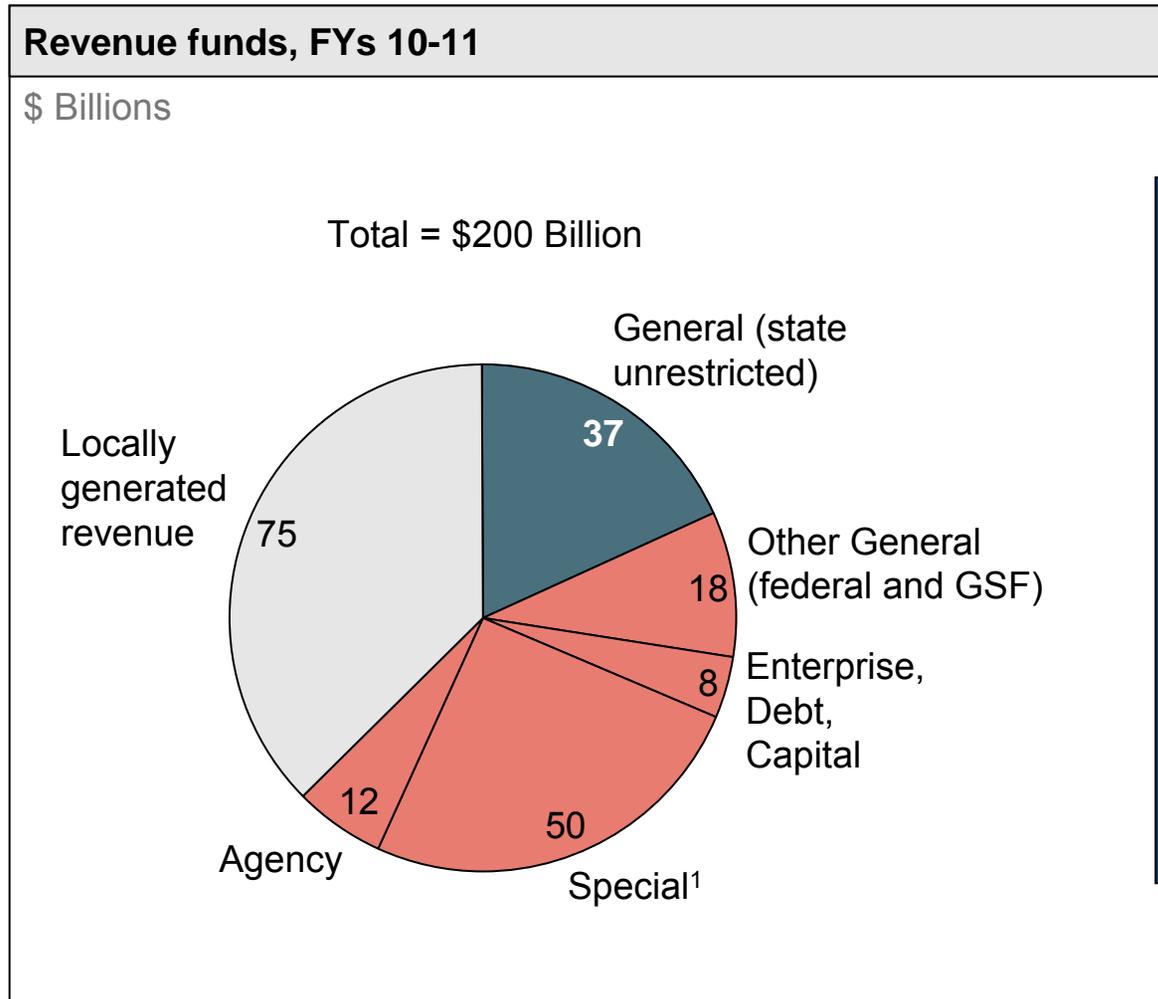
- Major revenue sources for Ohio are local revenue, federal grants and two major buckets of tax- personal income and sales/use tax
- Personal income and sales tax generally considered as major sources of state's general spending- most other sources of revenue are placed in restricted funds and appropriated accordingly (see next page)

SOURCE: Ohio Office of Budget and Management, Ohio Legislative Services Commission, McKinsey analysis

Depending on source, revenue flows into restricted and unrestricted funds

ROUGH ESTIMATES

- Local restricted
- State restricted
- State unrestricted



- \$37 billion in “General Revenue Fund” is unrestricted and can be spent and re-appropriated as government sees fit
- Other revenue, including federal money placed in the general fund, is tied to specific expenditures
- Of restricted state funding, only \$48B is constitutionally or federally protected- the remainder can be reallocated through law for other purposes or moved to general fund

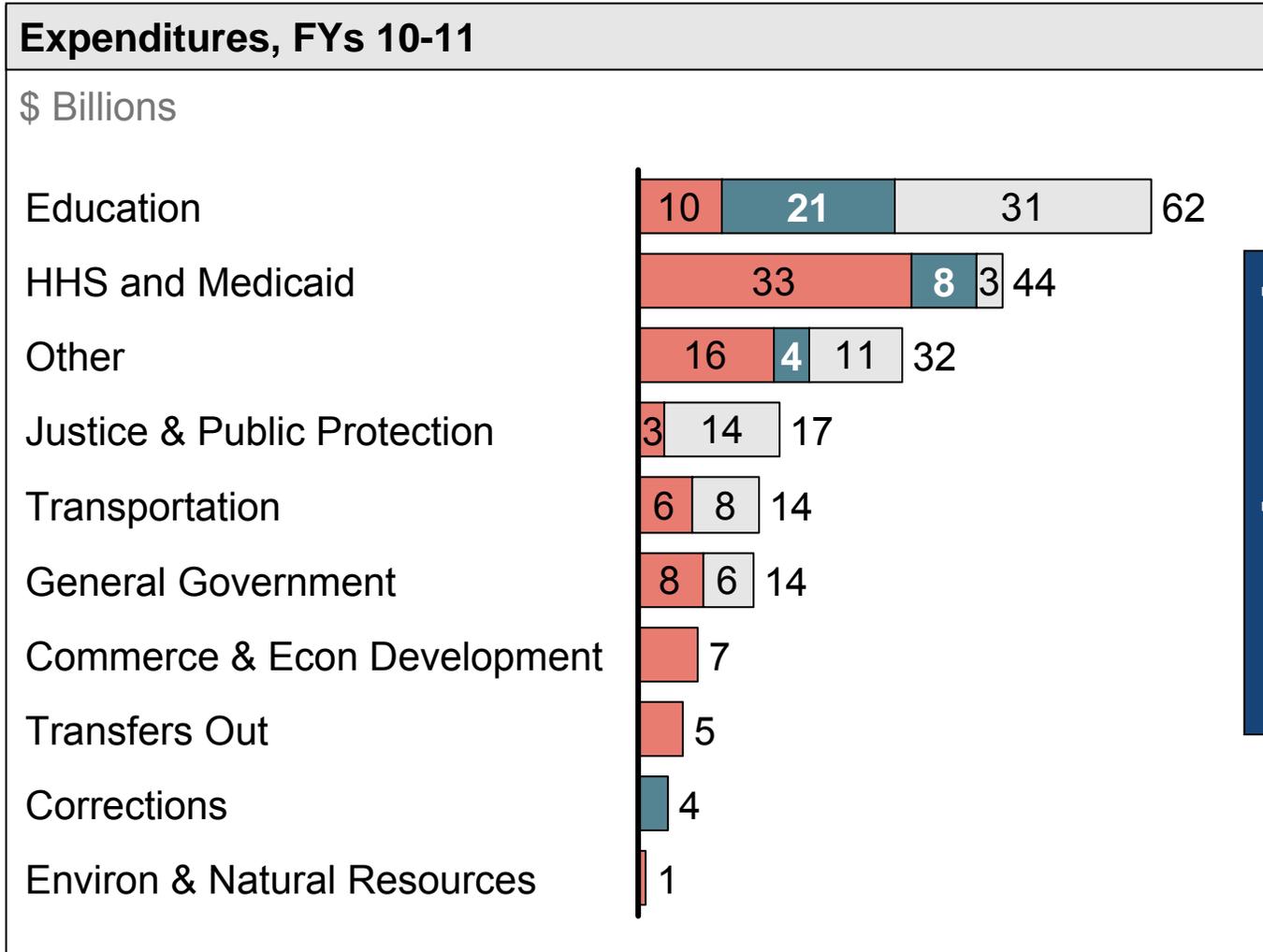
¹ Special revenue includes Highway Operating Fund, Federal Grants, Revenue Distribution Fund, Waterways Safety Fund, etc.

SOURCE: Ohio Office of Budget and Management, Ohio Legislative Services Commission, McKinsey analysis

Ohio then draws from state restricted and unrestricted funds to meet expenditure obligations

ROUGH ESTIMATES

- Restricted
- Unrestricted
- Local restricted



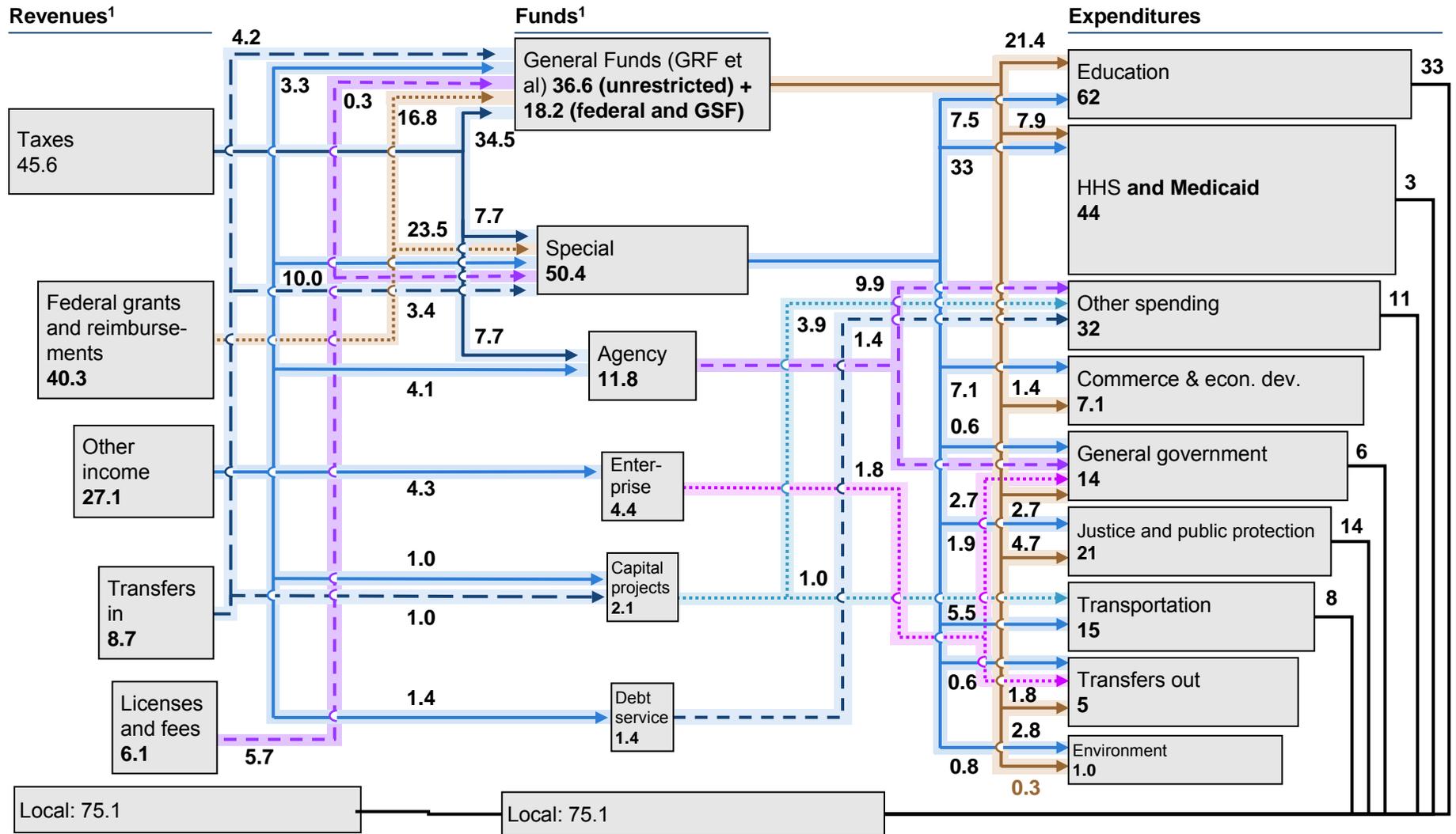
- Locally-generated revenue accounts for 38% of all state funds
- Education and HHS combined account for over half of total spending

SOURCE: Ohio Office of Budget and Management, Ohio Legislative Services Commission, U.S. Census Bureau

Revenue and expenditure flows (federal, state, and local), FYs 10-11

\$ Billions

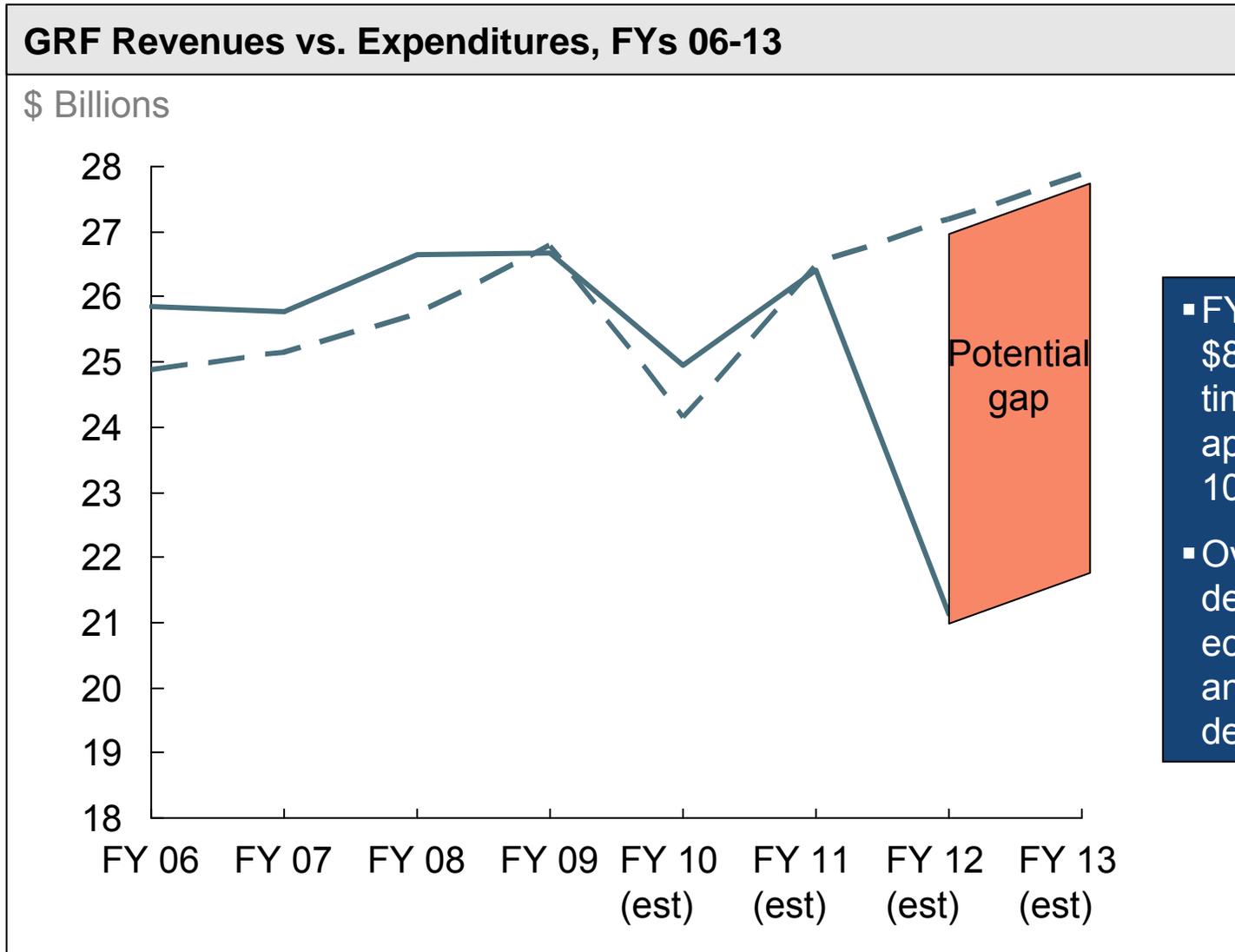
Revenues¹



¹ Estimated

SOURCE: Ohio Office of Budget and Management, Ohio Legislative Services Commission

Use of one-time funding sources in FYs 10-11 will lead to significant budget gap in FYs 12-13



— Revenues
 - - Expenditures

- FYs 12-13 will lack \$8 billion in one-time funding applied during FYs 10-11
- Overall gap will depend on economic growth and spending decisions

Ohio’s projected budget gap ranges from \$5-\$11 billion based on varying growth and spending projections

 Most likely

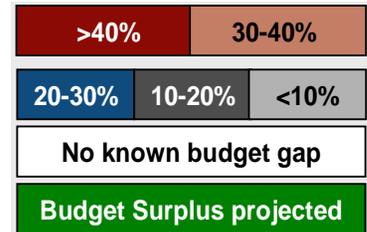
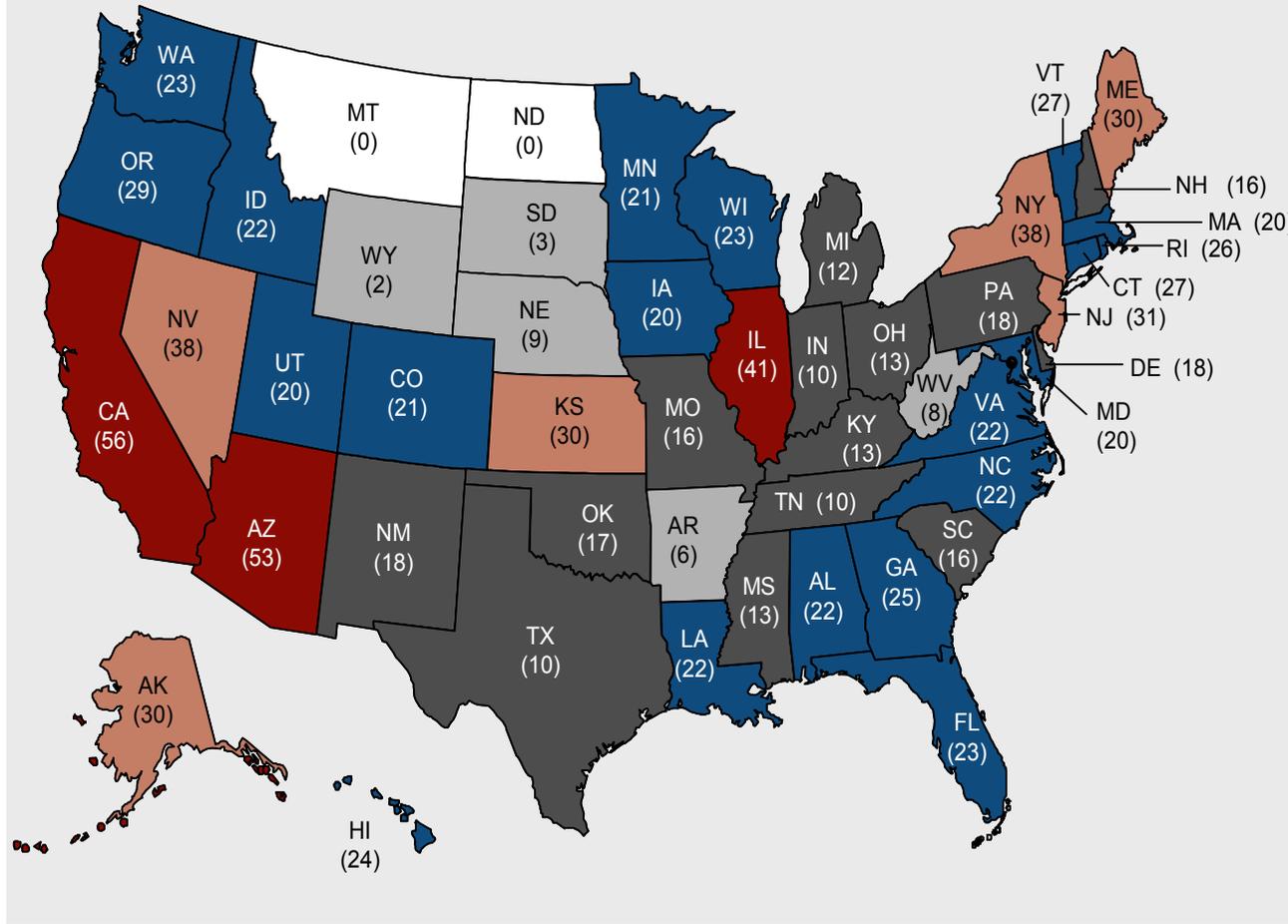
Inputs	Scenario		
	Negative	Baseline	Positive
Economic growth in 2012-2013	0%	1.1%, 1.5%	2.2%, 3.1%
Federal grant-making levels	Keep constant with economic growth in 2012-2013		
Increase in state spending in 2012-2013 ¹	2.6%	2.6%	0%
Loss of one-time funding (e.g., stimulus) ¹	\$8B	\$8B	\$8B
Additional political expenditure impacts	\$2.8B	\$0	\$0
Total size of budget gap	\$11B	\$8B	\$5B

¹ Ohio Legislative Service Commission (2.6% = compound annual growth in spending, 2001-2011)

¹ Ohio OBM, Ohio Legislative Service Commission

Ohio's budget gap is comparable to its neighbors

Budget Gap as Percentage of Each State's General Fund Revenue
Percent

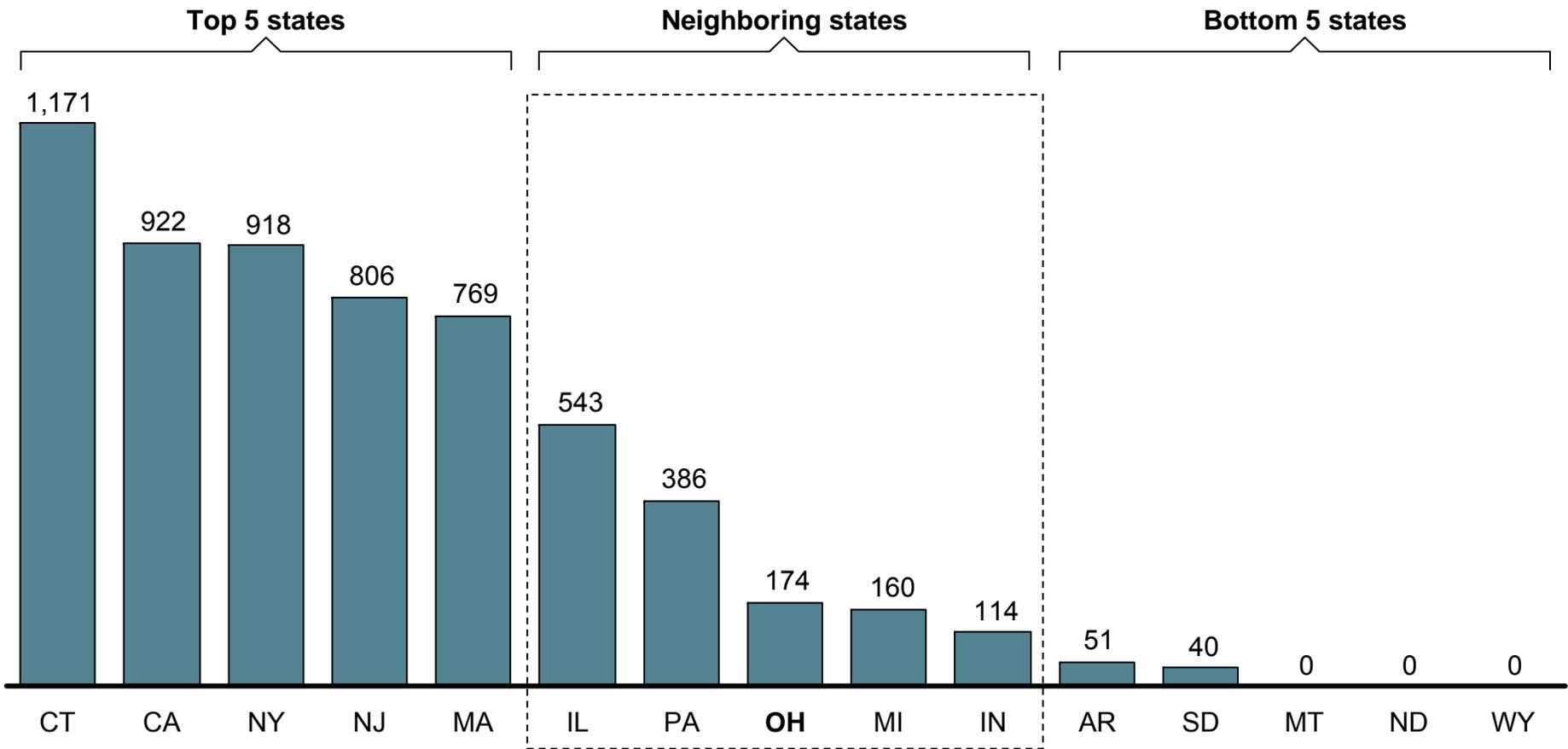


- Budget crisis is national in nature; Ohio's gap is not exceptional
- Problem is systemic – revenue growth alone cannot close the gap

SOURCE: Center on Budget and Policy Priorities (Nov 2009)

Ohio's per capita deficit ranks 32nd nationally

Total per capita deficit (estimate)*
\$, 2010



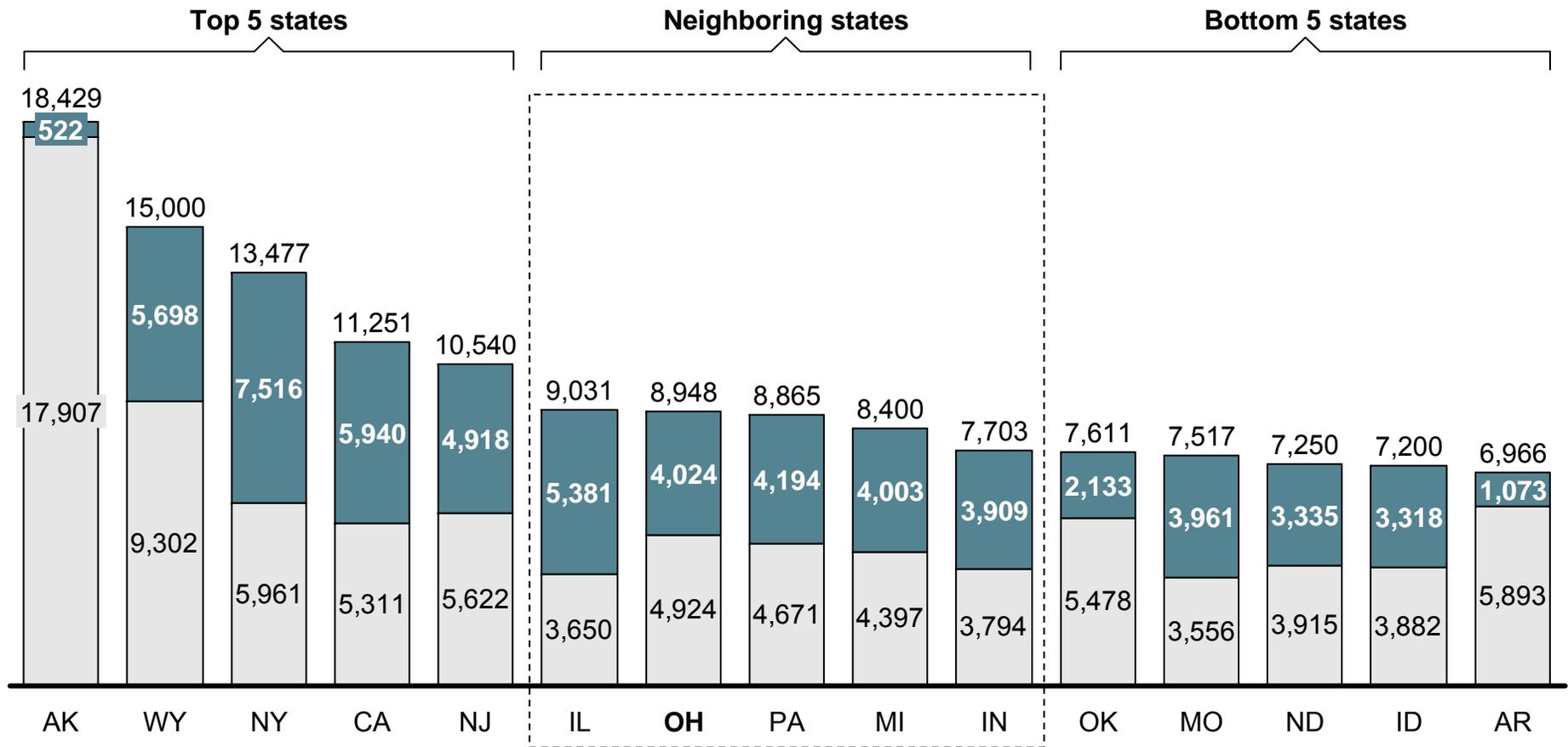
* To establish baseline comparison, this chart uses common data set for all states (deficit projections for Ohio vary depending on assumptions used; this comparison uses similar assumptions across all states)

