February 25, 2022

The Honorable David Gowan
Chairman, Joint Legislative Budget Committee
1700 W Washington
Phoenix, Arizona 85007

Dear Senator Gowan:

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, 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) 2023 will be developed in the summer of 2022 and begin October 1, 2022. Actuarial review of the most current medical cost and utilization trend data has not yet begun and 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, 2022.

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 3.1% to 5.1% for CYE 2023. The Centers for Medicare and Medicaid Services (CMS) Office of the Actuary's annual growth projection of the National Health Expenditures Accounts for Medicaid in 2023 is 5.7% nationally.

The AHCCCS high end estimate of 5.1% reflects a 0.6% decrease from the national projection to better align with lower cost trends observed with AHCCCS.

The low end estimate of 3.1% aligns with the JLBC baseline estimate of 3.1% growth for Fiscal Year (FY) 2023. The Executive Budget recommendation for FY 2023 assumes baseline capitation rate growth of 4.6% for all AHCCCS programs, which falls within the range estimated by AHCCCS. If the FY 2023 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 5.8% in the period 2022 through 2028. The CMS estimates account for projected costs attributable to both inflation and utilization.

Table I. CMS Office of the Actuary, Medicaid Spending Per Enrollee, Forecast Growth[1]

Year	2022	2023	2024	2025	2026	2027	2028
Forecast	5.8%	5.7%	5.1%	6.0%	6.7%	5.8%	5.8%

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

The COVID-19 pandemic has dramatically impacted the health care landscape and introduced unprecedented uncertainties to be considered in setting risk-based capitation payments. AHCCCS has observed a return to normal in the overall utilization of healthcare services; however the mix of utilization is different from pre-pandemic periods (e.g., higher acuity level of services, increased behavioral health usage) and enrollment has greatly increased due to the maintenance of coverage requirements during the public health emergency (PHE). At this time, AHCCCS is anticipating a continued shift to what is an expected "new normal" (ongoing utilization of telehealth services, for example) all while the public health emergency is expected

[1] Table 16, "Health Insurance Enrollment and Enrollment Growth Rates, Calendar Years, 2012-2028" Medicaid Spending per Enrollee. Office of the Actuary in the Centers for Medicare & Medicaid Services. "NHE Projections 2012-2028." Accessed January 26, 2022.
https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/NationalHealthAccountsProjected

to end by the beginning of, or during, CYE 2023. As the pandemic now impacts the base data that is used for rate development, AHCCCS is currently evaluating the extent to which a variety of factors may impact CYE 2023 capitation rate development in order to determine potential capitation rate impacts and risk mitigation options. Examples of such factors include: member disenrollment patterns associated with the end of the PHE, and the risk profile of the average AHCCCS member under an environment of stabilized enrollment in the future.

Minimum Wage Initiatives

Home and community based service (HCBS) and nursing facility (NF) provider rates were increased January 1, 2022 in order to address continued increases to the minimum wage under Proposition 206 (statewide impact) and Proposition 414 (Flagstaff impact). Arizona Long Term Care System (ALTCS) capitation rates were adjusted to account for these wage pressures. The increases to the CYE 2022 capitation rates due to this were significant, leading to a 1.2% increase to the Elderly and Physical Disabilities (ALTCS-EPD) program and a 0.6% increase to the Developmental Disabilities (ALTCS-DD) program. It is expected that the full realization of the legislatively required increases will have an additional increase of 0.1% to the CYE 2023 capitation rates.

Likewise, wage increases effective in 2023 will have an impact on CYE 2023 capitation rate development. The current statewide hourly minimum wage is $12.80. Under Tucson's 2021 Proposition 206, the Tucson minimum wage will increase to $13.50 on January 1, 2023. Under Proposition 414, effective January 1, 2023, the Flagstaff minimum wage will increase annually by the consumer price index. In accordance with A.R.S. § 35-113, AHCCCS delineates specific costs related to these wage increases in its budget request.

Pharmacy Costs

In prior years, the largest driver of overall medical cost trends has been pharmacy cost growth. However, this changed with the CYE 2022 rates due to a combination of factors. Market forces have slowed down retail prescription drug price increases, and this has been observed nationally across many Medicaid programs. Specifically for Arizona, AHCCCS implemented a novel pharmacy savings initiative that is proving to be a successful cost containment strategy. This initiative, which started with the CYE 2021 capitation rates, revalues MCO pharmacy expenditure data to the lesser of the MCO paid amounts or the AHCCCS Fee-for-Service amounts. The savings, which have been phased in over multiple years, resulted in $72.5 million in reduced pharmacy expenditures across all programs in CYE 2022.

As pharmacy is expected to still be a significant cost driver, AHCCCS will continue its efforts to identify opportunities to contain pharmacy costs with the intent to maintain lower cost trends.

American Rescue Plan Act (ARPA)

The federal passage of ARPA allows for significant investment by states for enhancing and strengthening home and community-based services. While much of the approved investment will be made to strengthen the workforce in the form of one-time lump sum payments to providers via MCOs, which will not impact capitation rates, a smaller portion of the ARPA HCBS funding will impact capitation rates to facilitate workforce development for HCBS. These ARPA initiatives are expected to add more than $140 million in federal funds ($105 million of that allocated to ALTCS-DD) to the capitation rates in CYE 2023. Due to federal investment, these additional expenses do not increase state expenditures.

Should you have any questions on any of these issues, please feel free to contact Colby Schaeffer, Chief Actuary, at colby.schaeffer@azahcccs.gov.

Sincerely,

Jami Snyder
Director

cc: The Honorable Regina Cobb, Vice Chairman, Joint Legislative Budget Committee
Richard Stavneak, Director, Joint Legislative Budget Committee
Christina Corieri, Senior Advisor, Office of the Governor
Matthew Gress, Director, Office of Strategic Planning and Budgeting
Cameron Dodd, Budget Analyst, Office of Strategic Planning and Budgeting