

February 23, 2024

The Honorable John Kavanagh
Chairman, Joint Legislative Budget Committee
1700 W Washington St.
Phoenix, Arizona 85007

Dear Senator Kavanagh:

Pursuant to a footnote in the General Appropriation Act, the Arizona Health Care Cost Containment System (AHCCCS) is required to report to the Joint Legislative Budget Committee (JLBC) by March 1 annually “on the preliminary actuarial estimates of the capitation rate changes for the following fiscal year along with the reasons for the estimated changes. For any actuarial estimates that include a range, the total range from minimum to maximum may not be more than 2%.”

In accordance with federal regulations, capitation rates paid to managed care organizations (MCOs) must be actuarially sound, meaning they must cover all anticipated costs for providing medically necessary services to AHCCCS members. As such, capitation rates are developed to reflect the costs of services provided as well as utilization of those services. Capitation rate trends reflect a combination of changes in cost and utilization, calculated as a per-member per month (PMPM) expenditure to AHCCCS Contractors (including other state agencies such as the Arizona Department of Economic Security/Division of Developmental Disabilities [DES/DDD] and the Department of Child Safety/Comprehensive Health Plan [DCS/CHP]).

The capitation rates for contract year ending (CYE) 2025 will be developed in the summer of 2024 and begin on October 1, 2024. Actuarial review of the most current medical cost and utilization trend data has not yet begun, so AHCCCS actuaries are unable to provide specific actuarial estimates for capitation rate growth at this time. In order to inform the budget decision-making process, AHCCCS is providing an estimated range of capitation rate growth and a summary of the key factors that are anticipated to be addressed in the capitation rate development process.

The actual capitation rates and accompanying actuarial certifications will be provided to JLBC for review in advance of implementation on October 1, 2024.

Preliminary Estimates for Capitation Rate Growth

Based on a preliminary review of historical medical cost and utilization trend data, AHCCCS estimates a statewide weighted average capitation rate increase of 2.5% to 4.5% for contract year ending CYE 2025. The Centers for Medicare and Medicaid Services (CMS) Office of the Actuary annual growth projection of the National Health Expenditures Accounts for Medicaid in 2025 is 5.9% nationally. The AHCCCS high end estimate of 4.5% reflects a 1.4% decrease from the national projection to better align with lower cost trends observed with AHCCCS.

AHCCCS’ mid-point estimate of 3.5% capitation rate growth is between the 3.0% baseline capitation rate growth assumed in the Executive Budget recommendation for Fiscal Year 2025 and the JLBC baseline

estimate of 4.0% growth for FY 2025. If the FY 2025 appropriation funds lower capitation rate growth than is ultimately required to ensure actuarial soundness, it may result in a need for supplemental funding.

Nationally, the CMS Office of the Actuary projects annual growth rates averaging 5.5% in the period 2024 through 2030. The CMS Office of the Actuary estimates account for projected costs attributable to both inflation and utilization.

Table I. CMS Office of the Actuary, Medicaid Spending Per Enrollee, Forecast Growth¹

Year	2024	2025	2026	2027	2028	2029	2030
Forecast	5.0%	5.9%	5.3%	5.7%	5.8%	5.6%	5.5%

Unit Cost and Utilization Drivers

Anticipated growth in spending per enrollee is a function of both changes in unit cost and changes in utilization, including shifts in services. Unit costs may increase for a variety of reasons, including provider rate increases, the impact of inflation on the price of medical services, and a shift in utilization patterns when members access more costly services. Similarly, costs associated with utilization may increase for a number of reasons, including changes in the ability of members to access services and changes in the types of services members receive.

COVID-19 Impacts to Capitation Rates

Maintenance of eligibility and enrollment requirements in Medicaid were removed effective April 1, 2023, by the December 2022 passage of H.R.2471 - Consolidated Appropriations Act, 2022 by the United States Congress. The result of the change is that AHCCCS began processing disenrollments starting April 1, 2023, for anyone found ineligible in March 2023 or later, after their Medicaid eligibility redetermination process was completed. The AHCCCS actuaries developed acuity adjustment factors for inclusion in the CYE 24 capitation rates to account for the expectation that members that remained eligible for Medicaid after redetermination would exhibit higher cost profiles than disenrolling members due to greater utilization of services. The impact of remaining eligibility redeterminations to be completed and incorporated into capitation rates for CYE 25 are expected to have a 0.4% increase over the final CYE 24 capitation rates. Additionally, the non-risk treatment (reimbursement at cost outside of the MCO capitation payments), which has been in place since October 1, 2021, of both the COVID-19 vaccines and the cost to administer the vaccines will be removed for CYE 25, with the potential increase to capitation rates being approximately 0.2%.

¹ Table 16, “National Health Expenditures (NHE), Amounts and Average Annual Growth From Previous Year Shown, By Type of Sponsor, Selected Calendar Years 2015-2031. “NHE Projections 2015-2031.” Accessed December 27, 2023. <https://www.cms.gov/data-research/statistics-trends-and-reports/national-health-expenditure-data/projected>

Minimum Wage Initiatives

HCBS and NF provider rates increased January 1, 2024, in order to address continued increases to the minimum wage under Proposition 206 and Proposition 414. The current statewide hourly minimum wage is \$14.35. The Tucson minimum wage will increase to \$15.00 on January 1, 2025, unless the federal or state minimum wage is higher. Under Proposition 414, the Flagstaff minimum wage increases annually by the August consumer price index, mirroring the state minimum wage annual CPI increase, and increased from \$16.80 to \$17.40 per hour effective January 1, 2024. Wage increases effective in 2025 will have an impact on CYE 25 capitation rate development. In accordance with A.R.S. § 35-113, AHCCCS delineates specific costs related to that wage increase in its budget requests.

FQHC Reimbursement

The state plan amendment (SPA) that allowed an Alternative Payment Methodology (APM) reimbursement method for FQHCs expired September 30, 2023, and AHCCCS reverted to the prior methodology that was in place from 2001 to 2018 for the FQHCs effective October 1, 2023. The anticipated change for the CYE 25 capitation rates for updates to the FQHC reimbursement is approximately a 0.2% increase over the CYE 24 capitation rates.

Trend and Inflation Pressure

National economic factors such as labor shortages and inflation can create upward pressure on unit cost trends, especially if provider contract negotiations with the MCOs reflect workforce challenges. Preliminary analysis of changes in the base data used between the CYE 24 and CYE 25 rates show some definitive increases in per capita costs, some portion of which is directly attributable to past legislative increases for nursing and home and community-based services while other portions are attributable to changing acuity; more analysis is needed to determine what portion of the increases are due to inflationary pressures. In prior years, the largest driver of overall medical cost trends has been pharmacy cost growth, and it is expected that retail prescription drug prices will again be a key contributor to projected trends. Other contributors could be increases in the prices of physician-administered drugs, new gene therapy drugs, and higher demand for behavioral health services.

Should you have any questions on any of these issues, please feel free to contact Erica Johnson, Chief Actuary, at erica.johnson@azahcccs.gov.

Sincerely,



Carmen Heredia
Cabinet Executive Officer and Executive Deputy Director

cc: The Honorable David Livingston, Vice Chairman, Joint Legislative Budget Committee
Richard Stavneak, Director, Joint Legislative Budget Committee
Sarah Brown, Director, Office of Strategic Planning and Budgeting
Cameron Dodd, Budget Manager, Office of Strategic Planning and Budgeting
Zaida Dedolph Picoro, Health Policy Advisor, Office of the Governor