SOURCE: U.S. Census Bureau, National Association of State Budget Officers, Team analysis

Ohio expenditure per capita is in line with neighboring states

Total state spending per capita¹
 \$, 2008

Local Only
 State only

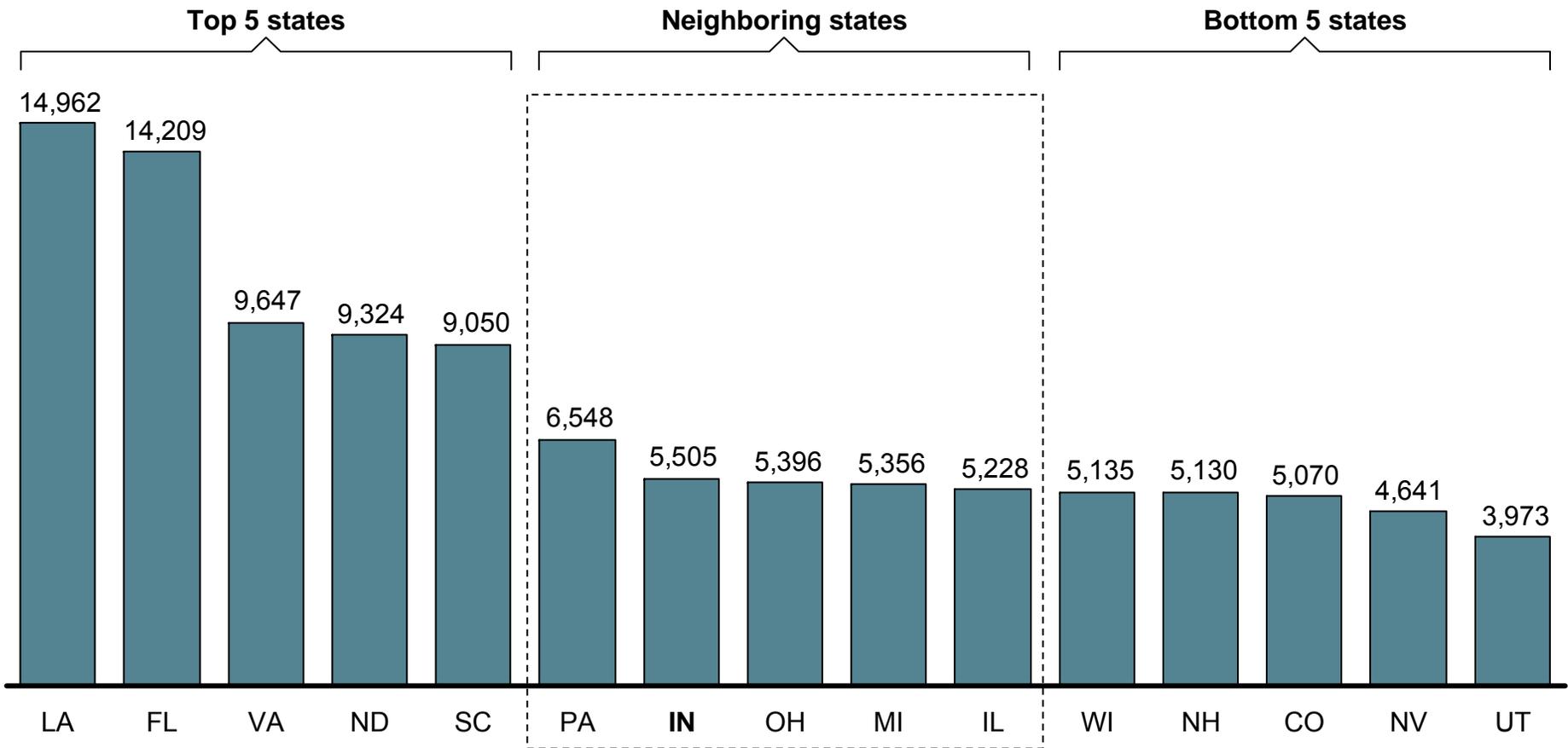


¹ Includes all known sources of funding including state general fund, federal funding, other state funds, bonds

SOURCE: State expenditure report, National Association of state budget officers; team analysis

Federal per capita spending in Ohio ranks 41st nationally

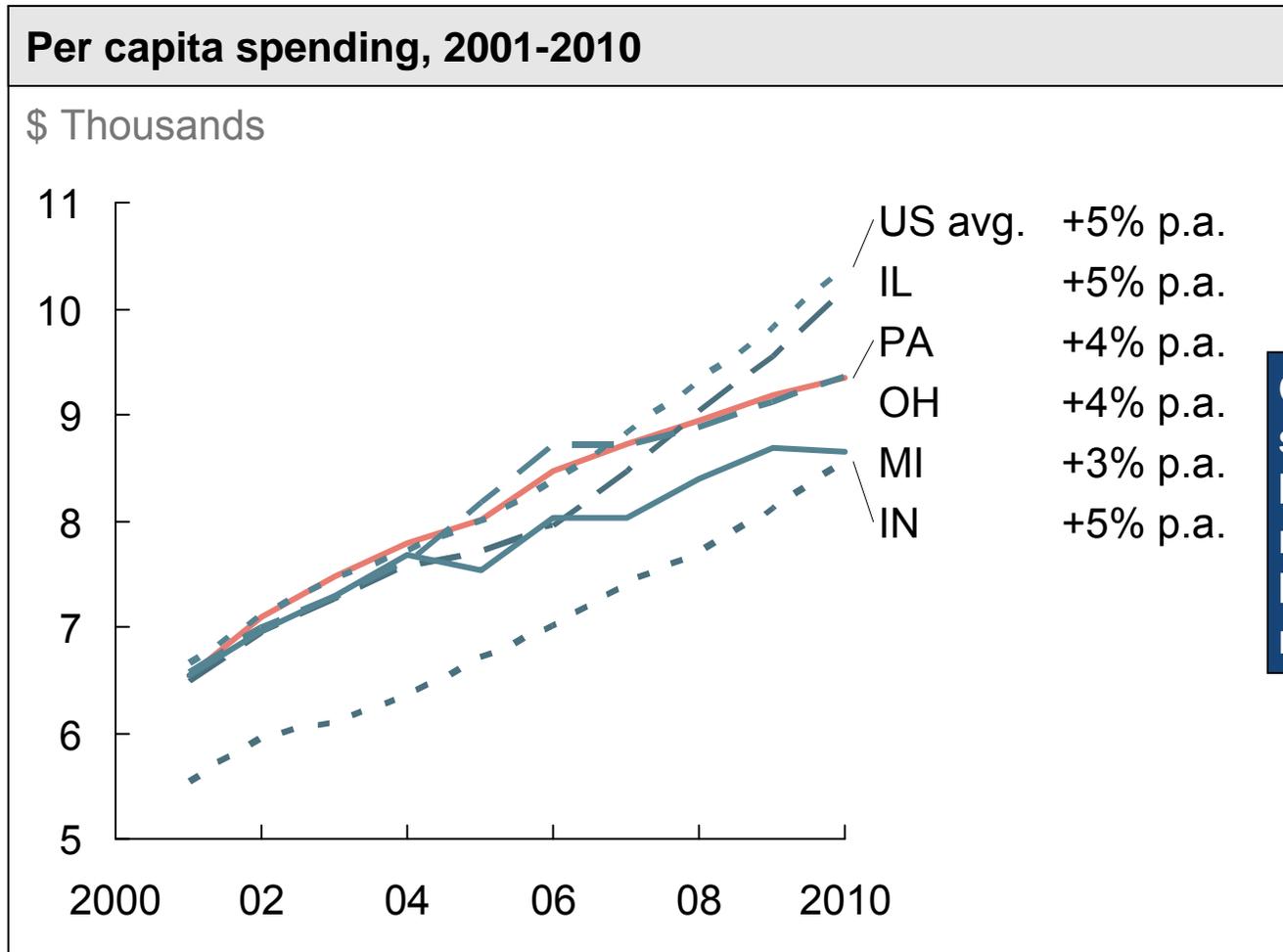
Federal per capita spending¹, 2001-2010 avg.
 \$, 2001-2010 (avg.)



¹ Federal spending includes all **federal contract and assistance awards**

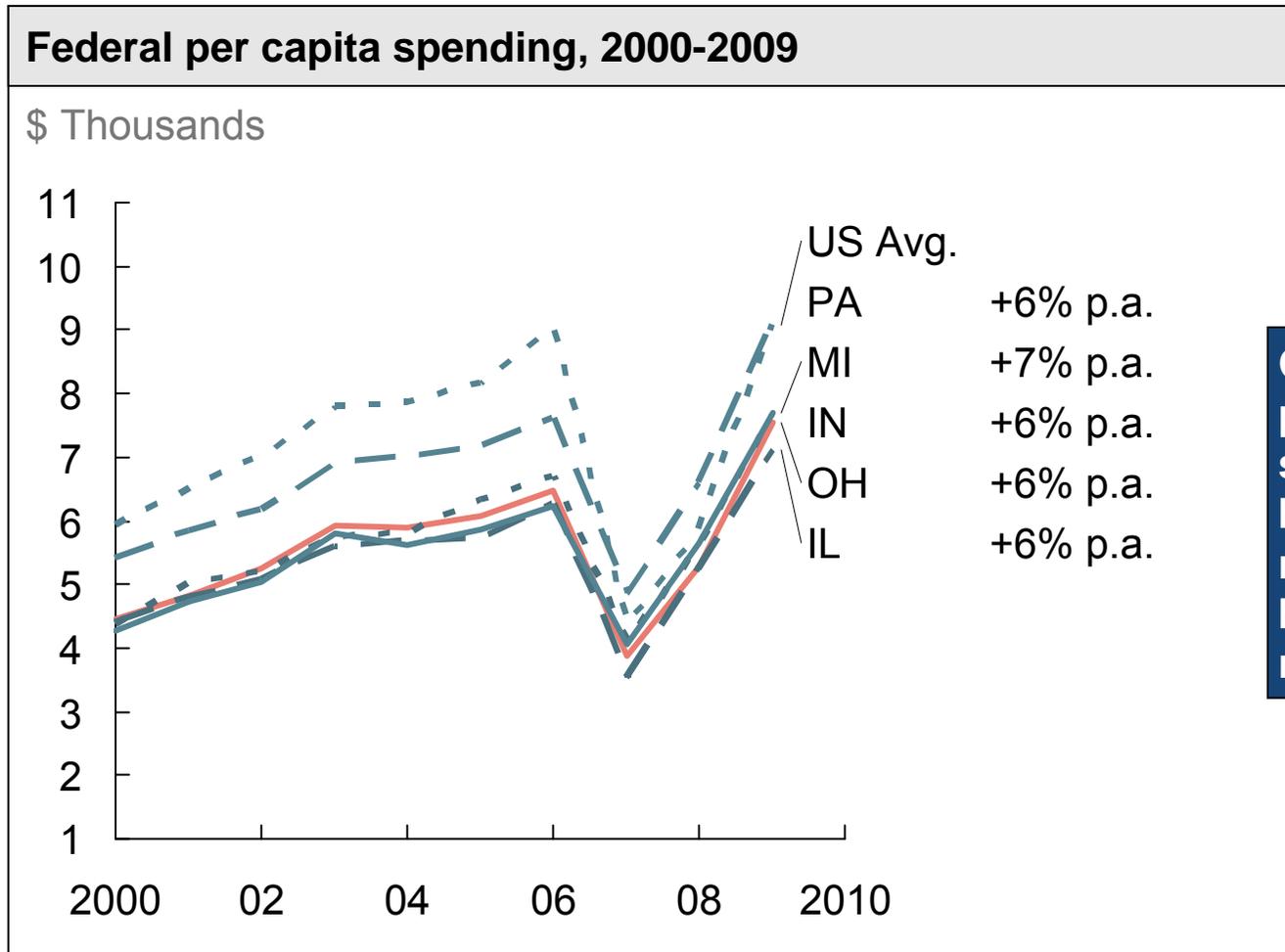
SOURCE: US Census Bureau, Moody's Analytics, USASpending.gov

Ohio's historic per capita spending is in line with neighboring states



Ohio's per capita spending is below the national average but in line with neighbors

Historic federal per capita spending in Ohio is in line with neighboring states

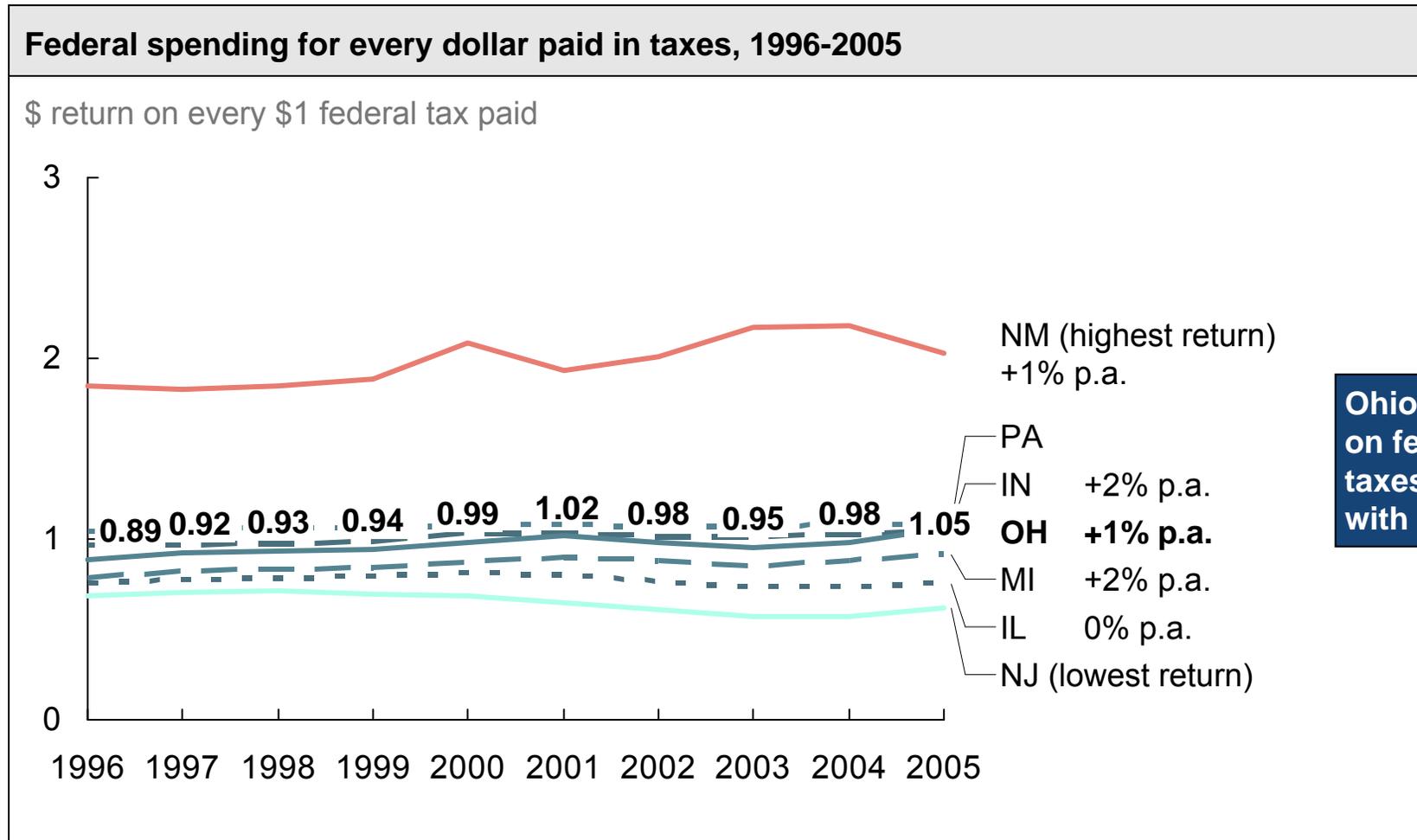


Ohio's federal per capita spending is below the national average but in line with neighbors

1 Federal spending includes all **federal contract and assistance awards**

SOURCE: US Census Bureau, Moody's Analytics, USASpending.gov

Ohio has historically received roughly the same amount in federal spending that it pays in federal taxes



Ohio's return on federal taxes is in line with neighbors

SOURCE: The Tax Foundation, Team Analysis

3/4 of total state funding should be considered “in-play” to address budget gap

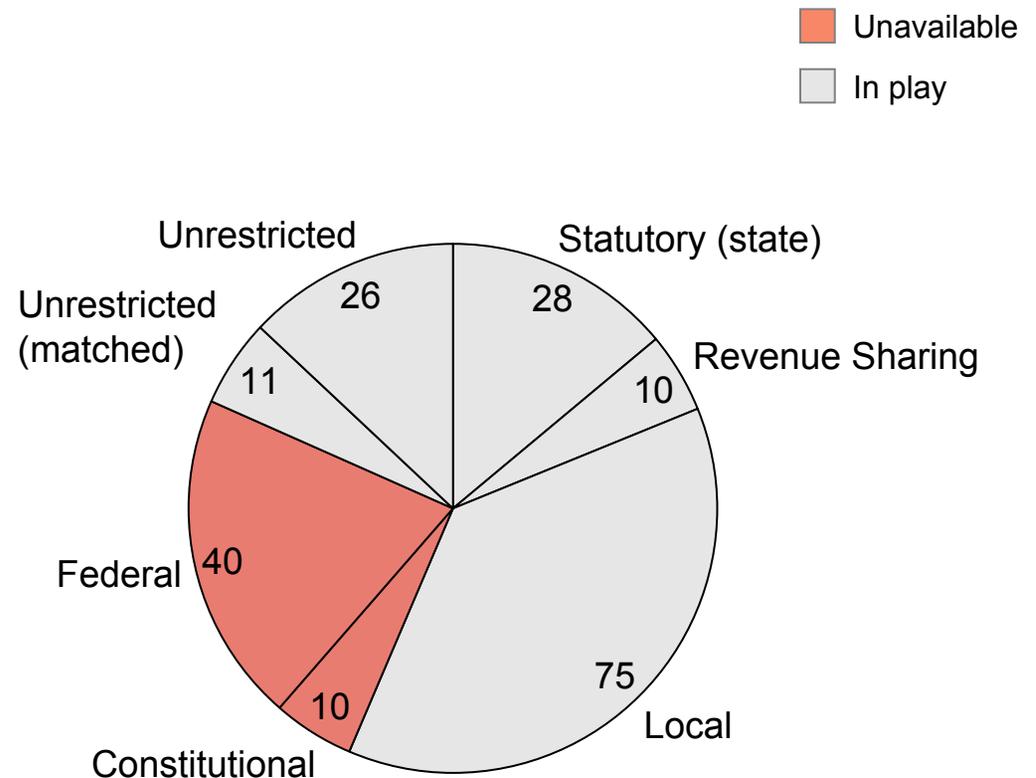
ROUGH ESTIMATES

Types of restricted funding

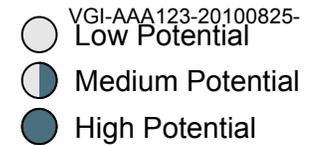
- **Constitutional and federal:** Completely restricted and unavailable for addressing budget gap
- **Local:** Revenue generated at the local level is not controlled by the state, but local spending decisions can be influenced indirectly
- **Revenue Sharing:** Statutory agreements compel state to share funds with local governments, but these can be re-negotiated
- **Statutory:** Certain state-generated revenues are designated for specific purposes, but may be re-appropriated with changes in the law
- **Unrestricted:** Funds may be appropriated freely, though some are tied to federal matching funds

Categories of restricted and unrestricted funds, 2010-2011

\$ Billions



Ohio restricted funds operate under different degrees of constraint



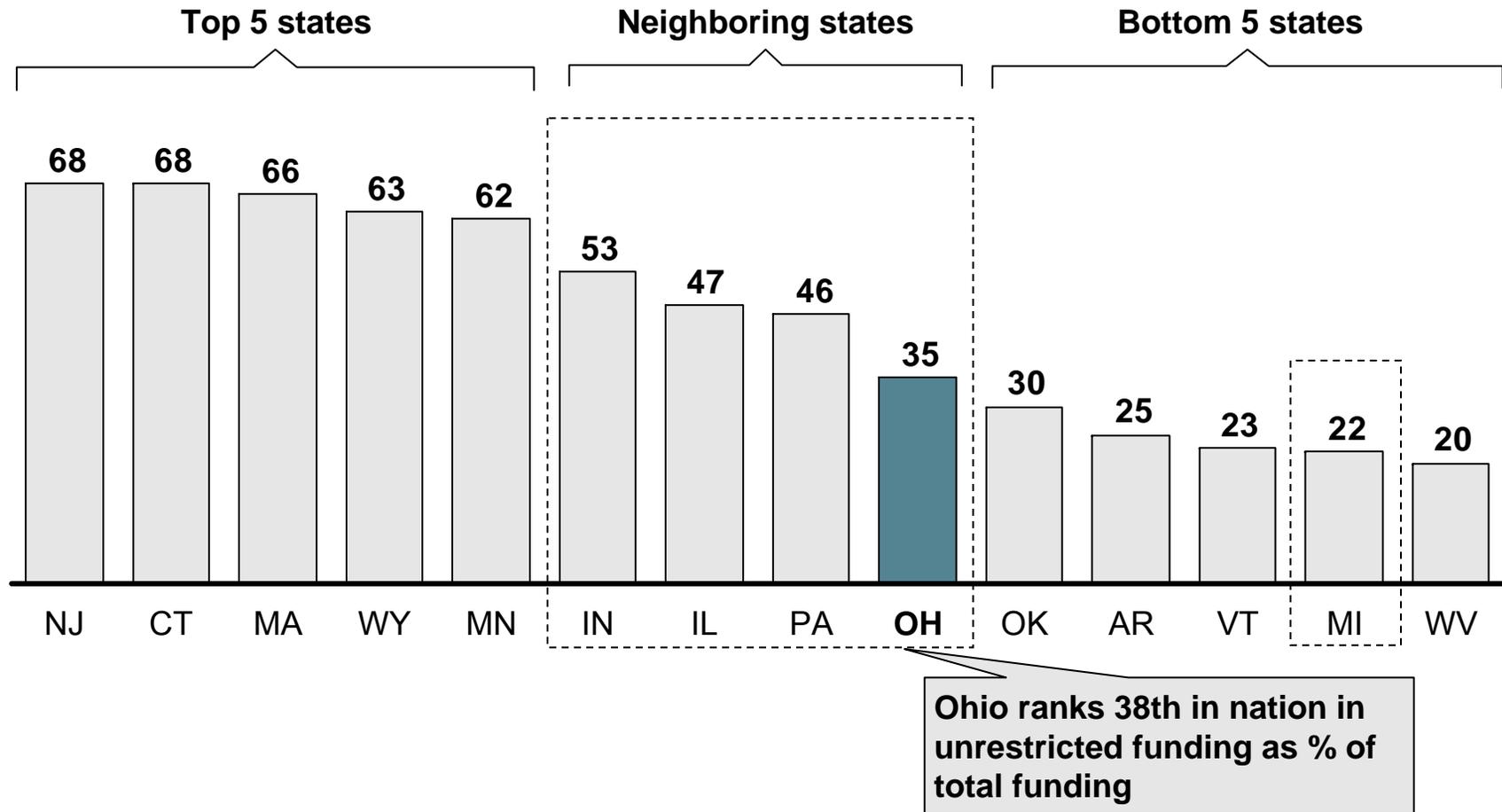
Type of constraint	Source of funds	Value (FYs 10-11)	Potential to re-designate
<ul style="list-style-type: none"> ▪ Constitutional¹ 	<ul style="list-style-type: none"> ▪ Highway funds ▪ Debt service funds ▪ Lottery fund 	\$10 billion	
<ul style="list-style-type: none"> ▪ Statutory – state restricted 	<ul style="list-style-type: none"> ▪ Other non-GRF – Agency fees, lottery etc. 	\$28 billion	
<ul style="list-style-type: none"> ▪ Statutory – federally restricted 	<ul style="list-style-type: none"> ▪ Federal Grants – General revenue fund – Special revenue fund 	\$40.3 billion	
<ul style="list-style-type: none"> ▪ Local – state contribution 	<ul style="list-style-type: none"> ▪ Revenue distribution fund ▪ “Hold harmless” replacement funds 	\$10 billion	
<ul style="list-style-type: none"> ▪ Local -- locally generated revenue 	<ul style="list-style-type: none"> ▪ Personal property tax, income and sales tax, local fees, etc. 	\$75.1 billion	
<ul style="list-style-type: none"> ▪ Unrestricted but federally matched 	<ul style="list-style-type: none"> ▪ GRF – HHS and Medicaid 	\$11 billion	} = \$36.6 billion 
<ul style="list-style-type: none"> ▪ Unrestricted 	<ul style="list-style-type: none"> ▪ GRF 	\$25.6 billion	

Re-designating funds does not necessarily lead to greater savings or efficiency

¹ Ohio constitution requires that 50% of income/estate tax return to locality of origin. This requirement is more than satisfied through state-controlled spending at the local level

Ohio ranks 38th in nation in percent of funding that is unrestricted

Unrestricted funding as percentage of total funding (local excluded)
Percent, 2008



SOURCE: State expenditure report, National Association of state budget officers; team analysis

Contents of the Fact Base

Ohio revenue and expenditure fact base

Medicaid and health care financing fact base

K-12 Education fact base

Corrections fact base

Higher education fact base

State pensions and benefits fact base

The team conducted an in-depth review of Ohio's Medicaid system to identify gaps and savings opportunities

