February 28, 2023

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

Dear Representative Livingston:

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) 2024 will be developed in the summer of 2023 and begin on October 1, 2023. 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, 2023.

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 2.3% to 4.3% for contract year ending CYE 2024. The Centers for Medicare and Medicaid Services (CMS) Office of the Actuary annual growth projection of the National Health Expenditures Accounts for Medicaid in 2024 is 5.1% nationally. The AHCCCS high end estimate of 4.3% reflects a 0.8% decrease from the national projection to better align with lower cost trends observed with AHCCCS.

The mid-point estimate of 3.3% is similar to the JLBC baseline estimate of 3.1% growth for Fiscal Year (FY) 2024. The Executive Budget recommendation for FY 2024 assumes baseline capitation rate growth of

4.0% for all AHCCCS programs, which is within the range estimated by AHCCCS, reflecting a 1.1% decrease from national projections. If the FY 2024 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 5.3% in the period 2023 through 2029. 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 Growth[1]

Year	2023	2024	2025	2026	2027	2028	2029
Forecast	5.0%	5.1%	5.4%	5.3%	5.3%	5.5%	5.4%

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

As of December 2022, the passage of H.R.2471 - Consolidated Appropriations Act, 2022 by the United States Congress, otherwise known as the "Omnibus bill," removed the maintenance of eligibility requirements in Medicaid from the COVID-19 PHE. The result is that AHCCCS will continue to process Medicaid eligibility redeterminations, as it has throughout the PHE, and subsequent disenrollments will proceed starting April 1, 2023, for anyone found ineligible from March 2023 onward. This brings forth certainty on the timing of disenrollments and allows for AHCCCS to better predict the changing levels of enrollment and average cost profiles. AHCCCS actuaries developed acuity adjustment factors within the CYE 23 capitation rates. Because of this sophisticated modeling, AHCCCS also has reasonable expectations for the impact to the CYE 24 due to significant changes in enrollment. Although total membership will decrease, it is anticipated that the members that remain in the program will exhibit a higher cost profile due to greater utilization of services. The impact of eligibility redeterminations in CYE 24 are expected to have a 0.7% increase over the final CYE 23 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 may end, partially or in full, for CYE 24. There are multiple determining factors that are currently unresolved that will impact those decisions; the range of impact will vary based upon the individual decisions, with the potential increase to capitation rates being approximately 0.3%.

[1] Table 16, "Health Insurance Enrollment and Enrollment Growth Rates, Calendar Years, 2014-2030, "Medicaid Spending per Enrollee. Office of the Actuary in the Centers for Medicare & Medicaid Services. "NHE Projections 2014-2030." Accessed January 3, 2023. https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/NationalHealthAccountsProjected

Minimum Wage Initiatives

HCBS and NF provider rates increased January 1, 2023, in order to address continued increases to the minimum wage under Proposition 206 and Proposition 414. ALTCS capitation rates were adjusted to account for these wage pressures. The increases to the CYE 23 capitation rates due to this were significant, leading to a 2.5% increase to EPD capitation and 1.3% increase to DES/DDD. It is expected that the full realization of the legislatively required increases will have an additional increase of 0.2% to the CYE 24 capitation rates.

The current statewide hourly minimum wage is $13.85. The Tucson minimum wage will increase to $14.25 on January 1, 2024, 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 $15.50 to $16.80 per hour effective January 1, 2023. Wage increases effective in 2024 will have an impact on CYE 24 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 current State Plan Amendment (SPA) for the FQHC includes an Alternative Payment Methodology (APM) reimbursement method that expires September 30, 2023. It is anticipated that at the expiration of the current SPA the FQHC reimbursement will revert to the methodology that was in place from 2001 to 2018 for the FQHCs. Reverting back to the previous methodology will result in at least a 0.70% increase to the capitation rates.

Trend and Inflation Pressure

National economic factors such as labor shortages and inflation could create upward pressure on unit cost trends, especially if provider contract negotiations with the MCOs start to reflect that. With that said, preliminary analysis of changes in the base data used between the CYE 23 and CYE 24 rates shows little increase in per capita costs. In prior years, the largest driver of overall medical cost trends has been pharmacy cost growth, and while this has slowed down, it is expected that retail prescription drug prices will be a key contributor to projected trends. Other contributors could be increases in the prices of physician-administered 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
Director

cc: The Honorable John Kavanaugh, Vice Chairman, Joint Legislative Budget Committee
Richard Stavneak, Director, Joint Legislative Budget Committee
Zaida Dedolph Piecoro, Health Policy Advisor, Office of the Governor
Sarah Brown, Director, Office of Strategic Planning and Budgeting
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