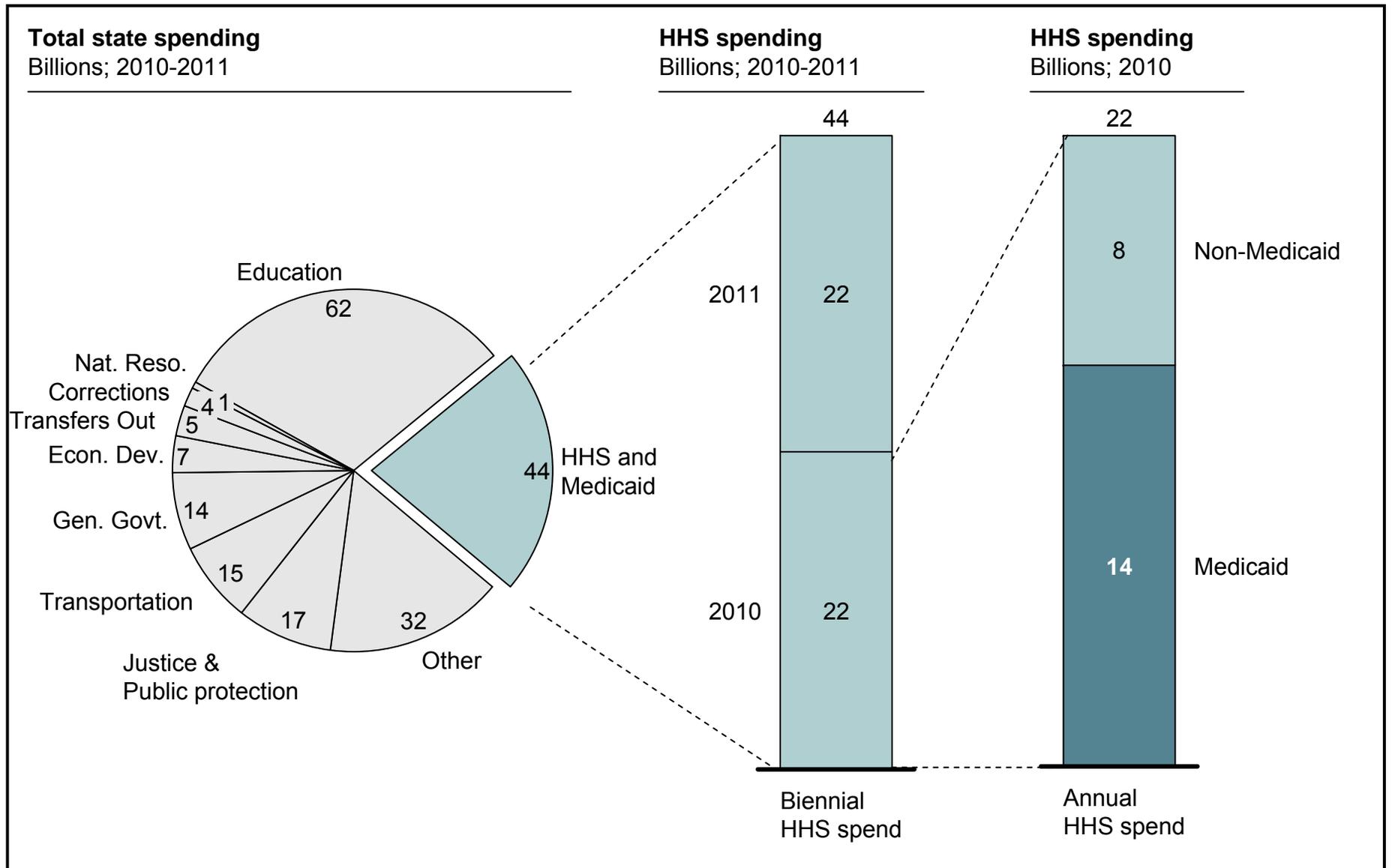
Facts on Ohio Medicaid

- Ohio spends about \$13B per year on Medicaid; **\$5B of which is true state spending** as the remaining \$8B is federal match
- Federal match means that every **\$1 in savings from the Medicaid program saves the state \$0.30-0.40 on average**, with remainder attributing back to federal government
- Aged, blind and disabled (ABD) population of Medicaid equals roughly **20% of enrollees but 80% of the cost**, with \$/individual being disproportionately high compared to other states
- Children and families (CFC) population are placed into managed care and **largely fall within national benchmarks** for \$/ individual
- Health care reform will bring about significant changes to Medicaid, including additional lives and costs, but will not impact state's bottom line until 2014

Critical challenges to address

- **Operational inefficiencies**, including an overly decentralized eligibility process and poorly coordinated claims systems
- Limited ability to impact **high use of expensive and/or unnecessary treatments, hospitalizations**
- **Poorly coordinated care of aged and disabled population**
- High cost and above-average use of **institutional care, particularly nursing homes**

Medicaid falls under the Health and Human Services category in the state budget

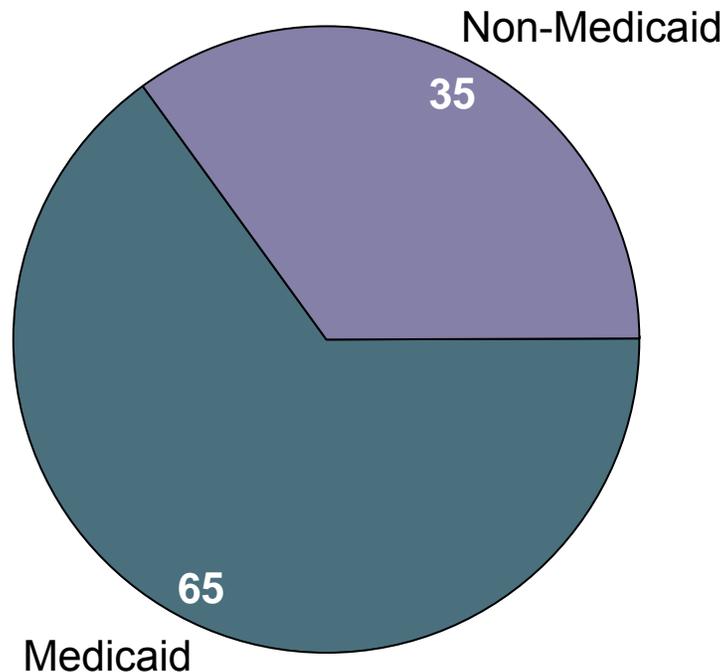


What falls under Health and Human Services?

HHS spending breakdown

Percent of total; 2010

100% = \$22B



Non-Medicaid HHS items

Family and Child Services

- TANF (Temporary Assistance for Needy Families)
- Child protective services,
- Foster care,
- Child support
- Adoption services

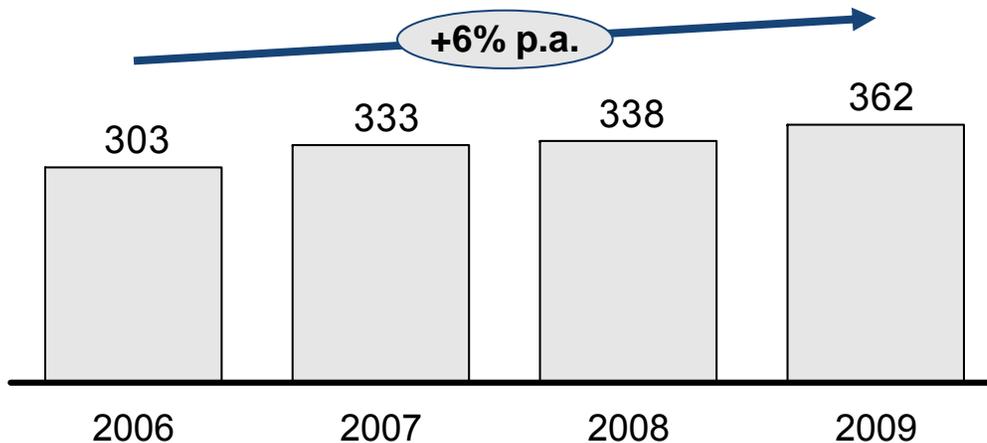
Workforce development

- Unemployment benefits
- Apprenticeship programs
- Workforce Investment Act (WIA)
- Veteran's Unemployment Services
- Various other jobs programs

What is Medicaid?

- Medicaid is a **federally-coordinated, state-administered program**, established in 1965 to provide **health care for the poorest Americans**
- Facilitates **payments to a variety of providers** of medical care; payments are matched by the federal government
- Covers families and children (CFC) as well as Aged, Blind, and Disabled (ABD) population
- Covers both **acute care** (shorter-term medical needs) and **long-term care**

Total US Medicaid expenses (Federal + State) \$ Billions



Top spending states (+DC) per capita

- | | |
|-------------------------|----------------------------|
| 1. New York (~\$2,400) | 7. New Mexico |
| 2. District of Columbia | 8. Louisiana |
| 3. Rhode Island | 9. Minnesota |
| 4. Maine | 10. Pennsylvania |
| 5. Massachusetts | 20. Ohio (~\$1,140) |
| 6. Vermont | |

The state and federal government each play a role in financing and administering Medicaid

State role in Medicaid

- **Administration** – states run the day-to-day operations of the program, coordinating eligibility at the county level as well as reimbursement at the federal level
- **Financing** – state Medicaid agencies make the payments directly to providers or managed care entities, but are reimbursed by the federal government's Medicaid funding mechanism (Federal Medical Assistance Percentage)
- **Eligibility** – states determine specific eligibility requirements per demographic

Medicaid facilitates payment for cost of services, combining state and federal dollars to pay providers and managed care organizations

Federal role in Medicaid

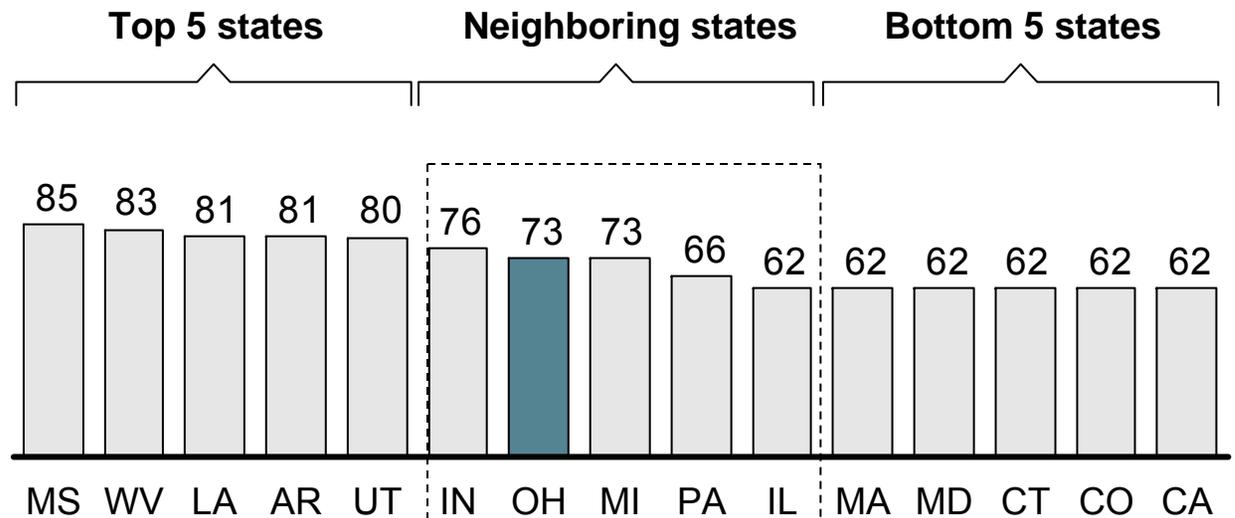
- **Administration** – Centers for Medicare and Medicaid Services (CMS) dictates national Medicaid policy and requirements
- **Financing** – CMS funds the majority of Medicaid expenses through reimbursement as dictated by the FMAP percentage, which ranges from 62%-85% depending on the state's unemployment rates and income distribution
- **Eligibility** – federal government outlines basic eligibility guidelines that all state Medicaid programs must follow

Federal funds are applied through the Federal Medical Assistance Percentage allocation, which varies by state

What is FMAP?

- CMS determines a reimbursement rate for each state's Medicaid expenditures
- The FMAP formula is driven largely by a state's income per capita, relative to the national average
- Minimum FMAP in 2008 (pre-stimulus) was 50%
- For 2009-2010, minimum was increased to 62% through stimulus funding

FMAP rate by state;
Percent; 2010



Ohio ranks 21st in the nation in overall FMAP rate

11 states currently receive the federal minimum FMAP rate of 61.6%

$$\text{State share} = 0.45 \times [\text{State Per Capita Income} / \text{U.S. Per Capita Income}]$$

In 2008, Ohio was drawing 61% in federal match; with the stimulus bill that rose to over 70% in 2009 and 73% in 2010

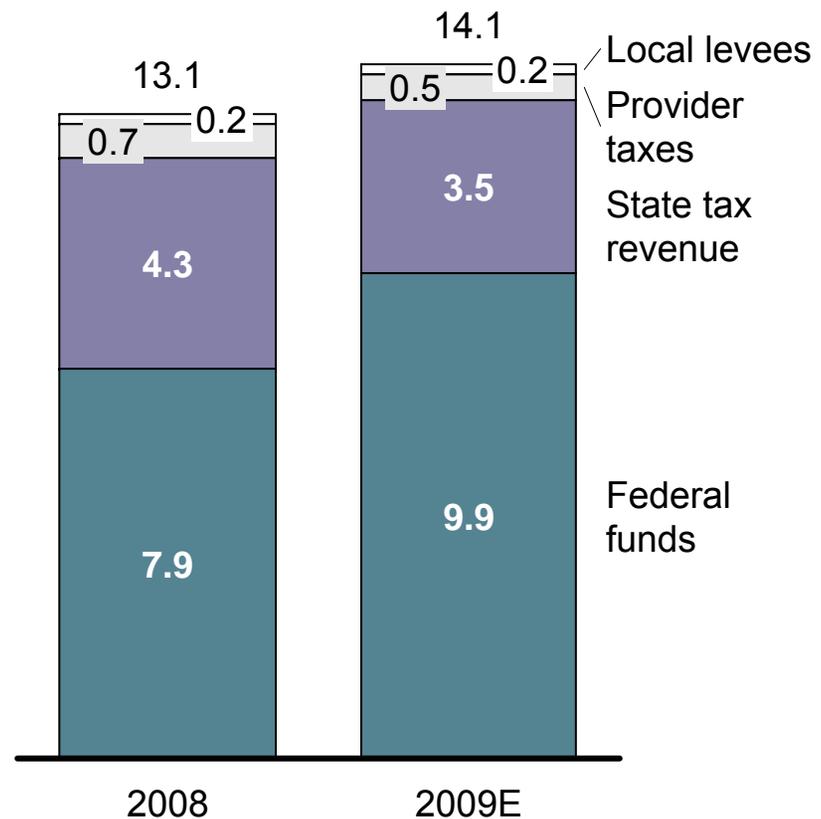
PRELIMINARY

Types of Medicaid funding

- **Federal funding** – reimbursed to the states on a quarterly basis depending on predetermined FMAP rate
- **State tax revenue** – largely flows from GRF to ODJFS
- **Local levee money** – some counties have local levees that alleviate the cost of some services provided at the county level
- **Provider fees** – taxes and fees on nursing homes, hospitals, etc.
 - Often used as a mechanism for drawing additional federal funding

Sources of Medicaid funding

\$ Billions; 2008



Medicaid covers a wide variety of medical services and coverage is delivered through two main mechanisms

What Medicaid covers

- Emergency room visits
- Primary and specialty physician visits
- X-Rays, labs, and other screens
- Durable medical equipment
- Pharmaceuticals
- Nursing home care
- Home and community based care
- Mental Health Facilities
- Numerous additional services

How it's delivered

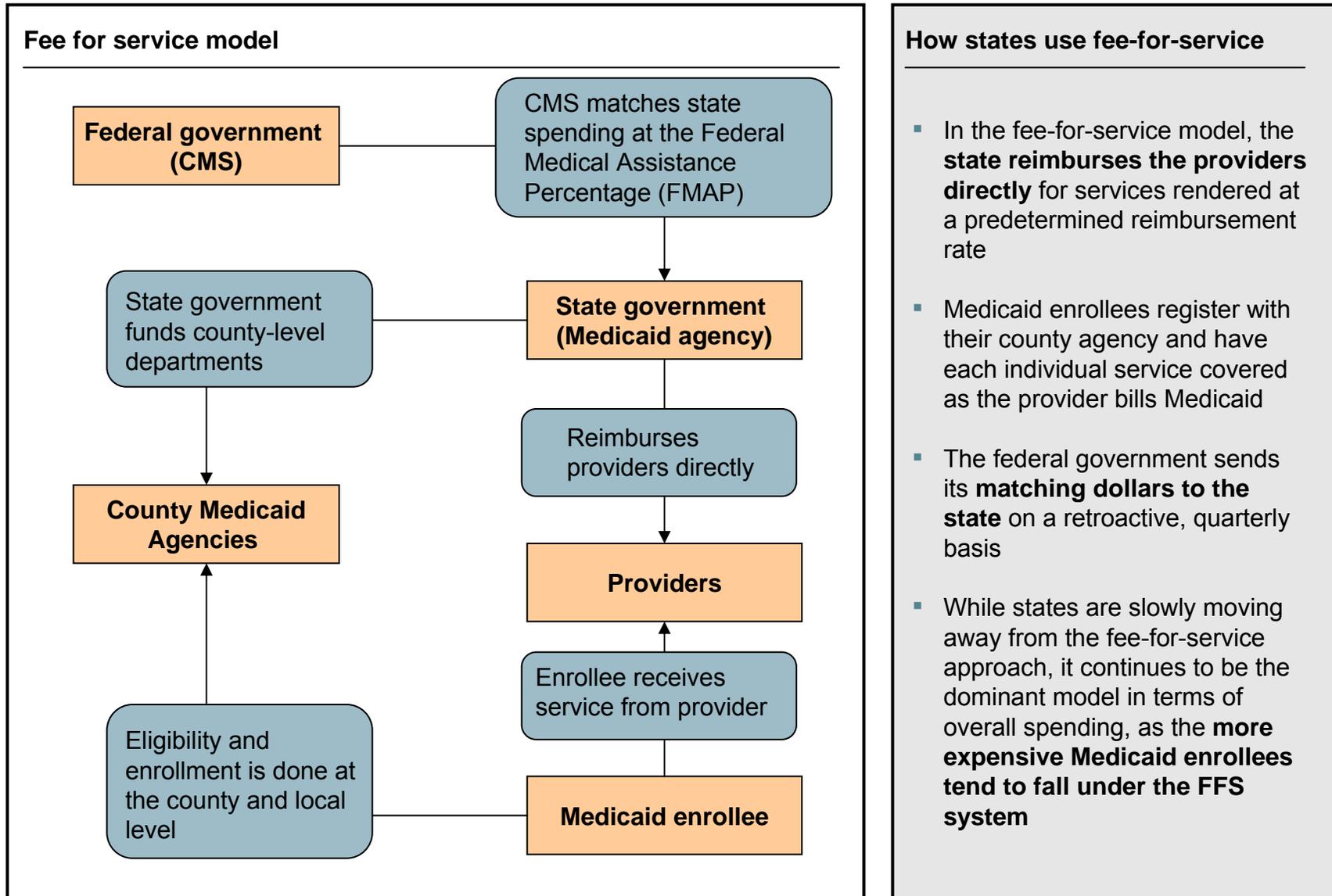
Fee-for-service

- State assumes the risk and financial burden
- Pays providers directly for Medicaid services

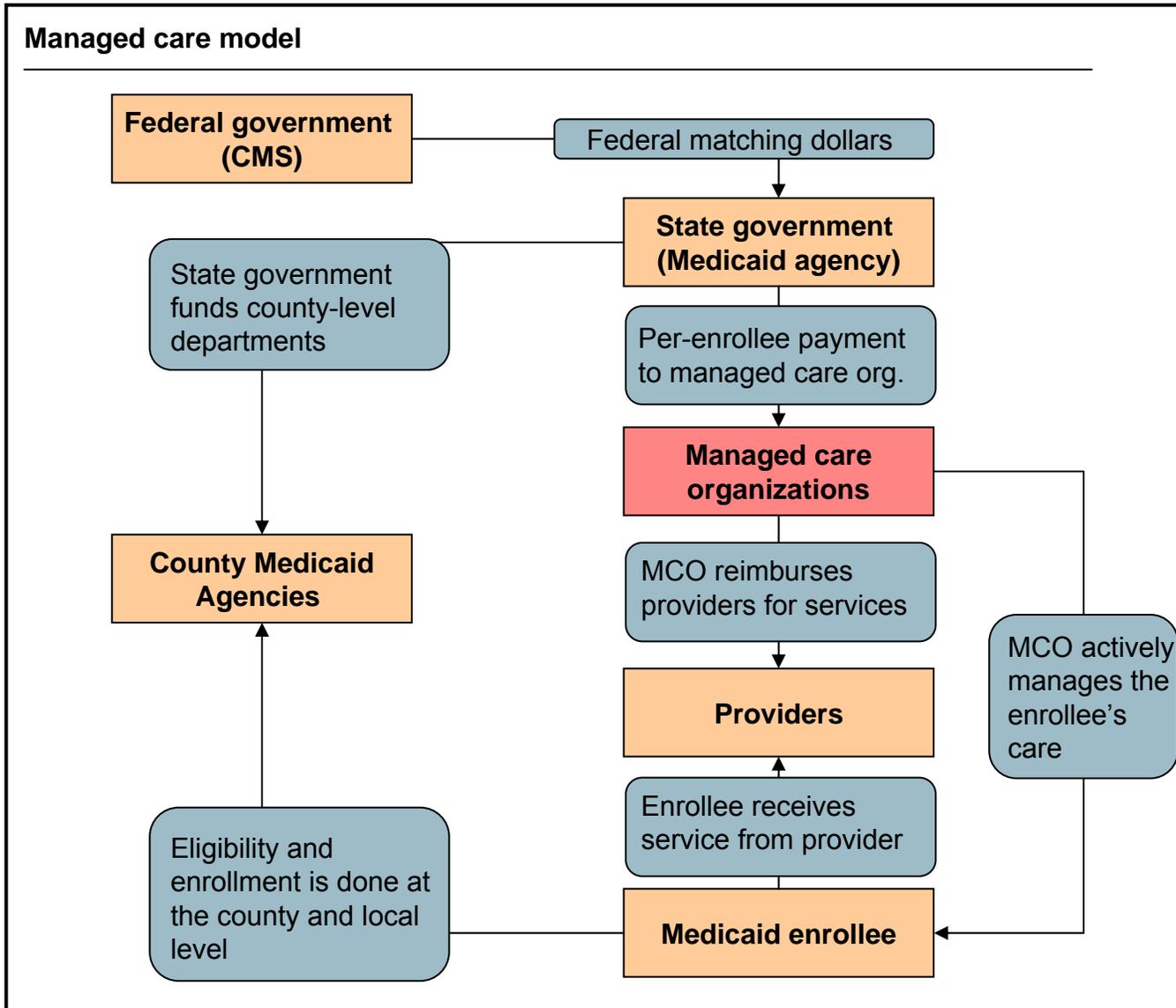
Managed care

- State passes risk along to private insurers
- Per-person capitation payments made directly to insurers instead of providers

In the fee-for-service model, the state Medicaid agency reimburses a variety of providers for services rendered



In the managed care model, states pay an insurance company a per-person fee to assume the liability and risk of the patient population



How states are using managed care

- In the managed care model, the insurer (MCO) assumes the risk for the patient population in exchange for a per-enrollee payment (capitation)
- Nationally, Medicaid programs are moving more enrollees into managed care, with 71% of the current national Medicaid population in MCOs – with an increasing proportion in Medicaid-only MCOs
- Most states limit managed care to the families and children population, but states are starting to experiment with managed care for the elderly and disabled populations

Additionally, CMS allows for a set of waivers that states can use to deliver care in creative and cost-effective ways

Type of waiver	What they are	Who's using them	Creative uses
1115 waivers	<ul style="list-style-type: none"> Grant authority to states to “test policy innovations” The widest scope of the three waiver types 	<ul style="list-style-type: none"> Tennessee California Colorado Illinois Oregon (+others) 	<ul style="list-style-type: none"> Tennessee used a 1115 waiver to create its TennCare program in 1994
1915(b) waivers	<ul style="list-style-type: none"> Allows states to leverage managed care organizations within the Medicaid program 	<ul style="list-style-type: none"> Florida Ohio Michigan Texas Washington (+ others) 	<ul style="list-style-type: none"> Texas was able to integrate acute and long term care under their managed care system
1915(c) waivers	<ul style="list-style-type: none"> Home and community-based care waiver Allows states to put more elderly enrollees in HCBS instead of nursing homes 	<ul style="list-style-type: none"> Every state except Arizona 	<ul style="list-style-type: none"> North Carolina was able to reduce ABD costs by enacting a combined 1915(b)/(c) waiver

Additionally, some waivers allow for new payor/provider taxes that can draw additional federal funding

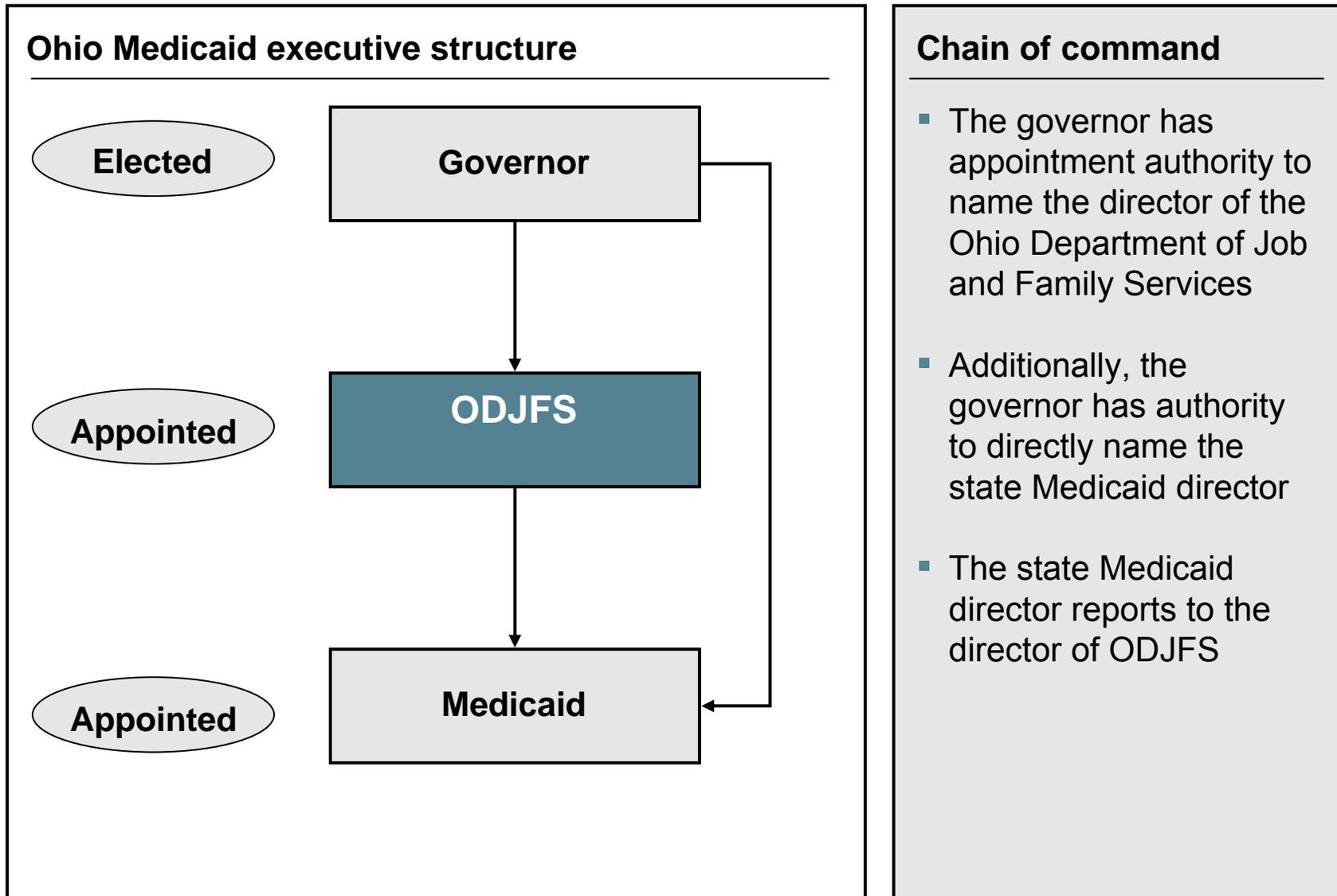
As the payer of last resort, Medicaid covers five different populations, but the state has discretion in setting specific eligibility levels

Category	Populations covered	Number of Ohio enrollees	Current Ohio eligibility level
Covered families and children (CFC)	▪ Children	956,000	▪ 300% FPL*
	▪ Adults	340,000	▪ 90% FPL
	▪ Pregnant women	25,000	▪ 200% FPL
Aged, Blind, and Disabled (ABD)	▪ Elderly	110,000	▪ 65% FPL
	▪ Disabled	260,000	▪ 65% FPL (Disabled workers at 250%)

While states have historically had discretion in setting eligibility levels, **health care reform has handcuffed states in their ability to lower levels of eligibility** beyond where they were as the law was enacted

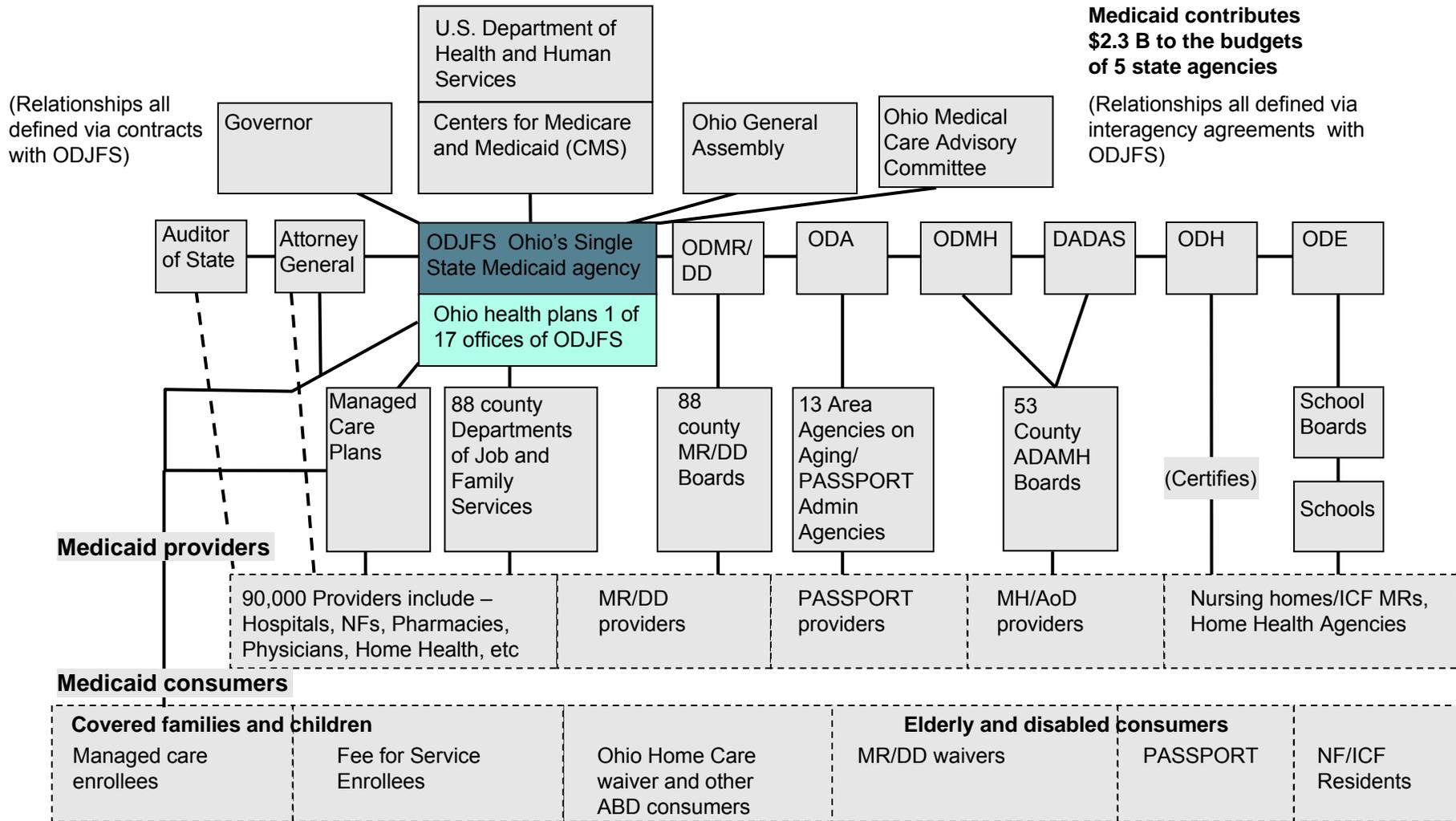
***Federal Poverty Level (FPL)** – defined as \$10,830 in annual income for an individual and \$22,050 for a family of four

The Ohio Department of Job and Family Services is the single state Medicaid agency...



...but there are numerous other departments and entities that add additional layers of complexity

Major Organizational Relationships of Ohio's Medicaid Program

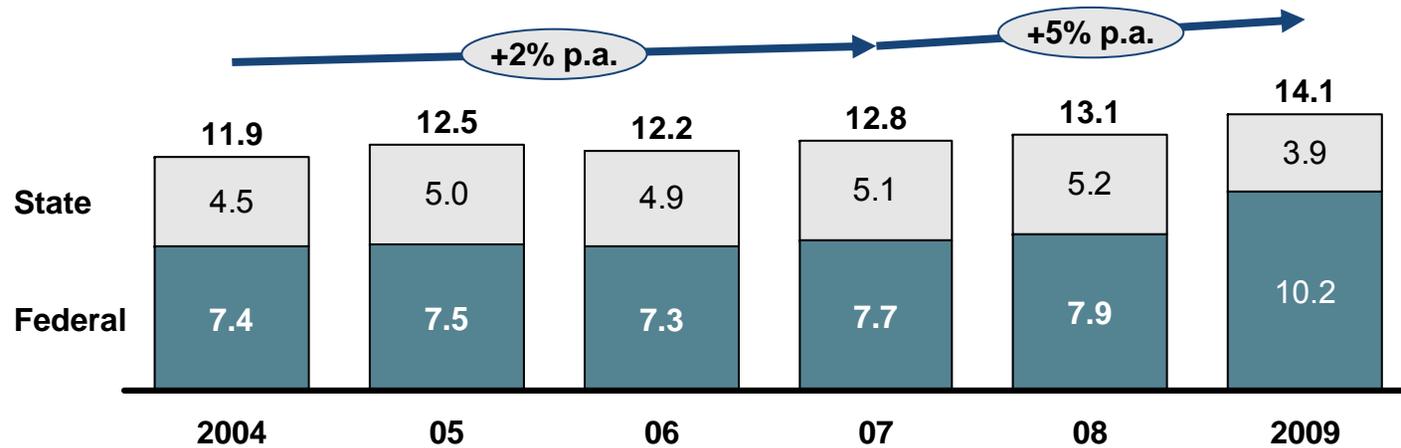


Note: ODJFS, Ohio Dept of Job and Family Services; ODMR/DD, Ohio Dept of Mental Retardation and Developmental Disabilities; ODA, Ohio Dept of Aging; ODMH, Ohio Dept of Mental Health; DADAS, Dept of Alcohol and Drug Addiction Services; ODH, Ohio Dept of Health; ODE, Ohio Dept of Education; ICF, Intermediate Care Facility ; AoD, Alcohol and other Drugs

Ohio's Medicaid spending continues to increase year over year, largely driven by an increasing number of enrollees

Using 2008 data going forward for state comparisons

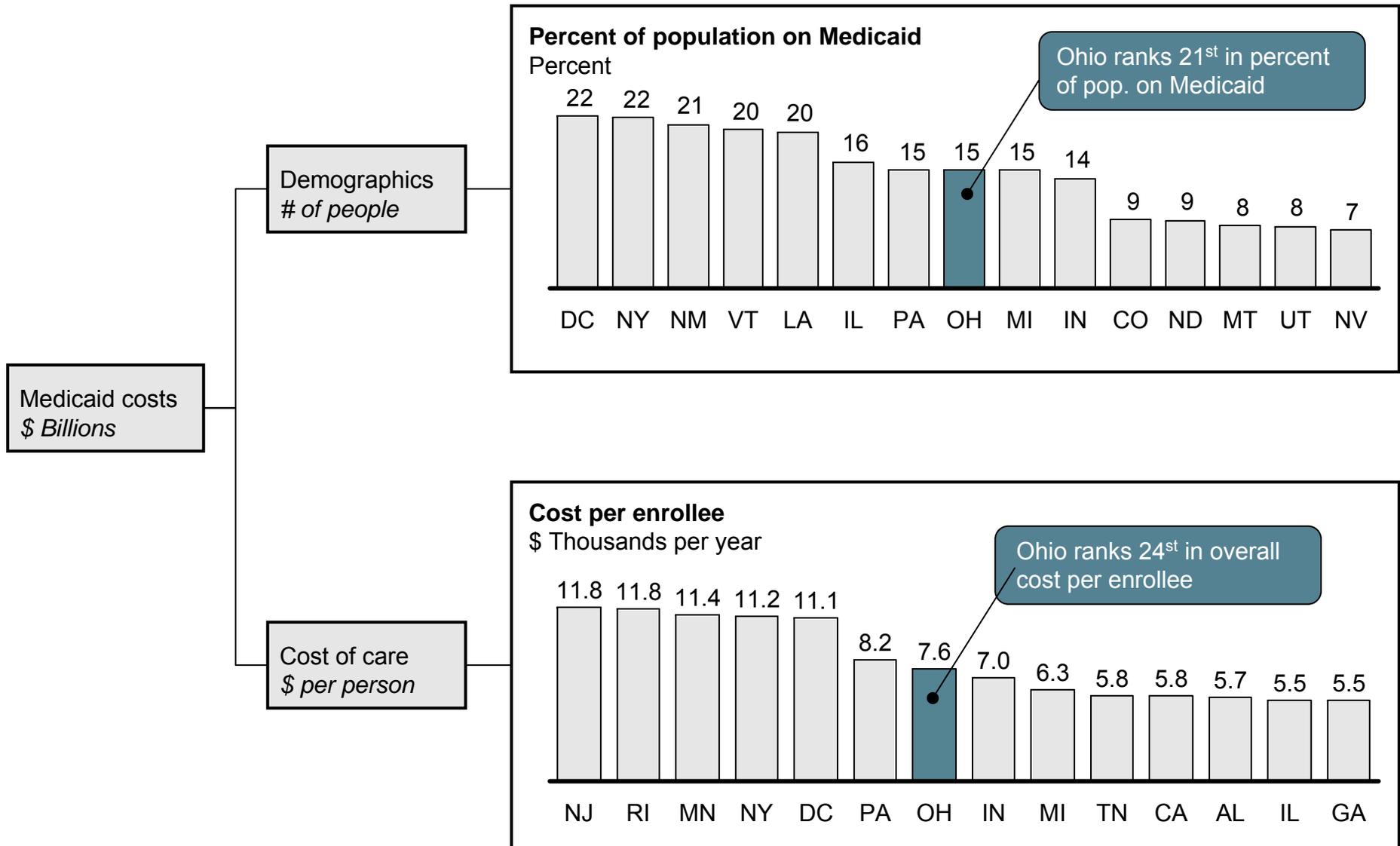
Total Medicaid spend – Ohio
\$ Billions



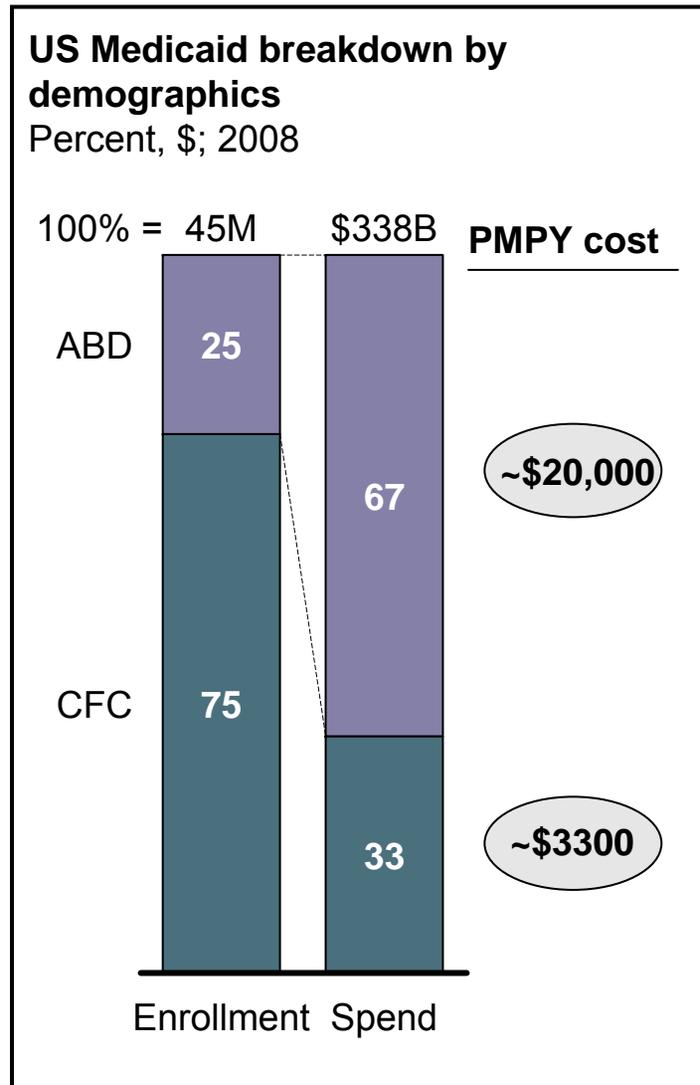
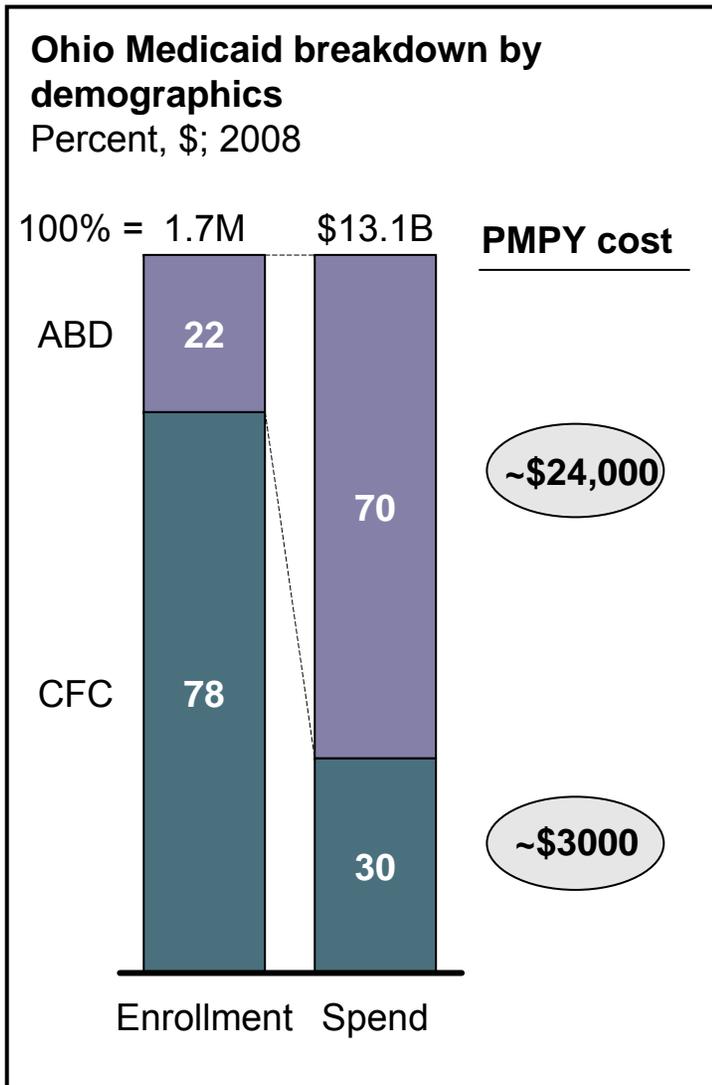
The 2007-2009 increase is **driven more by an increase in the number of total enrollees** rather than an increase in the cost per enrollee

	2004	05	06	07	08	2009	CAGR
Number of enrollees Millions	1.6	1.6	1.6	1.6	1.7	1.8	2%
Average cost per enrollee USD \$	7,672	7,832	7,687	7,985	7,643	7,815	0.4%

Ohio is an average state in terms of the size of its Medicaid population and overall cost per enrollee



Ohio's Covered Families and Children (CFC) per member costs are below the national average, but Aged/ Blind/ Disabled are 20% higher

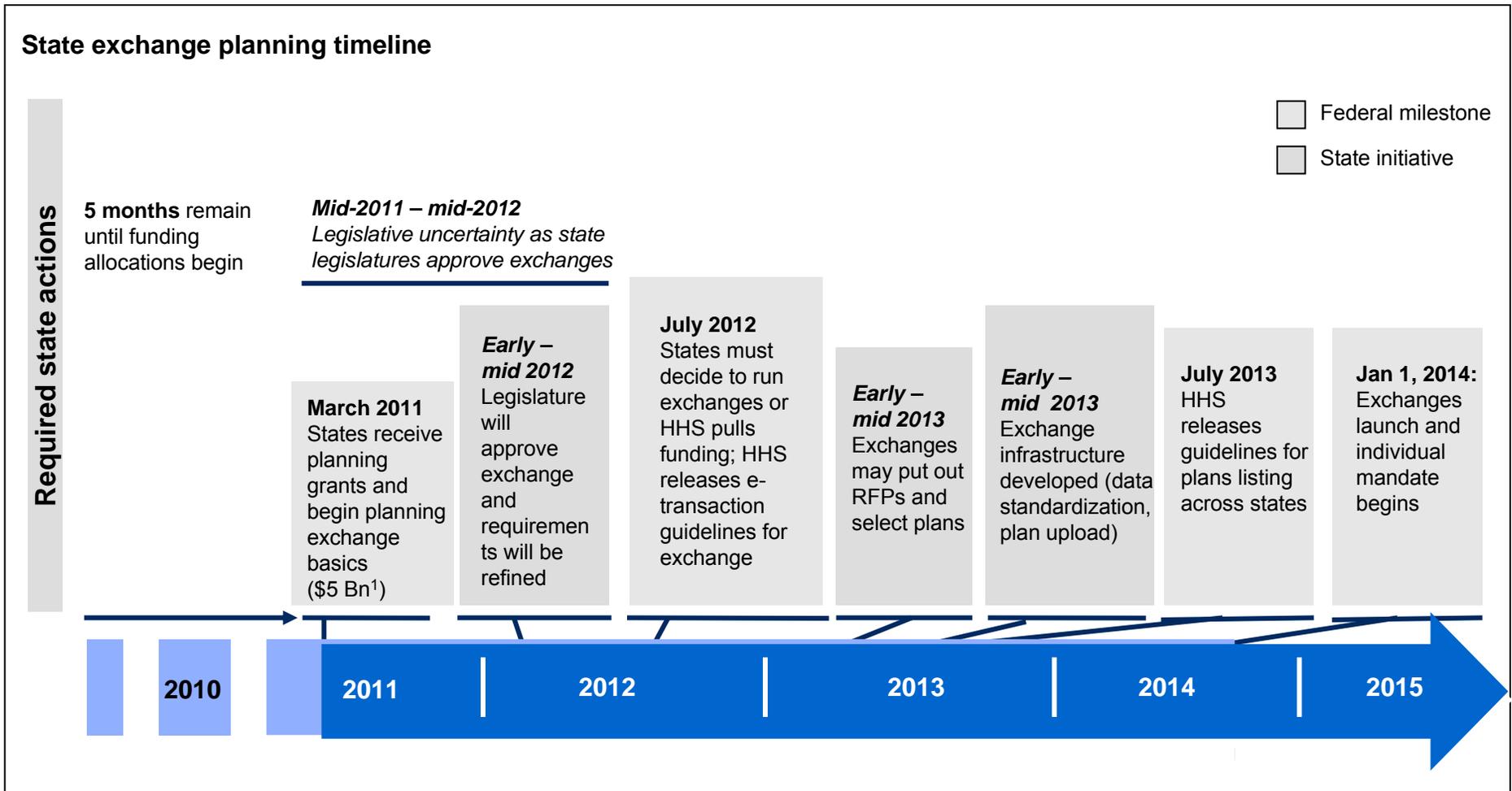


While Ohio performs under national average cost for the CFC population, the state **spends 20% more per year on ABDs**

What is health care reform and what does it change?

Insurance exchange	Changes to Medicare and Medicaid	Insurance reforms	Mandates
<ul style="list-style-type: none"> ▪ Exchange – by 2014, states must have an operational insurance exchange for the uninsured population to purchase private insurance ▪ States must hit certain milestones to continue to receive HHS funding for their exchange planning ▪ Those between 133%-400% of the FPL are eligible for government subsidies 	<ul style="list-style-type: none"> ▪ Medicaid – will now be forced to cover every person up to 133% of the FPL ▪ Childless adults will be eligible for Medicaid ▪ Feds cover 100% of new eligible cost for 2014-2016 <ul style="list-style-type: none"> ▪ Medicare – closes prescription drug coverage gap (part D) starting in 2011 ▪ \$500 Billion in Medicare cuts over next decade 	<ul style="list-style-type: none"> ▪ Pre-existing conditions – insurers can no longer deny or drop coverage for children’s pre-existing conditions ▪ Starting in 2014, insurance companies can no longer deny adult coverage for pre-existing conditions <ul style="list-style-type: none"> ▪ Children on parents’ plans – children can now stay on their parents’ plan until age 26 	<ul style="list-style-type: none"> ▪ Individual mandate – individuals are required to have health insurance by 2014 or face a \$695 fine (some exceptions) <ul style="list-style-type: none"> ▪ Employee mandate – employers with more than 50 employees must provide insurance or face a \$2000 per worker fine (if they qualify for subsidies)

Under the Affordable Care Act, states will be responsible for establishing and operating insurance exchanges for the remaining uninsured



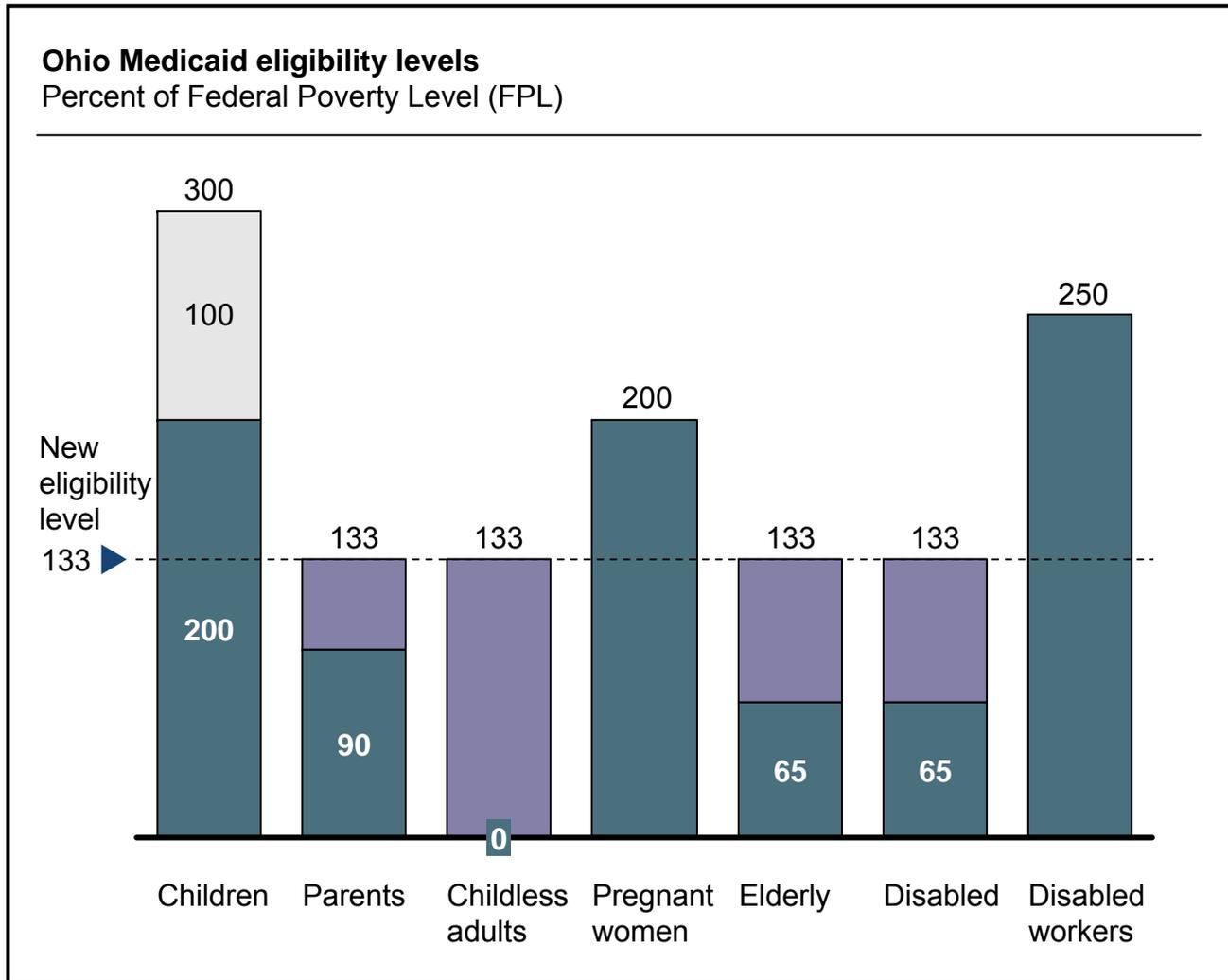
1 PPACA; \$5 Bn total allocation for exchange administration, portion to be allocated for funding

Health care reform will increase the state's Medicaid burden, but will supply additional federal funds to cover new enrollees

	Effective date	Description	Who pays?	\$ impact
Uniform 133% FPL eligibility	2014	<ul style="list-style-type: none"> New federal minimum eligibility of 133% FPL; will add additional people to the state Medicaid rolls; 	<ul style="list-style-type: none"> Federal govt. covers 100% of 2014-2016, 95% in 2017, 94% in 2018, 93% in 2019 and 90% for 2020+ 	~\$300M
Elimination of cost-sharing	2011	<ul style="list-style-type: none"> No more cost sharing of preventative services between Medicaid and Medicare for patients that are dually-eligible 	<ul style="list-style-type: none"> Unclear whether burden falls on Medicare or Medicaid systems 	TBD
Reduced DSH payments	2011	<ul style="list-style-type: none"> Reduced DSH payments by 50%; 25% once uninsured rate decreased by 45% or more 	<ul style="list-style-type: none"> If states wish to compensate hospitals, they will be forced to assume the cost burden 	TBD
Reduced readmit payments	2012	<ul style="list-style-type: none"> Reduced payments to hospitals to avoid unnecessary hospital readmissions 	<ul style="list-style-type: none"> Cost of readmissions may be borne by the hospitals themselves 	TBD
Increase in fed. Rx pricing disc.	2013	<ul style="list-style-type: none"> Disallows states from negotiating additional savings on top of federal best pricing 	<ul style="list-style-type: none"> State transfer to federal government 	<\$100M

State Medicaid eligibility must meet federal requirements, which will increase all categories to 133% of the federal poverty level (FPL) in 2014

PRELIMINARY



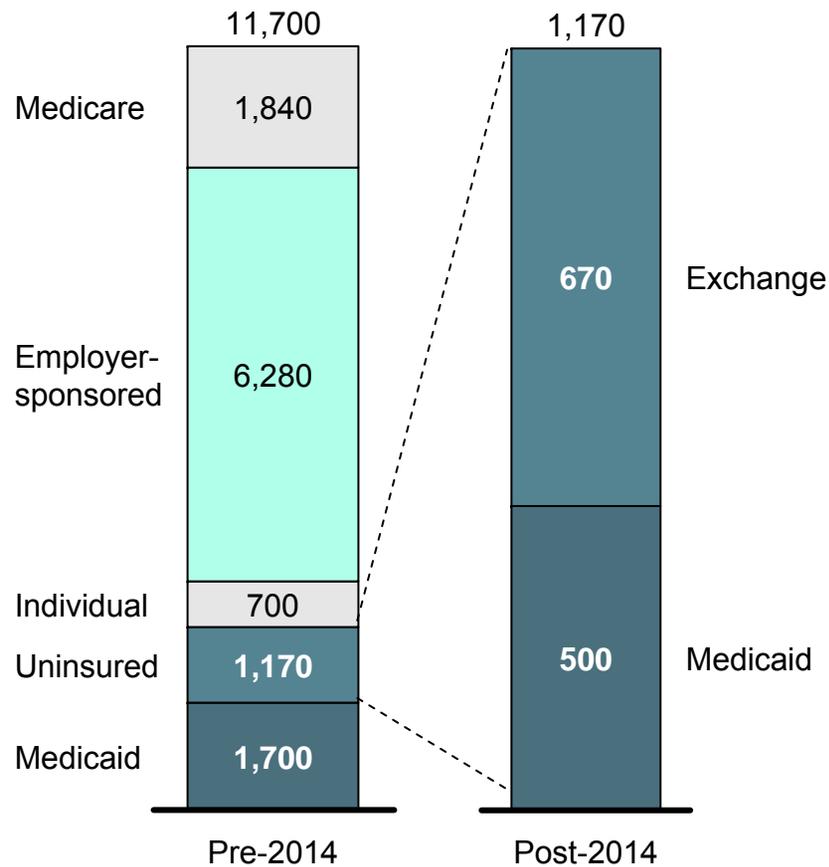
- Proposed 2010-2011 change
- Expanded Medicaid population
- Current eligibility

- After 2014, when the Affordable Care Act changes federal Medicaid eligibility statutes, **states will be forced to cover every category at 133% FPL** minimum, adding extra pressure to the state's coffers
- Additionally, Gov. Strickland has outlined a **300% FPL eligibility for children** in the FY2010 budget

While reform adds additional people to the Medicaid rolls, the majority of the uninsured will be placed into the insurance exchange

ESTIMATES

Ohio population by health insurance coverage
Number of residents (Thousands)



Creation of insurance exchange –

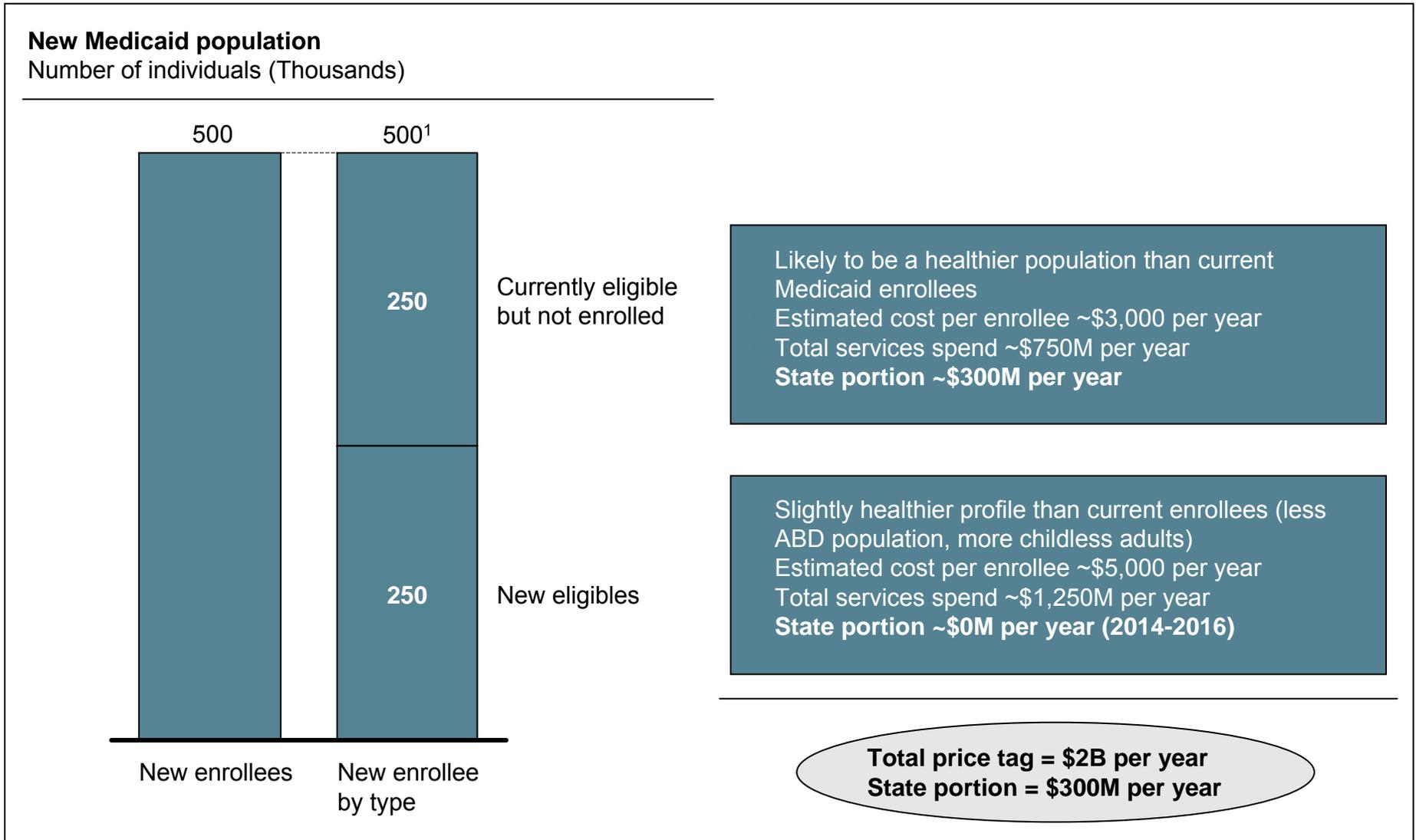
- Government administered exchange for consumers to find private insurance plans
- Individuals between 133-400% of the poverty line will qualify for government subsidies to purchase insurance
- Cost to state government purely administrative
- Additional pressure may come from small businesses that choose to pay the fine rather than continue coverage

Expansion of Medicaid eligibility

- Uniform eligibility for individuals at or below 133% FPL
- For newly eligibles, the federal government will cover 100% of costs for 2014-2016, with a sliding scale down to 90% coverage in 2020 and beyond
- However, new enrollees that are already eligible (to avoid the individual mandate fine) will be covered at existing FMAP rates instead of 100%

The total increase in Ohio Medicaid spending post-reform will approach \$2B, but the portion the state is responsible for is ~\$300M

ESTIMATES



1 Interviews and external sources have validated that this split is 50% current eligibles; 50% new eligibles

Contents of the Fact Base

Ohio revenue and expenditure fact base

Medicaid and health care financing fact base

K-12 Education fact base

Corrections fact base

Higher education fact base

State pensions and benefits fact base

The team conducted an in-depth review of Ohio's K-12 education system to identify gaps and savings opportunities

Facts on Ohio K-12 education

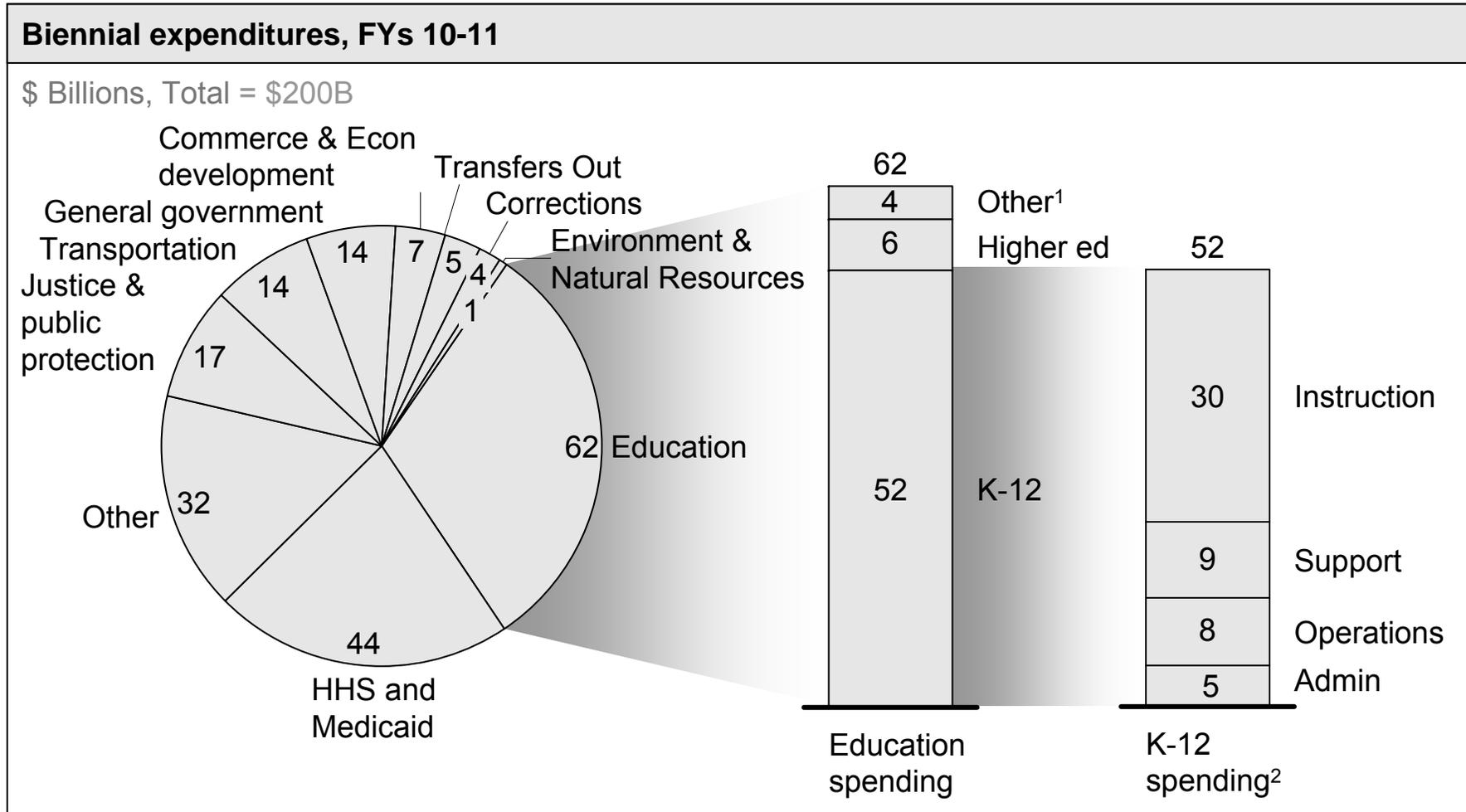
- Ohio's K-12 education system is a \$52 billion/ biennium program, and is the largest user of state and local funds in the budget
- Ohio's K-12 education system is responsible for 612 school districts and 1.9 million students, primarily educated through traditional public schools but with growing charter participation
- Ohio schools receive varied amounts of state and local funding, dependent on their ability to use levies for local dollars; funding levels vary from ~\$6900/ student at low end to ~\$20,000 at high end
- Due to the structure of funding, savings in K-12 education will need to be captured at local level, as districts have majority of control in how dollars are spent and saved

Critical challenges to address

- **Administrative bloat-** Ohio ranks 47th in nation in % of spending in classroom and 49th in ratio of teacher comp to total comp
- **Undersized districts-** districts significantly smaller than neighboring states, with disproportionate per pupil expenditures on support and operations
- **Rules around teacher pay and employment**
 - Collective bargaining increases pay at unsustainable rate
 - Last-in first-out lay-offs eliminate performance as a key consideration

Ohio's education budget comprises almost 1/3 of total public spending

ROUGH ESTIMATES



1 Other includes some Pre-K and other uncategorized education funding

2 Expenditure breakdown for FYs 10-11 extrapolated from 2008 NCES financial data

SOURCE: Ohio Office of Budget and Management; Ohio Legislative Services Commission; U.S. Census Bureau

Ohio K-12 schools are controlled by up to five layers of governance

Key institutions/people

Typical roles/control

- Multiple federal agencies

Federal



- Leverage via allocation of federal funding, can intervene on civil rights

- Governor of Ohio
- Ohio Department of Education

State



- Most direct regulatory, policy responsibility; implement NCLB and other system expectations

- 612 public school districts**

Districts



- Determine local taxing policies, school budgets and operations, staffing decisions**

- ~4,020 schools**
(public and charter)

Schools



- Deliver instruction, interact with students and families

- ~1.9M students**

Students



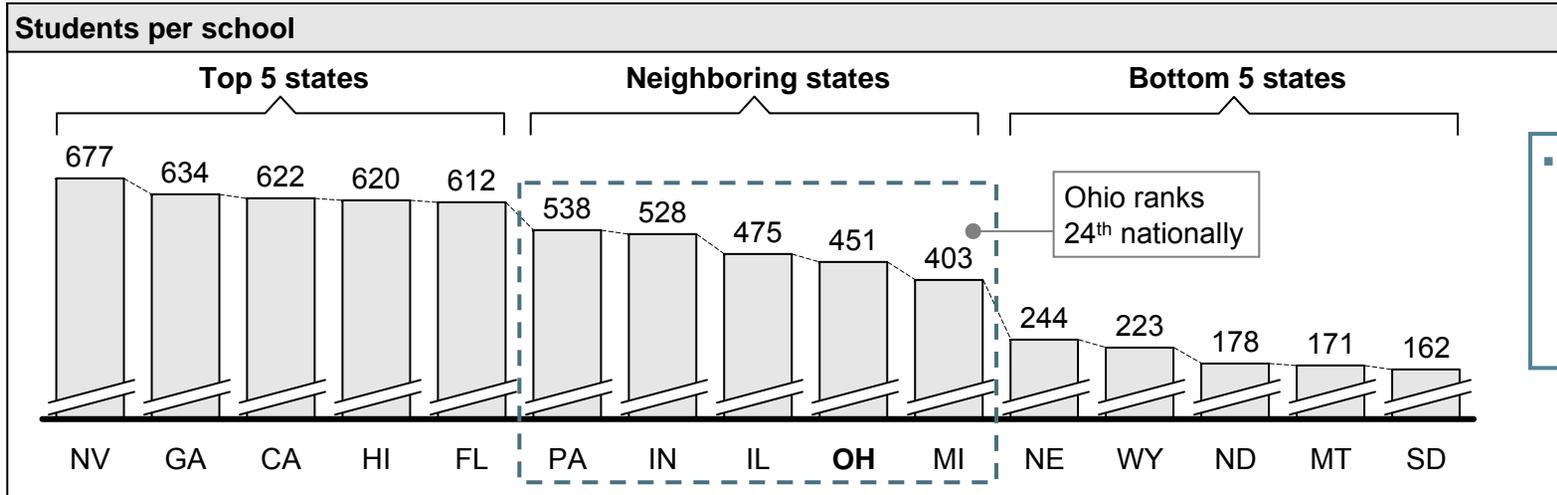
- In some districts, ability to choose schools provides students and families some level of control

In terms of financial control, the most important organizational unit in the Ohio education system is the school district

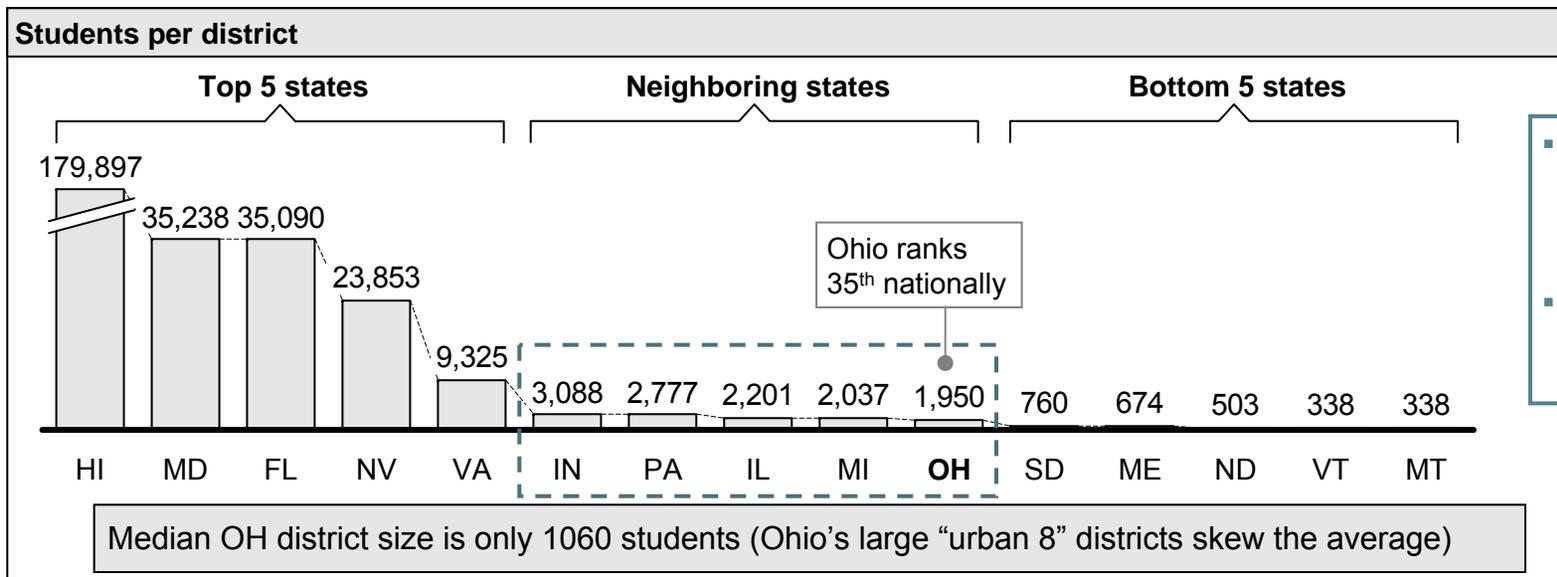
SOURCE: Team analysis

Ohio average school enrollment is in line with other states, but its districts are smaller

2008



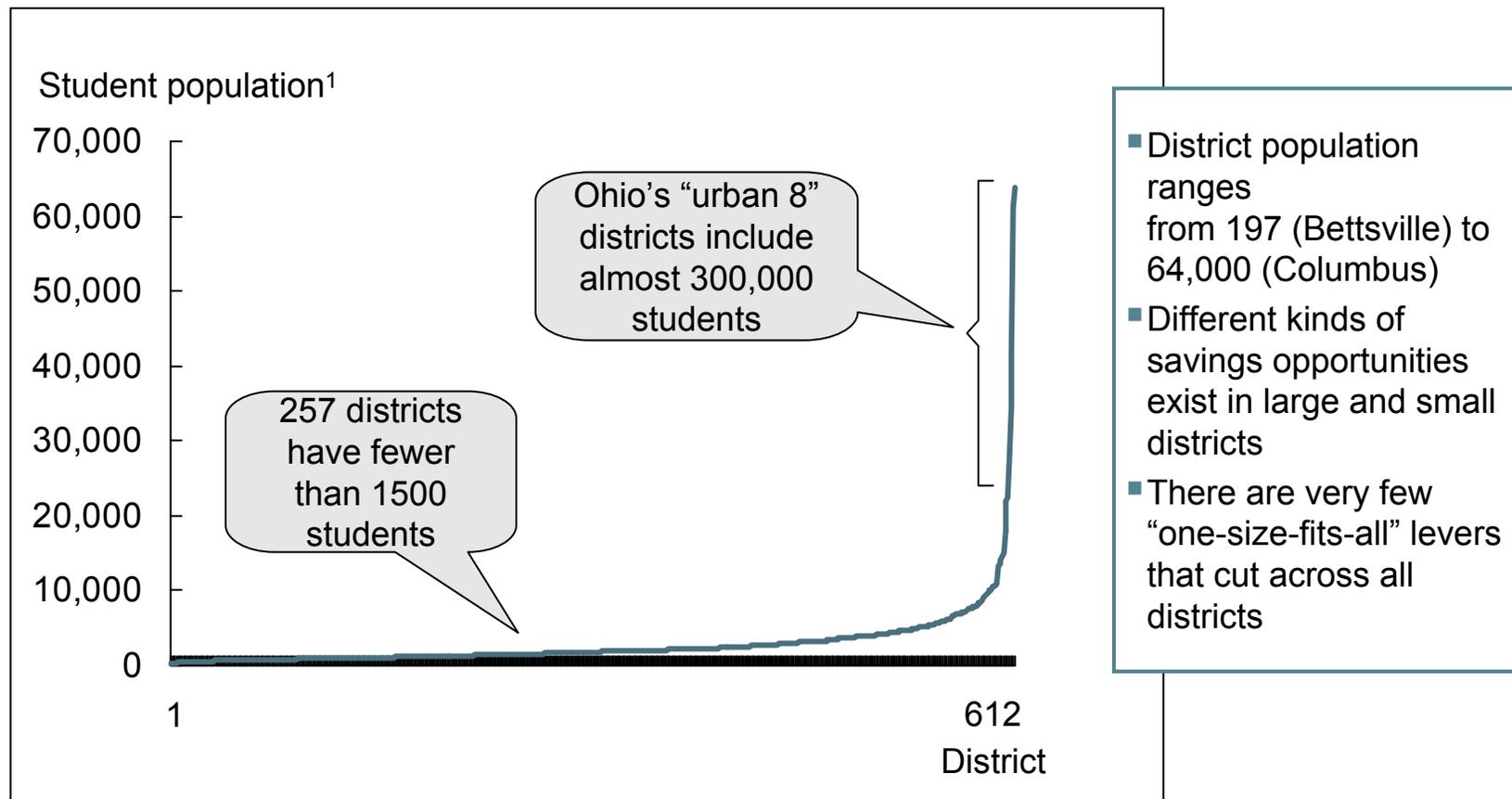
- Ohio's average school size is in line with neighboring states



- Ohio lags neighboring states in district size
- Most of the states below Ohio are rural

SOURCE: NCES, team analysis

Student population distribution varies widely across Ohio districts



1 In Ohio, districts receive funding according to the number of students who reside there, not the number who are enrolled there

SOURCE: 2010 Cupp Report, team analysis

Ohio system is predominantly traditional public schools with growing number of charter schools

Public School

Enrollment: 95.1% Funding: 96.6%

- Governed primarily by local school board, with state and federal mandates and oversight
- Contracts negotiated through teacher unions
- Average school size of 451 students
- **Funding primarily from local and state sources, with federal supplements**
- Enrollment open to all district residents; many Ohio schools offer open enrollment to adjacent districts

**Average per pupil funding level:
\$9,995**

Charter School

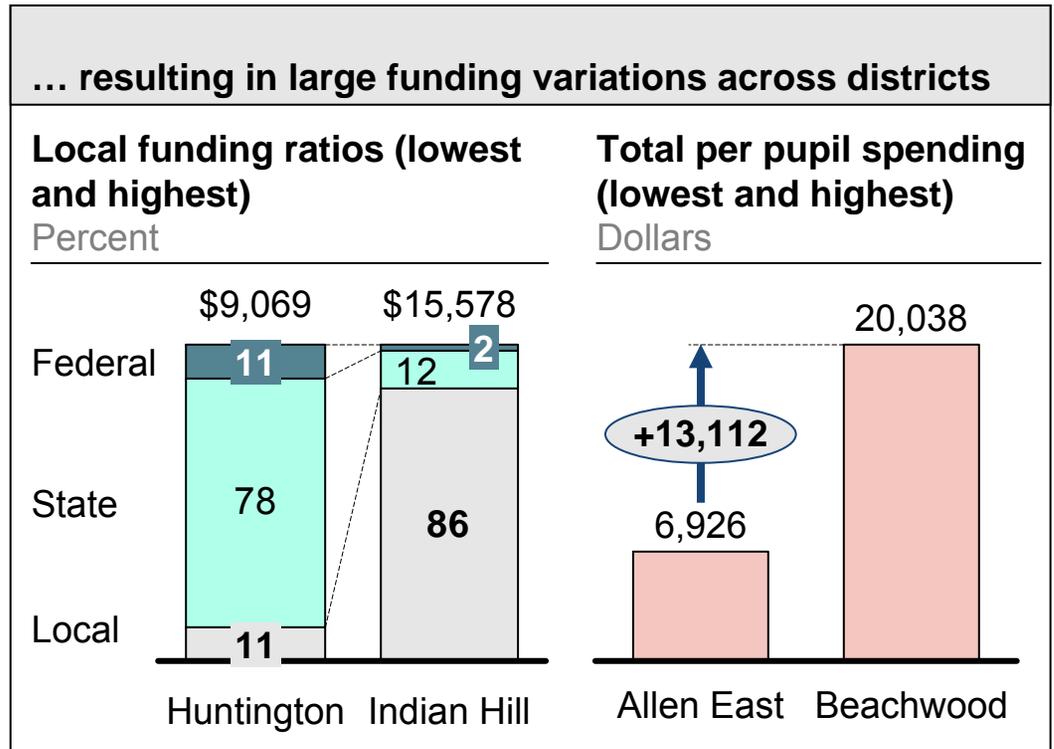
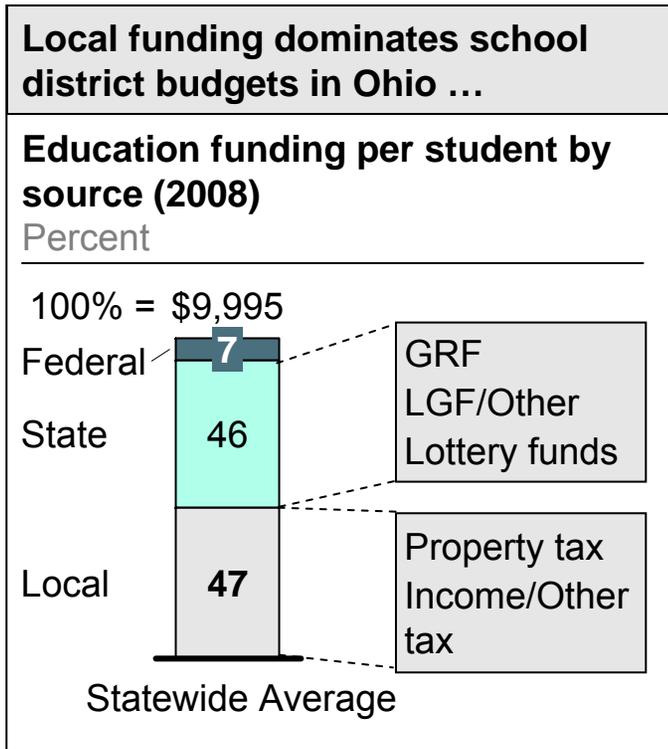
Enrollment: 4.9% Funding: 3.4%

- Governed internally, with limited school board oversight; most state and federal mandates still apply
- Contracts negotiated directly with employees
- Average school size of 281 students
- **Funding almost entirely from the state**; some private contributions primarily in the form of grants
- Enrollment by application
- Growing in importance, particularly in urban areas

**Average per pupil funding level:
\$6,852 (state dollars)**

SOURCE: ODE interviews; expert interviews; team analysis

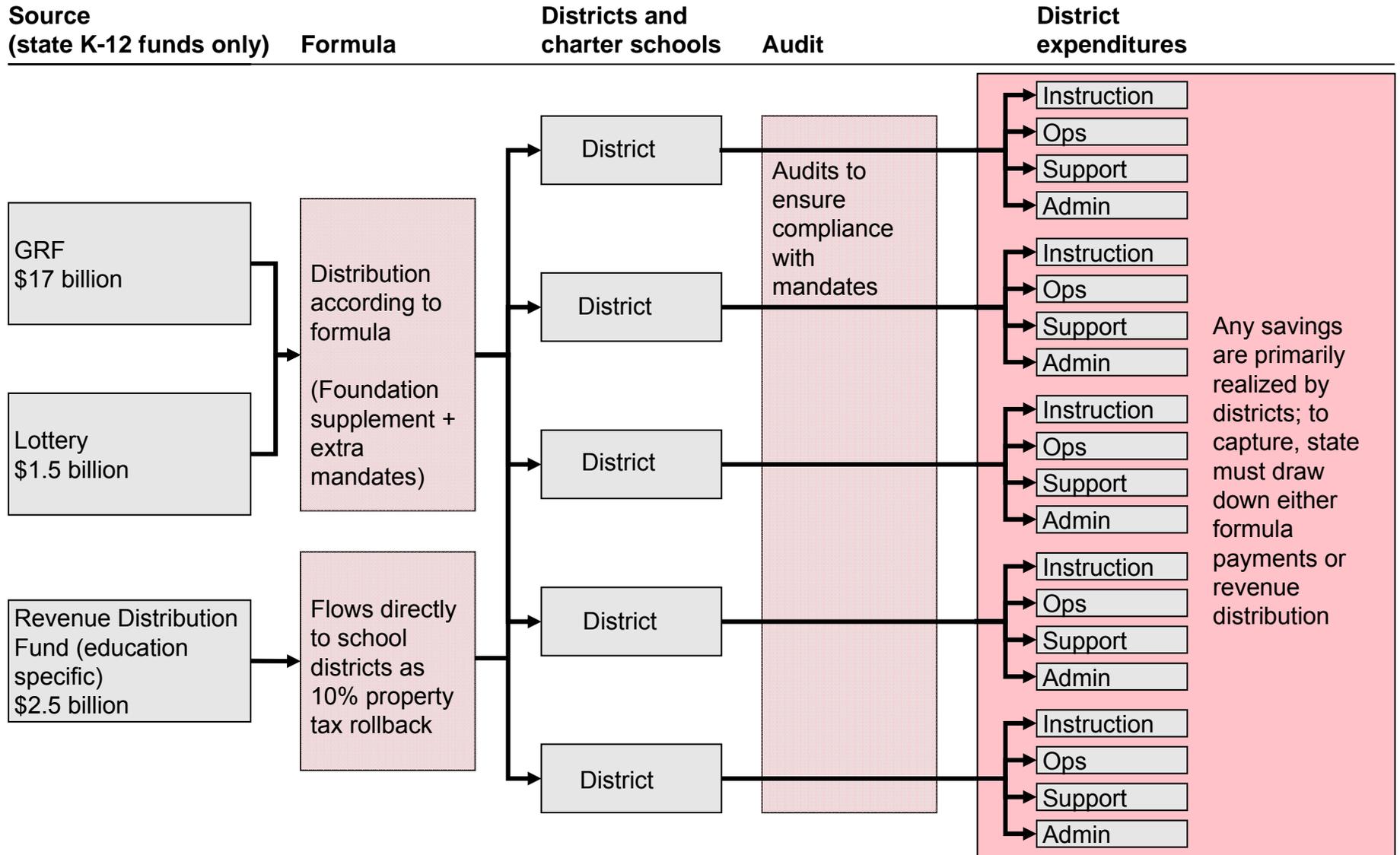
The majority of Ohio's K-12 education funding comes from state and local sources, with large variations between districts



- Variation in funding level across districts are driven mostly by the differences in revenues, but are also influenced by differences in funding formulas and specific student needs
- Local funding typically relies on property taxes, giving an advantage to more affluent neighborhoods; state policy has been designed in part to mitigate this gap

SOURCE: U.S. Census Bureau; NCES; team analysis

Most state funding flows directly to districts to supplement foundational aid



SOURCE: OBM; NCES; Team analysis

There are significant differences between the Evidence Based Model and the old funding formula

	Previous funding model	Current funding model (EBM)
State Basic Aid	<ul style="list-style-type: none"> Based on average teacher salary and student-teacher ratios, state determined how much it should cost to educate a student with no special needs or support requirements 	<ul style="list-style-type: none"> Formula includes an “Ohio Instructional Quality Index” (OIQ) based on a district’s community wealth, ability to recruit/hire teachers, etc.; replaces poverty based assistance
+ Minimum Local Share	<ul style="list-style-type: none"> Local school district pay a portion of the foundation amount equal to a 23 mill property tax 	<ul style="list-style-type: none"> When fully phased in, local districts required to contribute 20 mills
= Foundation Level	<ul style="list-style-type: none"> Resulting “foundation amount” was \$5,732 per pupil 	<ul style="list-style-type: none"> Resulting “foundation amount” now differs by district because of OIQ inflation/deflation
+ Beyond Basic Aid	<ul style="list-style-type: none"> Special education, vocational education, transportation, Poverty Based Assistance, parity aid 	<ul style="list-style-type: none"> Supplemental costs now factored into basic aid formula
+ Transitional Aid¹	<ul style="list-style-type: none"> Formula guaranteed in recent years funding equal or above prior year 	<ul style="list-style-type: none"> Formula gradually phases out old guarantee to align funding with actual student enrollment
+ Additional Local Contribution	<ul style="list-style-type: none"> Districts face no limitations on what they may contribute beyond state funding 	

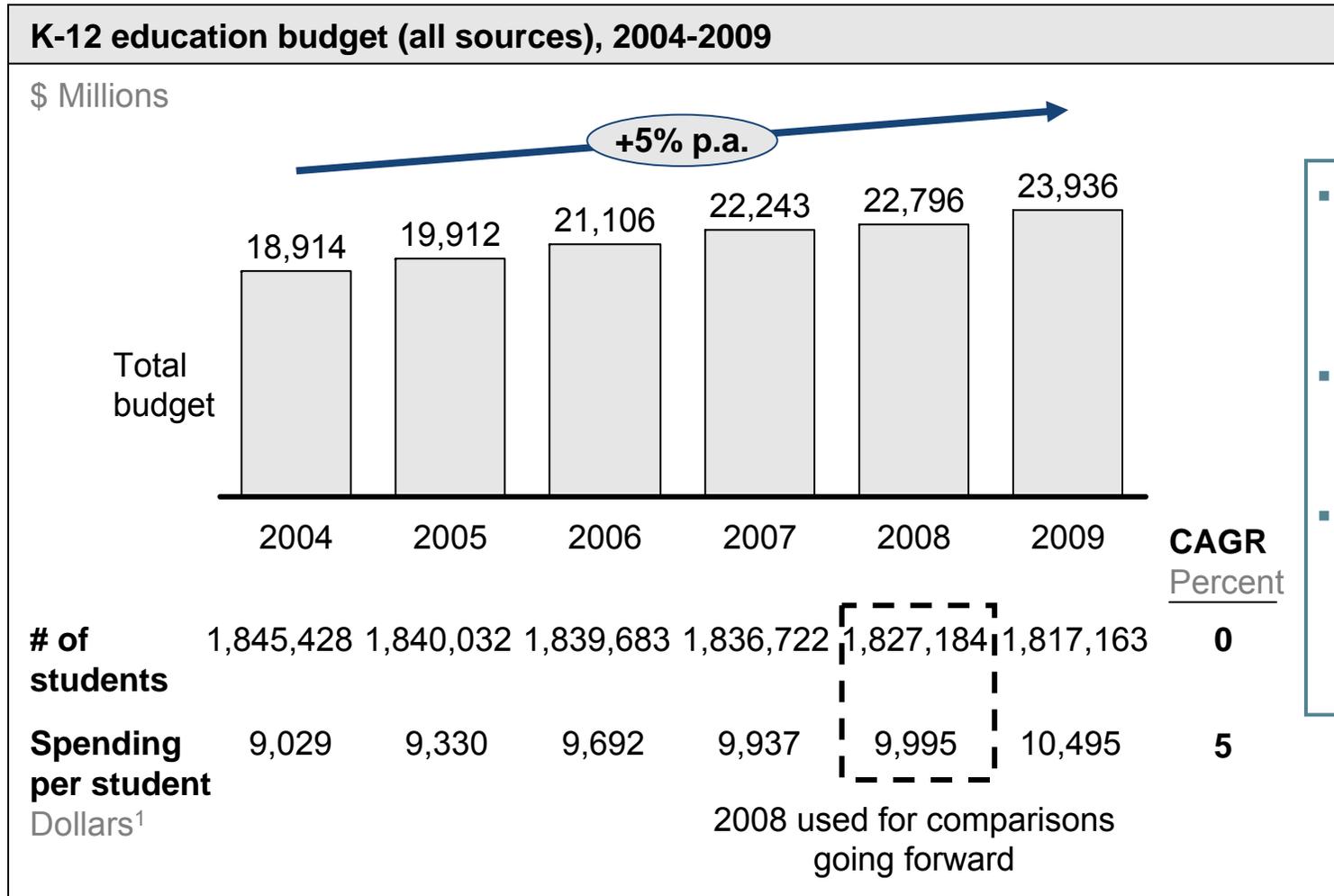


EBM requires more staffing through new mandates but lacks full funding; model may revert to previous mode depending on outcome of gubernatorial election

¹ Transitional aid was the reason that “ghost payments” existed for non-existent students in districts with declining enrollment

SOURCE: ODE, schoolfundingmatters.org

Ohio's K-12 education budget has steadily increased, while the student population has remained flat

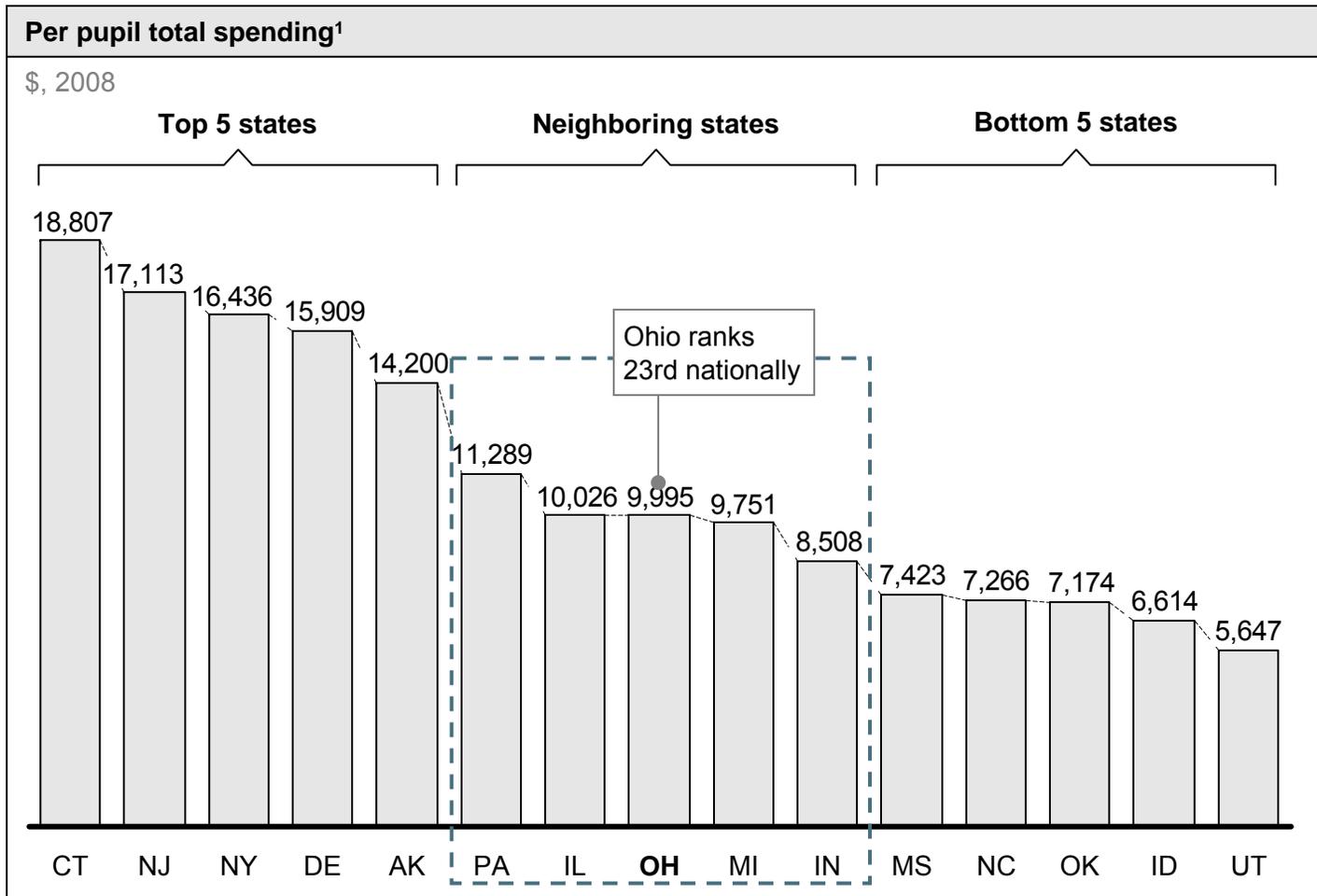


- 5% growth from 2004-2009 is in line with other states
- Ohio expects growth to continue for FYs 10 and 11
- A few states (e.g. New Jersey, Indiana) have curbed this trend for FY 10

¹ NCES data does not include certain expenditures (i.e. interest on debt, some capital outlays) in "per student" calculations

SOURCE: US Census; NCES; team analysis

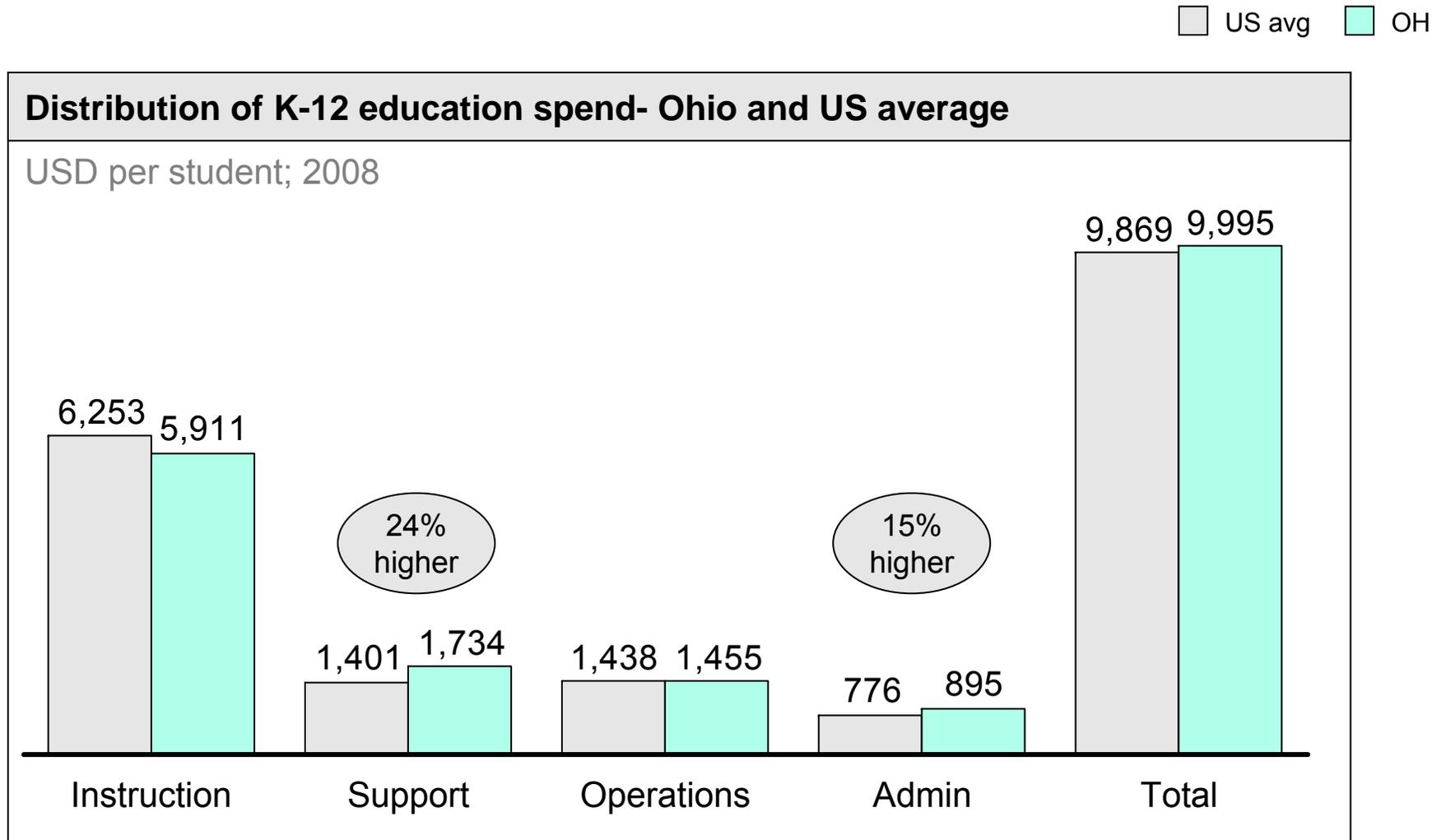
Ohio's per pupil spending is in line with neighboring states and overall national average



¹ US Census data does not include certain expenditures (i.e. interest on debt) in "per student" calculations

SOURCE: NCES

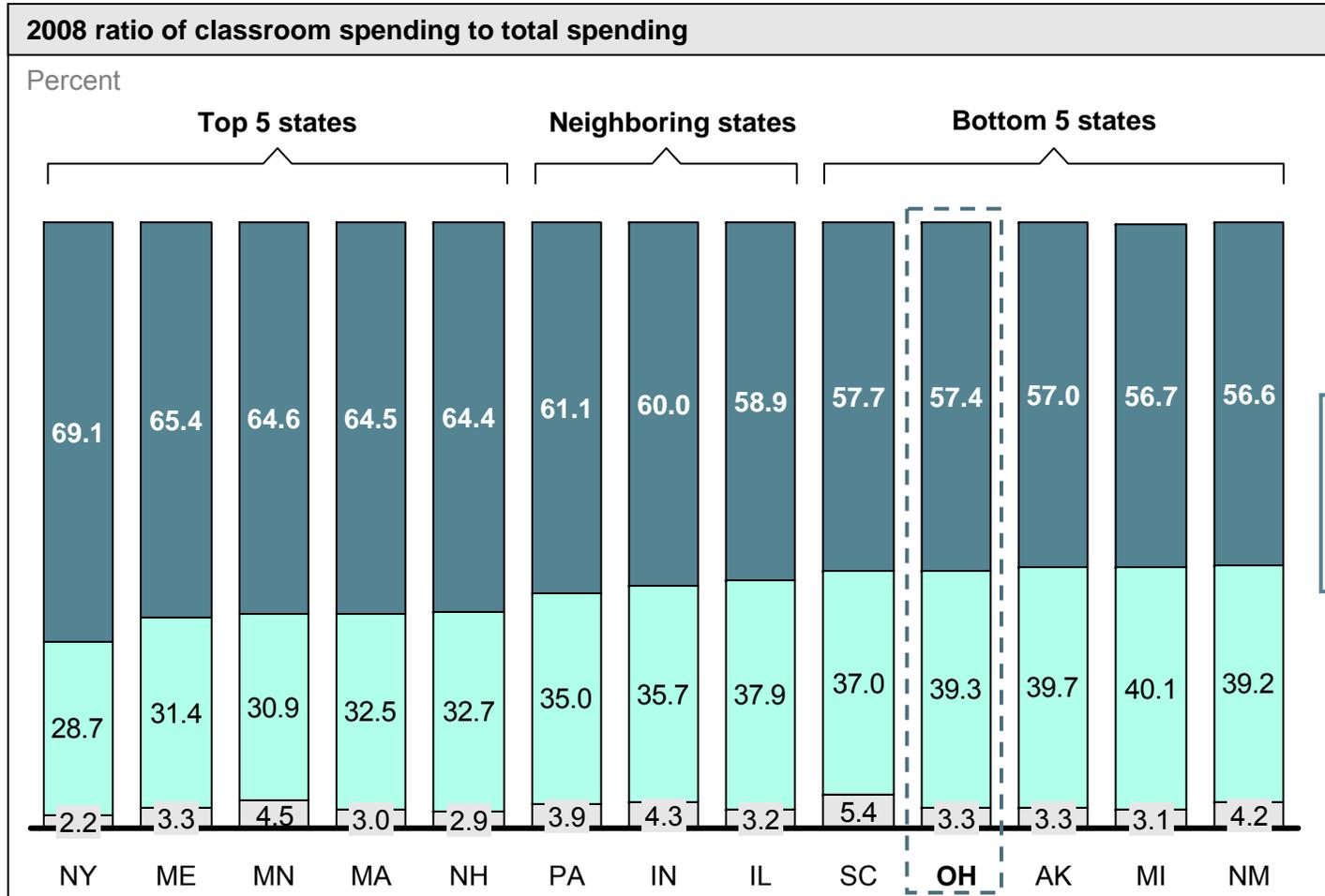
Expenditure breakdown shows Ohio has above average spending in support and admin categories



1 US Census data does not include certain expenditures (i.e. interest on debt) in "per student" calculations

SOURCE: US Census; team analysis

Ohio ranks 47th nationally in total classroom spending ratio

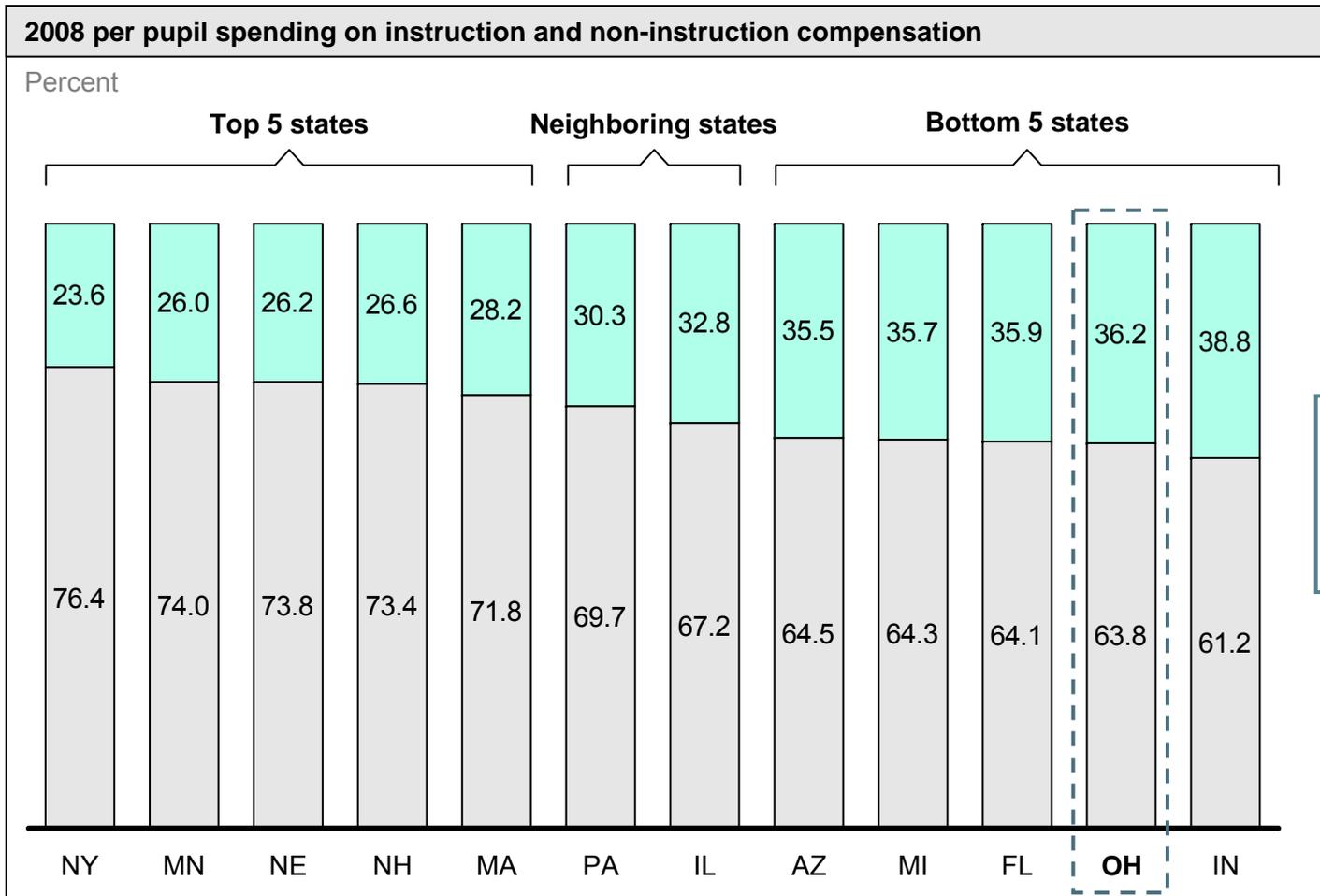


Ohio's schools are top-heavy with administration and other non-classroom spending demands

SOURCE: NCES

Ohio ranks 49th nationally in ratio of teacher compensation to total compensation

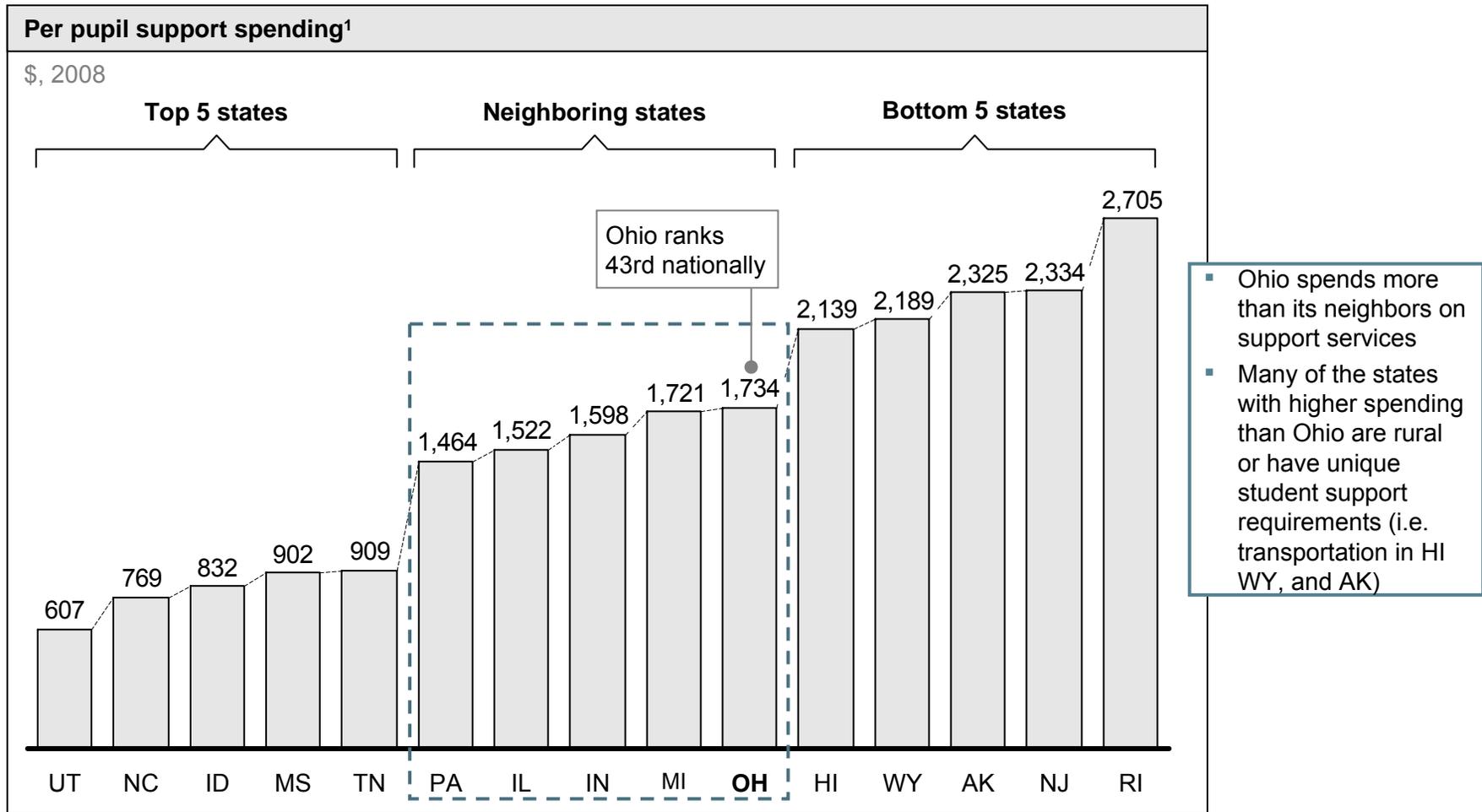
■ Non-instruction
■ Instruction



Over 1/3 of Ohio's total spending on salaries and benefits goes to non-classroom workers

SOURCE: NCES

Ohio's support spending exceeds national average and all neighboring states



¹ US Census data does not include certain expenditures (i.e. interest on debt) in "per student" calculations

SOURCE: NCES

Contents of the Fact Base

Ohio revenue and expenditure fact base

Medicaid and health care financing fact base

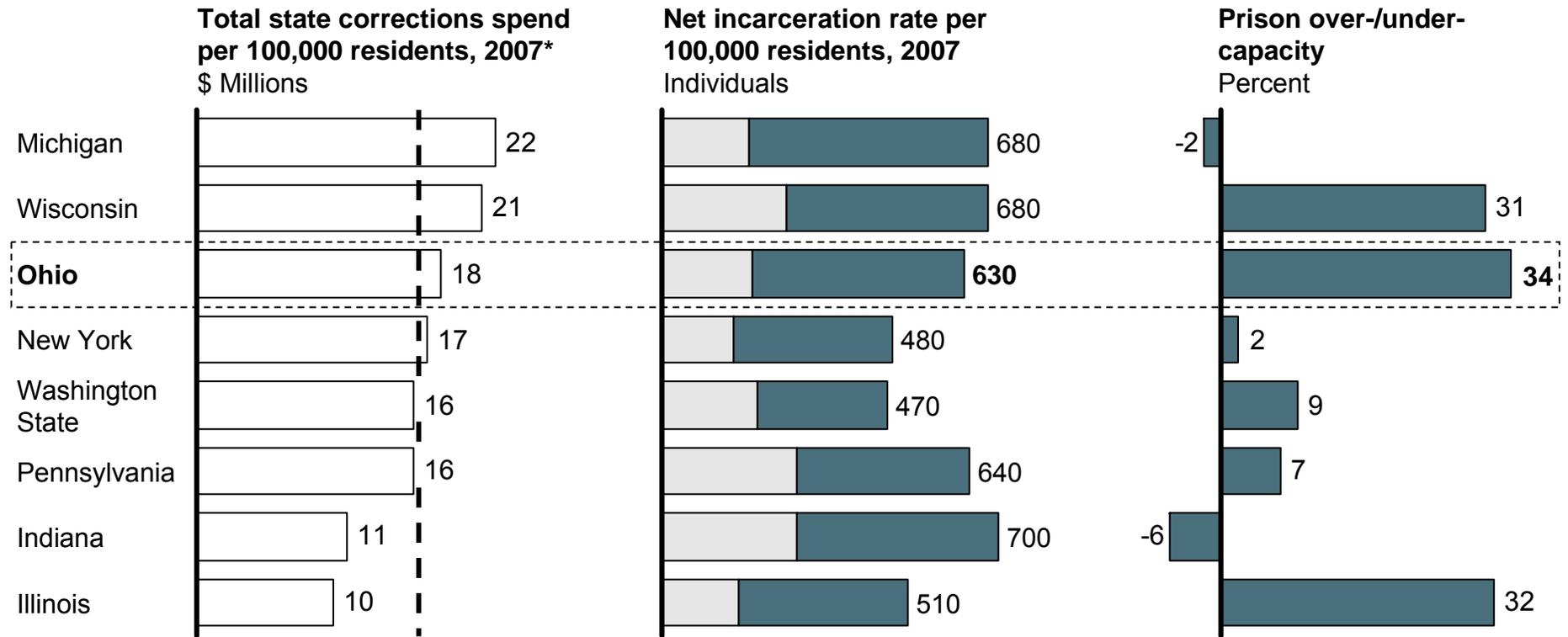
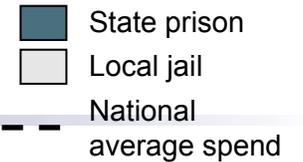
K-12 Education fact base

Corrections fact base

Higher education fact base

State pensions and benefits fact base

Incarceration rate is a big cost driver for Ohio, made more severe by higher prison overcapacity

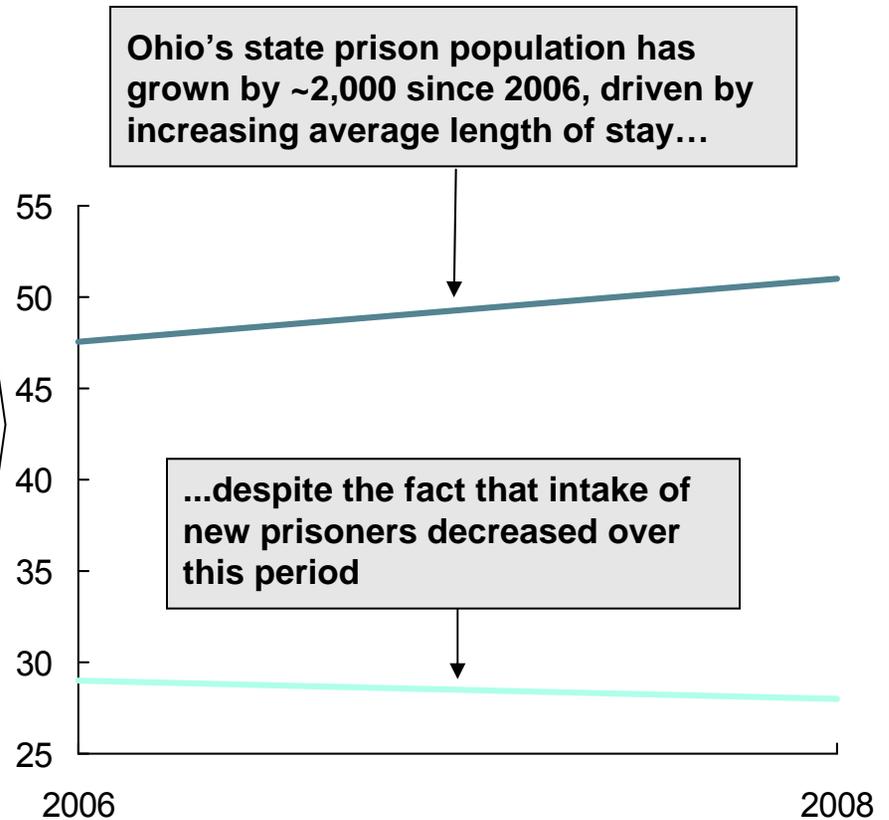
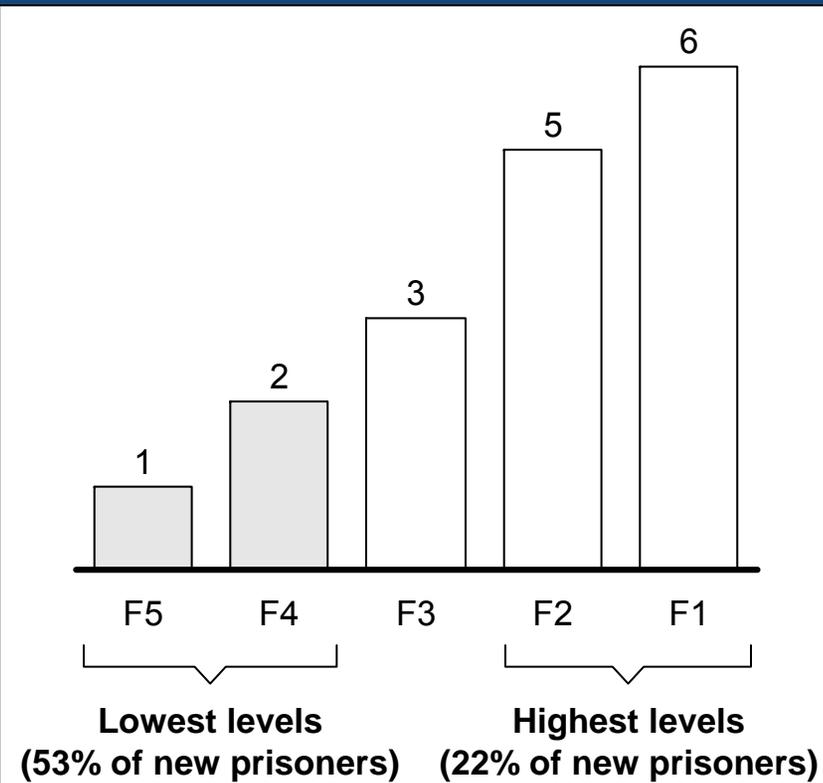


- **Indiana** has low cost and strong prison capacity despite higher incarceration rate
- **Ohio's** prison overcapacity (5th worst in nation) leaves state with less room than peers to manage current costs (39th worst in nation) and absorb future incarceration
- Ohio might look at **Washington State** – one of the most progressive states in the correction space – for ideas on incarceration front

* General fund plus other state fund spending, bond financing, and federal funds

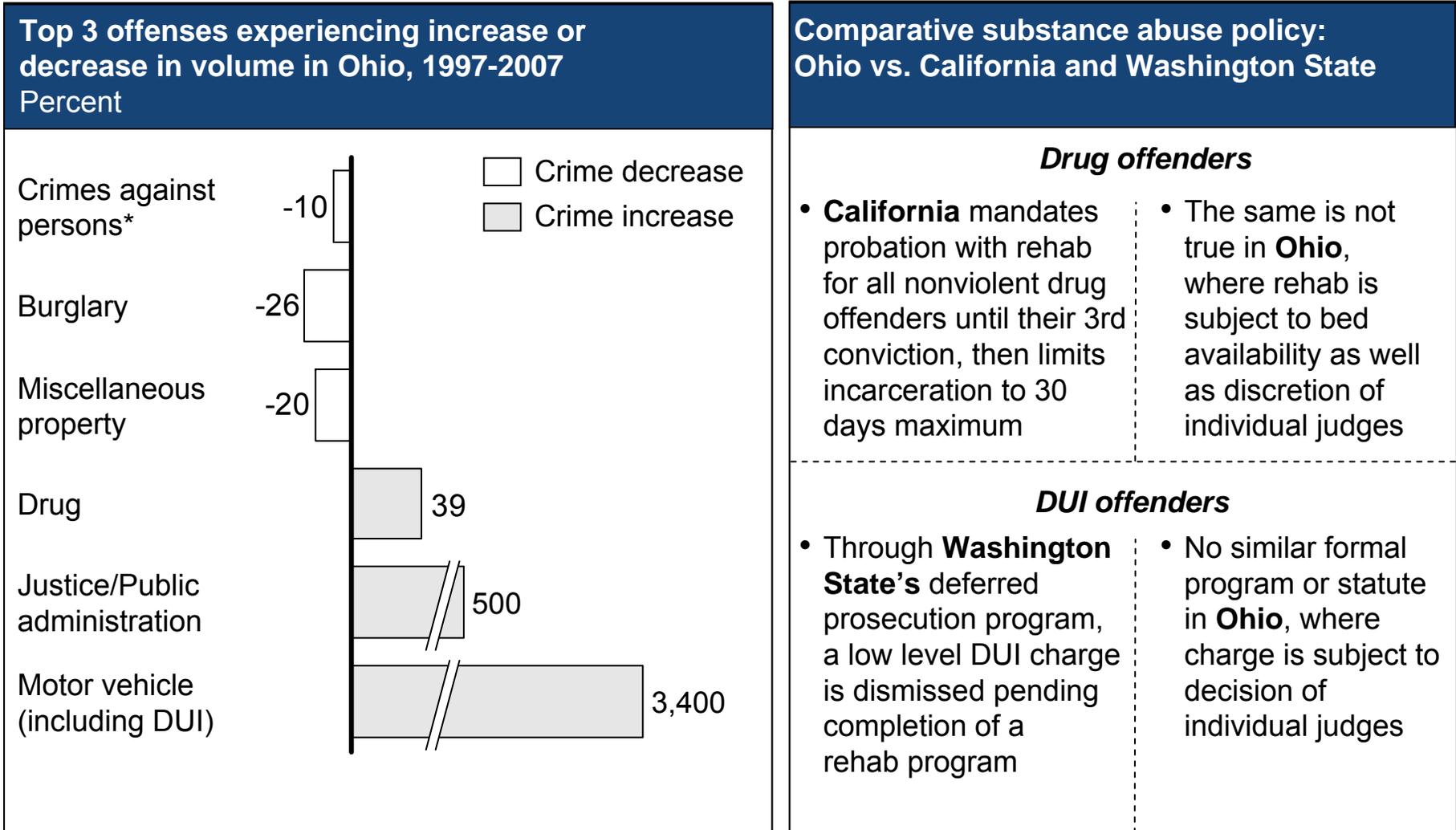
Another major cost driver is rising average length of prison stay, which has increased since 2006 court ruling

Change in average expected length of stay for new prisoners by felony level since 2005
Months

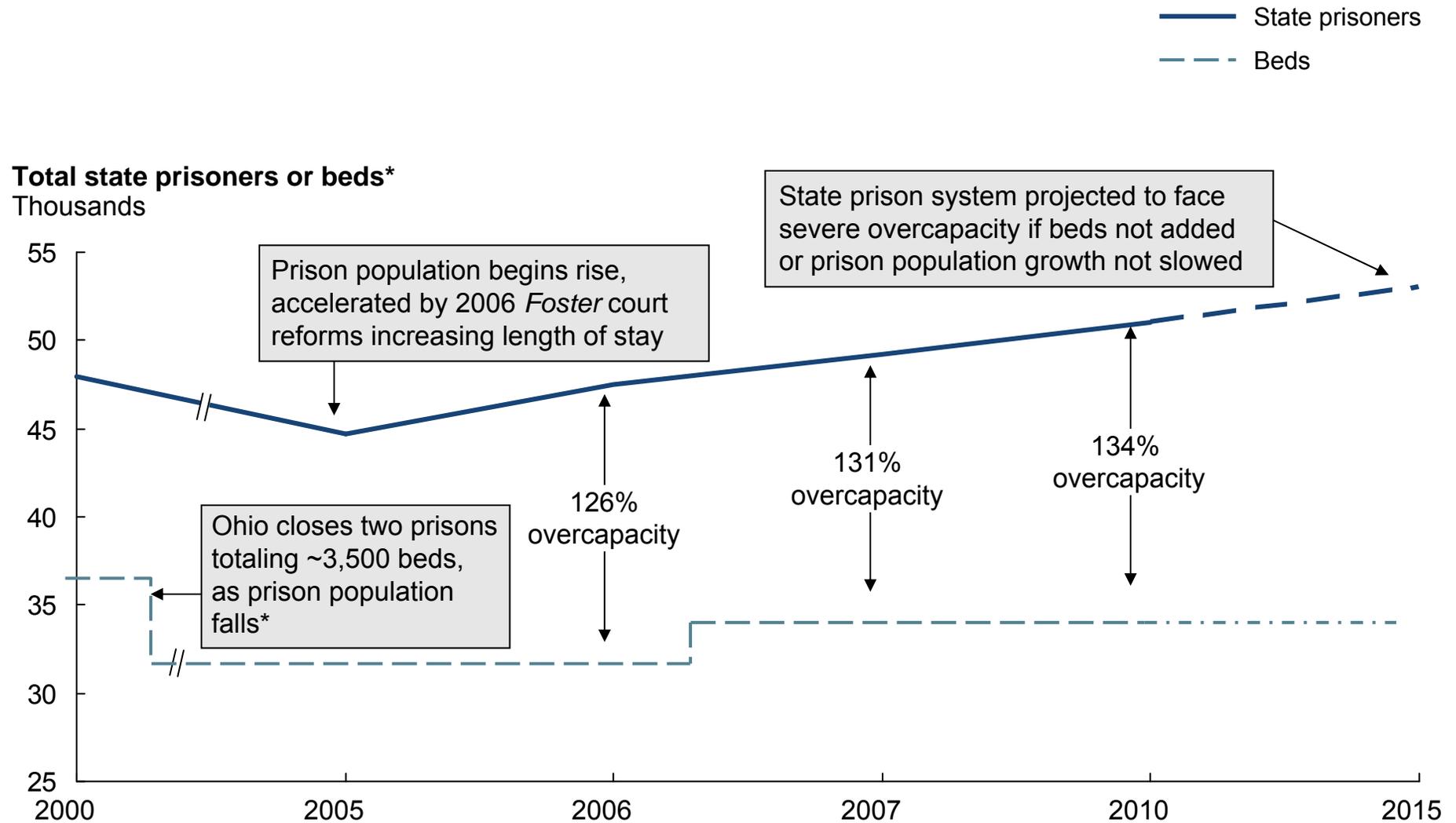


* February 2006 *Foster* decision by Ohio Supreme Court held that Common Pleas judges no longer had to make specific findings of fact to justify giving harsh sentences or imposing consecutive sentences

Large spike in substance abuse offenders in Ohio has driven overcapacity

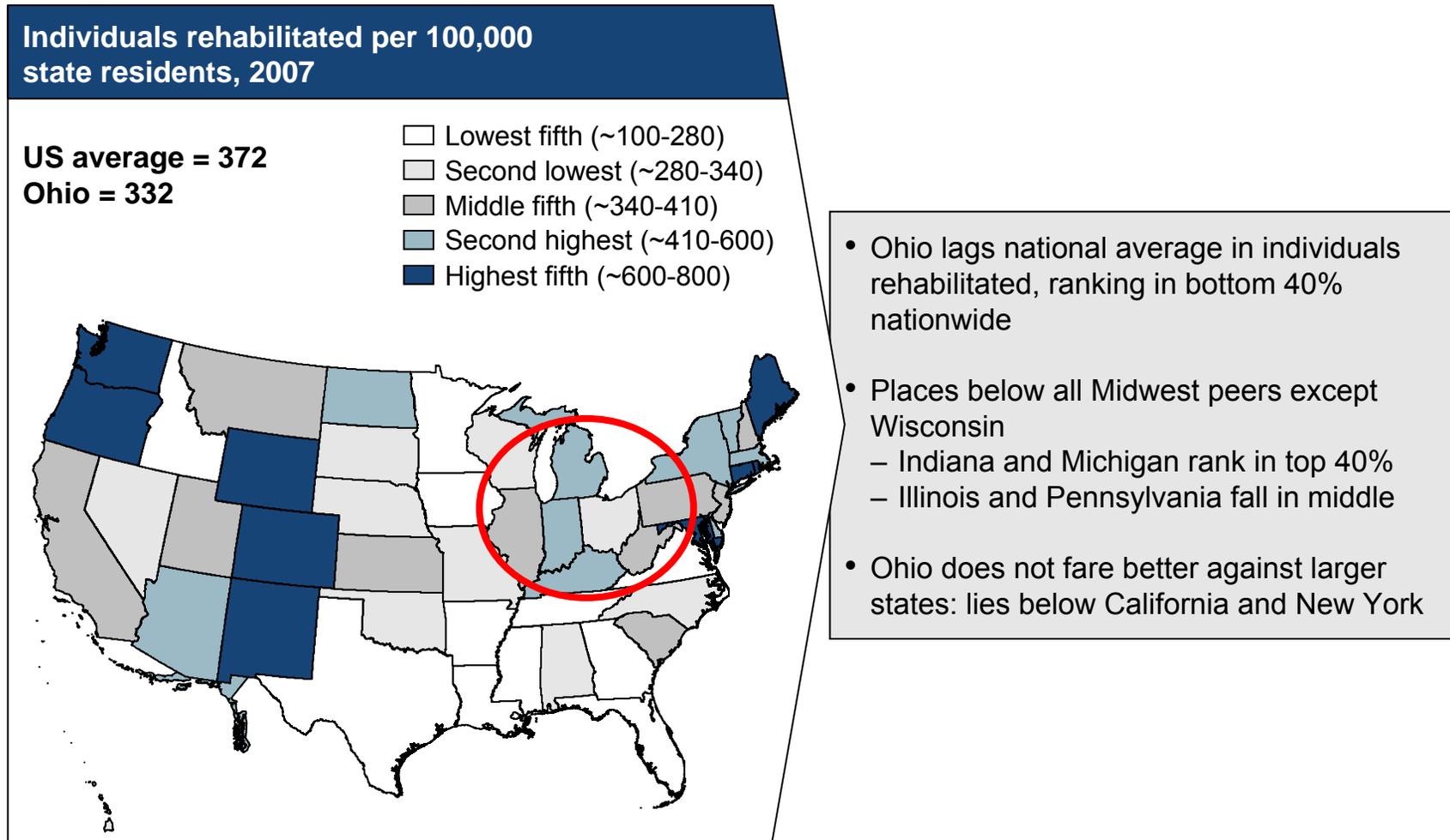


Current overcapacity in state prisons leaves limited opportunity for cutting fixed and non-marginal costs



* Bed total fluctuated somewhat over 2006-2008 period but remained fairly constant at ~38,000
 Source: DRC statistics; Pew Research

Presently, Ohio is in the bottom 40% nationwide in individuals rehabilitated



Contents of the Fact Base

Ohio revenue and expenditure fact base

Medicaid and health care financing fact base

K-12 Education fact base

Corrections fact base

Higher education fact base

State pensions and benefits fact base

Higher education- basic facts

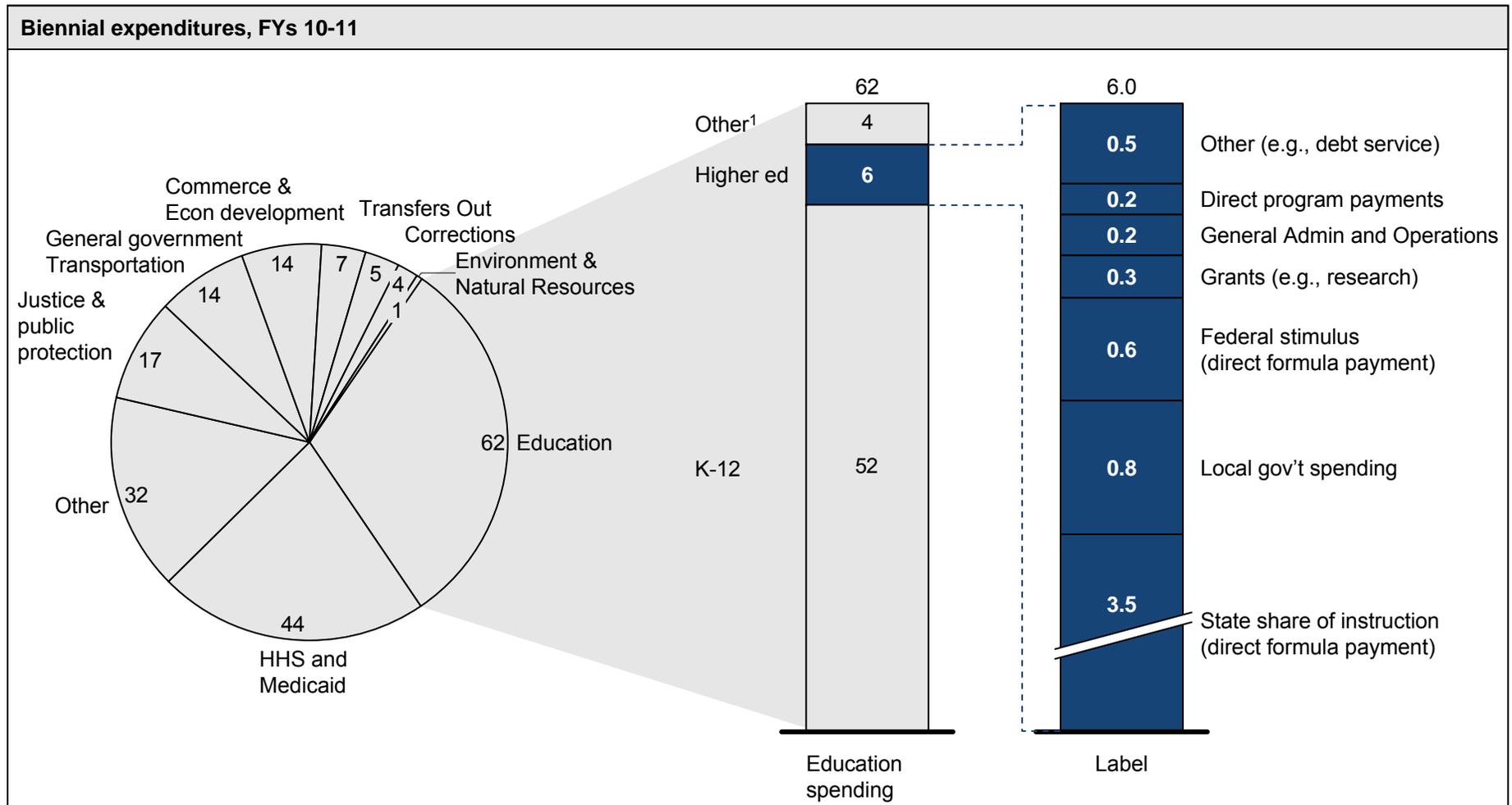
- Higher education is a \$3 billion annual spend by the state, supporting range of colleges and Universities in Ohio
- Most state support is determined by a state-wide formula, based primarily on type of student (e.g., FTE, program) and graduation rates
- For majority of funding, universities and colleges determine how they choose to utilize these funds; as a result, the largest lever for state savings is a reduction in the rate paid; there are some specific programs the state operates that could be cut or shut down
- However, the state has the potential to influence several operational aspects of the Universities and help to achieve savings at school level so as to keep overall level of education given constant

SOURCE: Team interviews; OBM; team analysis

Higher education dollars are a component of education spend in Ohio that pays out directly to Ohio's colleges and universities

ROUGH ESTIMATES

\$ Billions



1 Other includes some Pre-K and other uncategorized education funding

2 Expenditure breakdown for FYs 10-11 extrapolated from 2008 NCES financial data

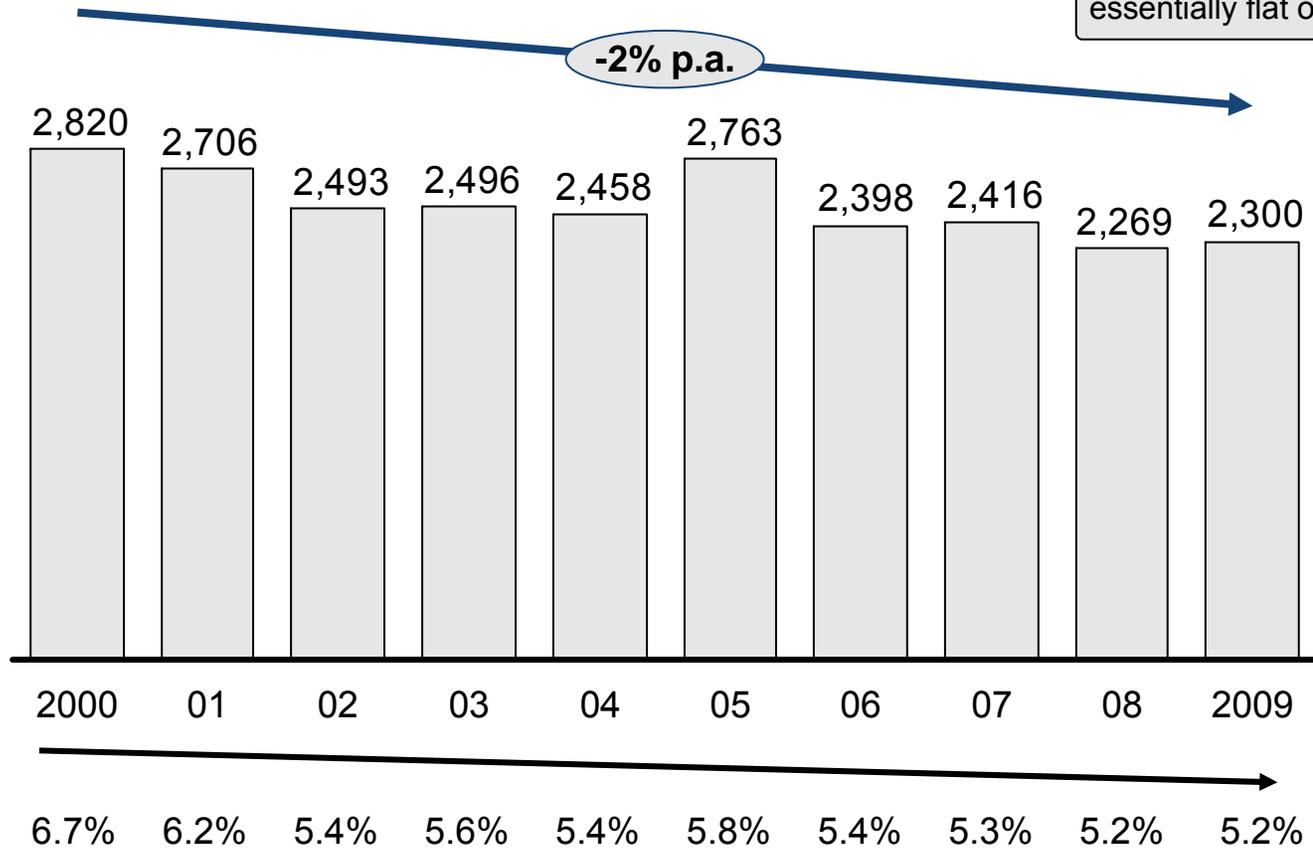
SOURCE: Ohio Office of Budget and Management; Ohio Legislative Services Commission; U.S. Census Bureau

Overall funding for higher education has declined at 2% per annum over last ten years when adjusted for inflation

Ohio annual spend on higher education

Millions, adjusted for inflation, base year 2000

Non-adjusted funding was essentially flat over period



SOURCE: OBM, team analysis

A “State Share of Instruction” formula is used to distribute most higher education dollars to individual public colleges and universities

Background on the SSI formula

- State Share of Instruction formula used in some form since 1960’s to allocate higher ed dollars
- Formula is **based on average cost to educate a full time equivalent (FTE) student**, adjusted for costs of degree program (e.g., schools receive significantly higher payout for FTE medical student vs. FTE first year sciences degree) and includes increases for degree completion and other factors
- **Formula is intended to reward schools for enrollment and degree completion** and varies by school in overall coverage it provides to colleges and universities

Use of funds at Ohio colleges and universities

- Once received by the college or university, the state money becomes open revenue and can be used as the school sees fit
- State funding represents a relatively small portion of college and university budgets, with most relying on the state for less than 30% of overall budget; over 70% of the budgets at colleges and universities in Ohio come from tuition
- While schools are able to determine how to spend state-allocated money, the state does place certain restrictions and guidelines on operations that must be followed- e.g., guidelines for construction of new property
- Today’s system allows for individual management and overall efficiency- any savings measures implemented by a university or college are gains for the college, not for the state

SOURCE: Ohio Board of Regents; OBM; team analysis

Contents of the Fact Base

Ohio revenue and expenditure fact base

Medicaid and health care financing fact base

K-12 Education fact base

Corrections fact base

Higher education fact base

State pensions and benefits fact base

Ohio's pension and state employee health benefits are largely in line with national benchmarks, but there are still potential savings

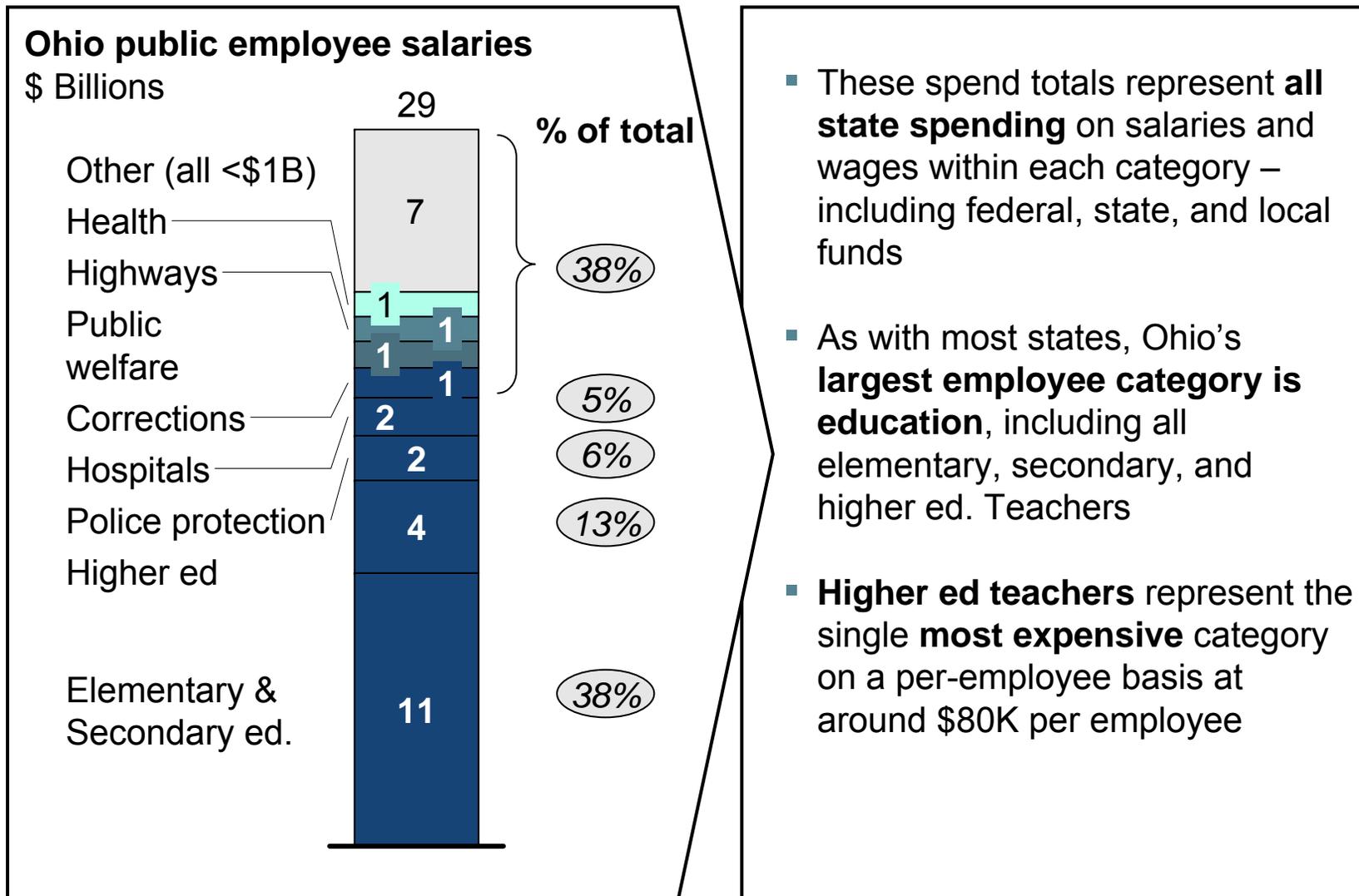
Pensions

- While many states, like Illinois, are dealing with large unfunded pension liabilities, **Ohio has been able to maintain pension funding in large part**
- Ohio is one of 16 states to receive a **“solid performer” rating from the Pew Center** in the handling of their pension plans
- However, Ohio's Public Employees Retire System had the **second highest percentage investment loss** of any state pension fund

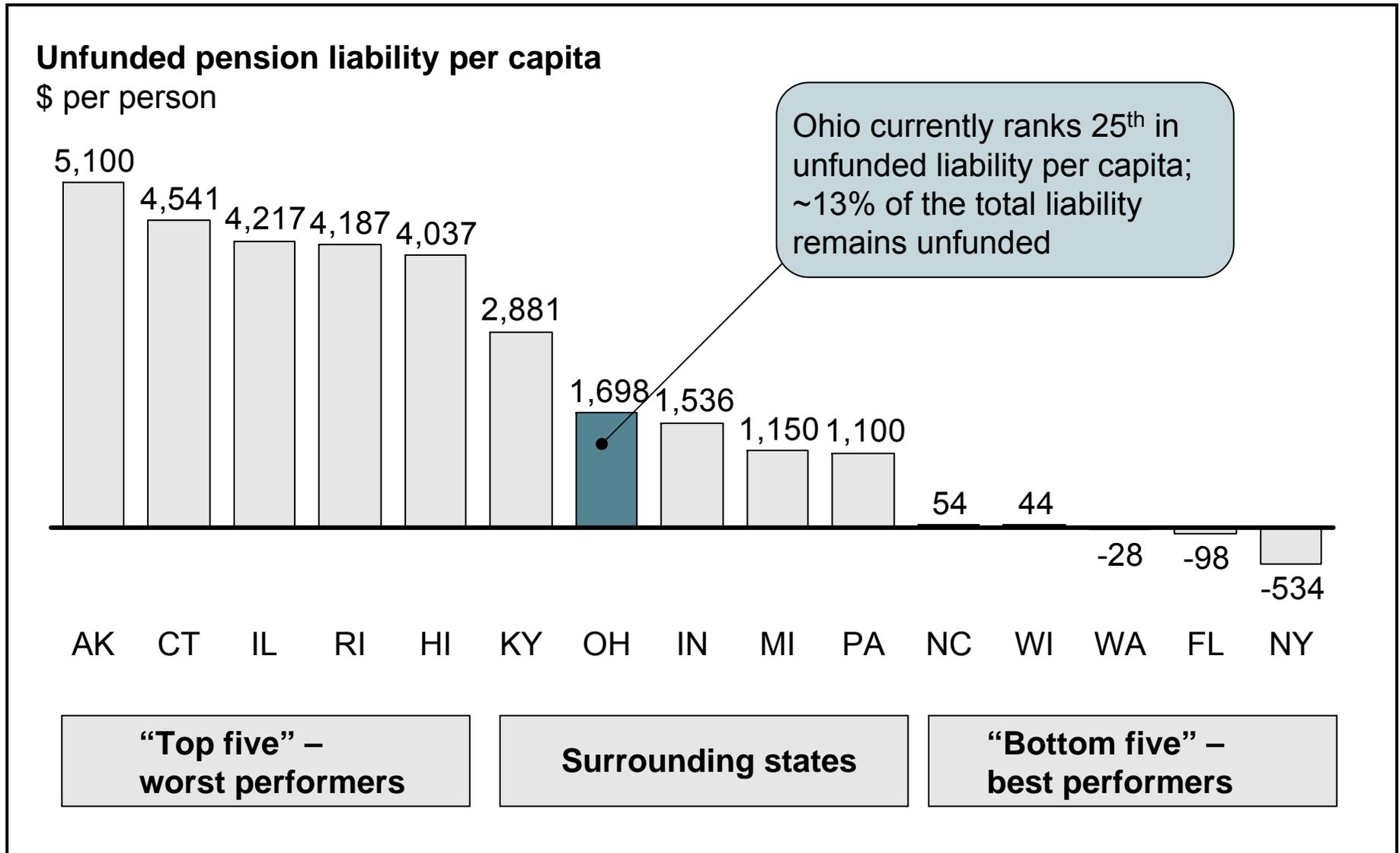
State employee health benefits

- When comparing the average health and other benefits offered to state employees, **Ohio is actually below the national averages**
- Ohio pays **~\$100 less per member, per month in premiums** for employee health care coverage than the national average
- In addition, **Ohio requires a higher employee contribution** to their employee health care plans than most states

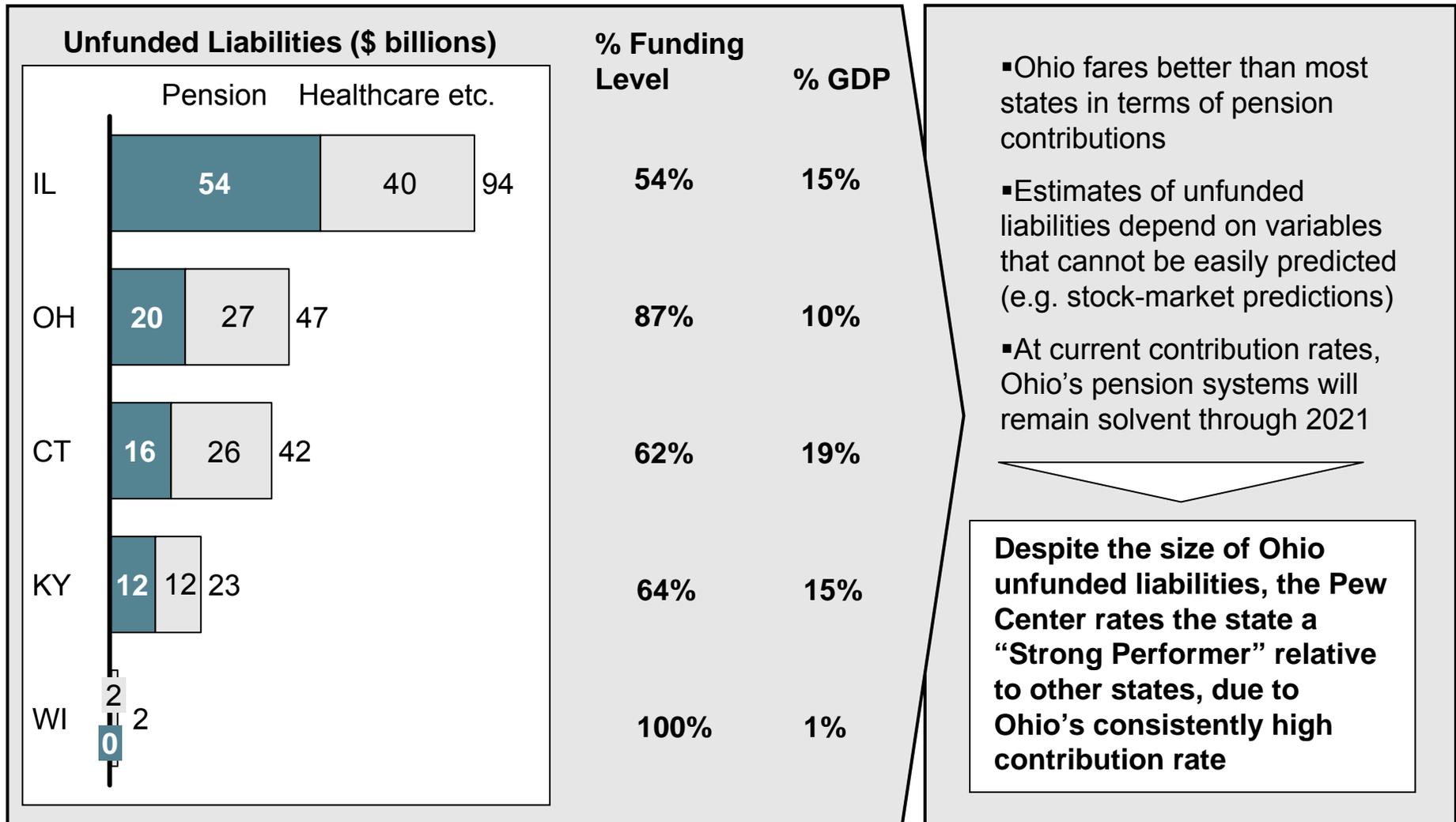
The state of Ohio, including local governments, employs over 750,000 people in Ohio, at a total cost of \$29B per year



Ohio is currently funding its pension system at 87%, leaving it right at the median in unfunded liability per capita



However, despite likely being solvent until 2021, Ohio still has ~\$50B in unfunded liabilities outstanding



Normalizing for education, most private sector employees are paid higher than their public sector counterparts

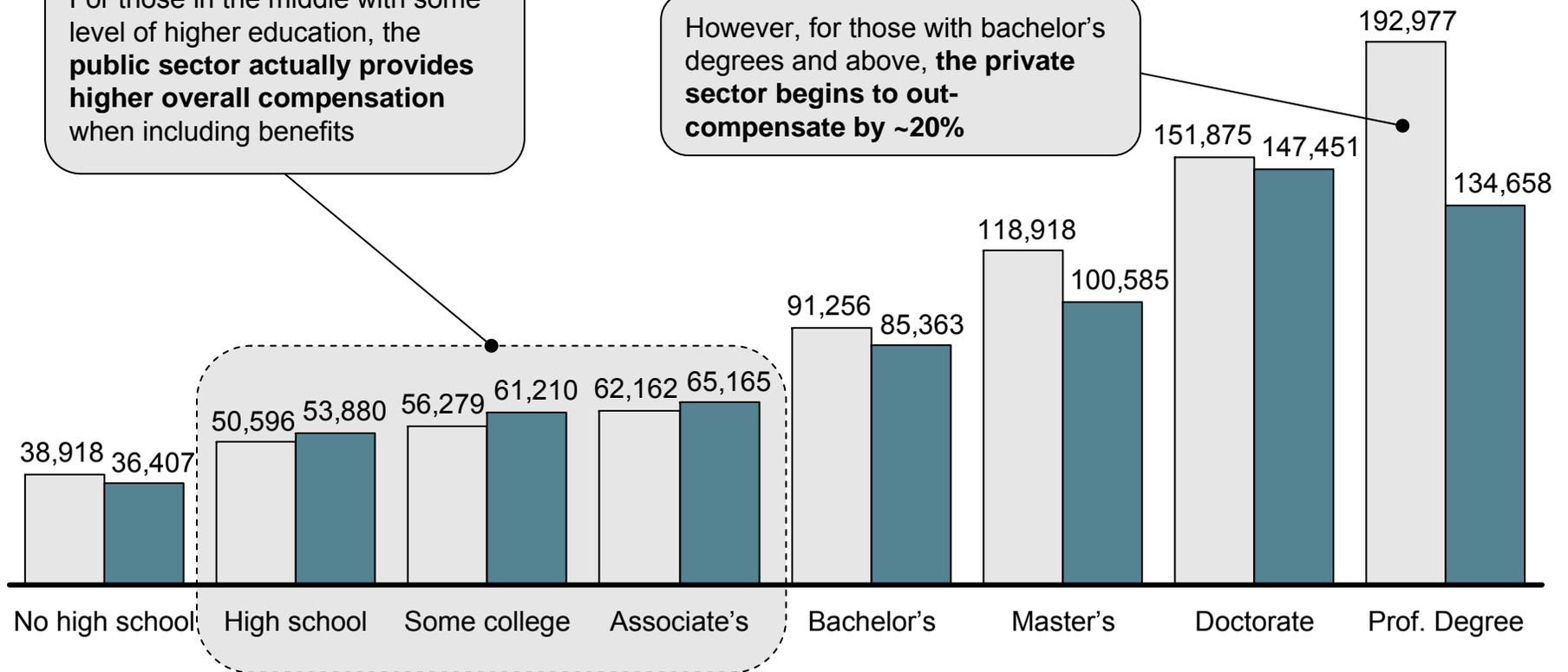
Total compensation by degree and employee type
\$ USD

Public sector salaries have been adjusted to account for less avg. hours worked per week

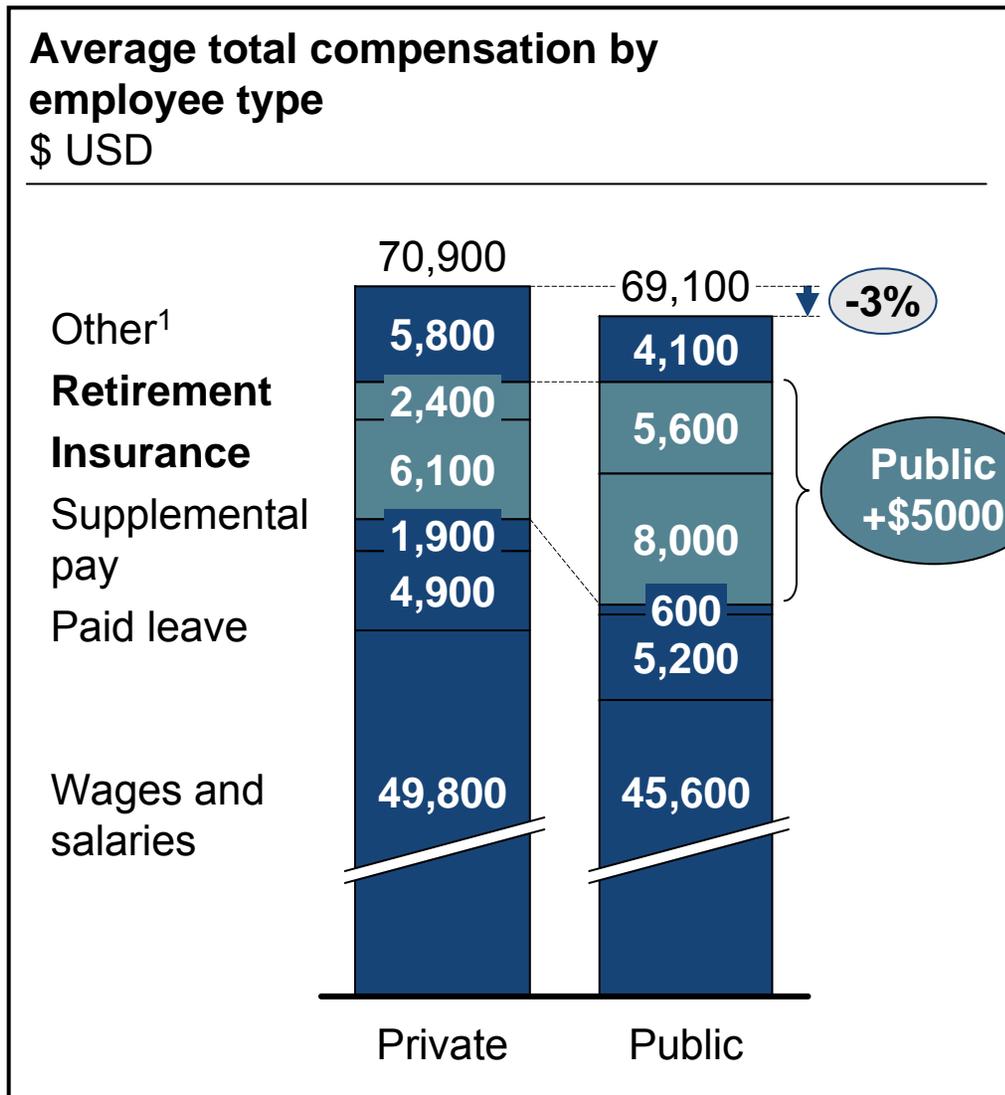
Private
Public

For those in the middle with some level of higher education, the **public sector actually provides higher overall compensation** when including benefits

However, for those with bachelor's degrees and above, the **private sector begins to out-compensate by ~20%**



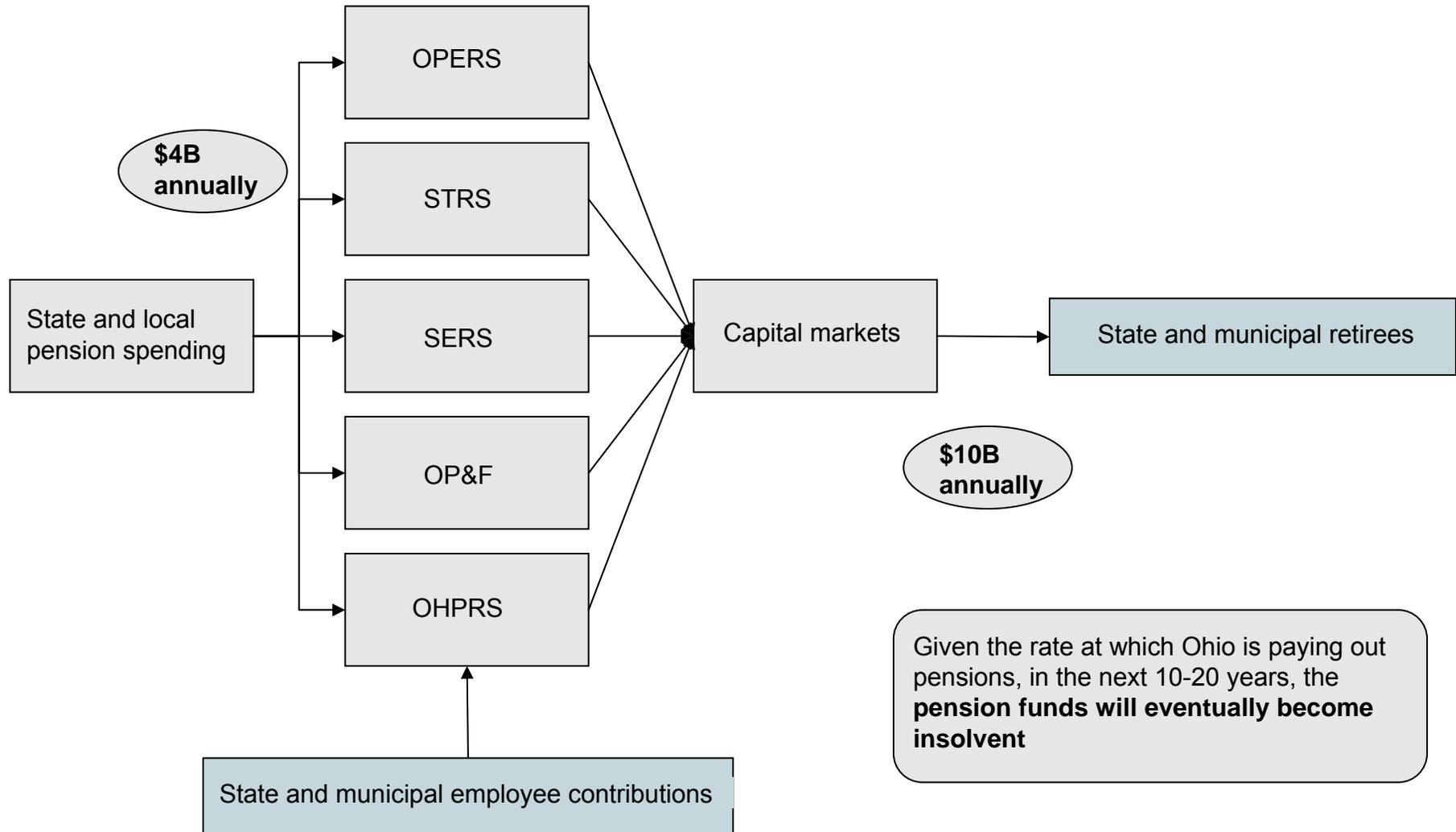
However, public sector employees receive richer benefits in order to partially offset lower salaries



- In aggregate across all states, **public employees are compensated at a lower rate than their private counterparts** (adjusting for education and position)
- However, most of this discrepancy is accounted for within **wages and salaries and supplemental pay**
- Between insurance and retirement benefits, public employees actually receive over **\$5,000 more per person**

¹ Includes Social Security, Medicare, Unemployment, Workers Comp, etc.

How the Ohio pension system works



Ohio has five public employee retirement systems that almost all state and local employees are required to enroll in¹

	Who's eligible?	Membership	Annual payouts
Public employees retirement system (PERS)	<ul style="list-style-type: none"> All full-time state employees who do not fall under another pension plan 	<ul style="list-style-type: none"> 374,000 – active members 395,000 – inactive 167,000 – retirees 	\$4B
State teacher retirement system (STRS)	<ul style="list-style-type: none"> Teachers and admins from K-12 through higher education 	<ul style="list-style-type: none"> 130,000 – retirees 	\$4B
School employees retirement system (SERS)	<ul style="list-style-type: none"> Non-teacher and admin positions within education (some private-employed individuals within ed) 	<ul style="list-style-type: none"> 125,000 – actives 50,000 – retirees 	\$1B
Ohio Police and Fire Pension Fund (OP&F)	<ul style="list-style-type: none"> Full time police officers and firefighters across all municipalities 	<ul style="list-style-type: none"> 130,000 – retirees 	\$1B
Ohio highway patrol retirement system (OHPRS)	<ul style="list-style-type: none"> Qualified employees within the HP's uniformed division 	<ul style="list-style-type: none"> 1,300 – retirees 	\$60M

¹ Cincinnati municipal employees and some higher education instructors are offered pension plans outside of these five