

March 3, 2025

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) 2026 will be developed in the summer of 2025 and begin on October 1, 2025. 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, 2025.

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 3.0% to 5.0% for contract year ending CYE 2026. The Centers for Medicare and Medicaid Services (CMS) Office of the Actuary annual growth projection of the National Health Expenditures Accounts for Medicaid in 2026 is 4.9% nationally. The AHCCCS high

end estimate of 5.0% is narrowly above the national projection, reflecting the current environment within Arizona of higher acuity membership and increased HCBS services utilized by our ALTCS DD and EPD members, made possible by federal and state workforce development initiatives.

AHCCCS’ mid-point estimate of 4.0% capitation rate growth is in line with the baseline capitation rate growth assumed in the Executive Budget recommendation for Fiscal Year 2026 and is a percentage point higher than the JLBC baseline estimate of 3.0% growth for FY 2026. If the FY 2026 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 5.4% in the period 2025 through 2032. 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	2025	2026	2027	2028	2029	2030	2031	2032
Forecast	6.7%	4.9%	5.3%	5.7%	5.1%	5.0%	5.0%	5.2%

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 (recent enhancements to the workforce through legislatively mandated rate increases are an example of this) and changes in the types of services members receive.

Acuity Changes Due to Declining Enrollment

During the pandemic, there were maintenance of eligibility and enrollment requirements for Medicaid which were removed effective April 1, 2023. 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. This process was completed within the allotted timeframe, however, since the end of the “unwinding”, the AHCCCS population has continued to decline. The majority of the

¹ Table 17, “Health Insurance Enrollment and Enrollment Growth Rates, Calendar Years, 2013-2032”. “NHE Projections 2023-2032.” Annual Growth Rates (%), Spending per Enrollee (Medicaid). Accessed December 27, 2024. <https://www.cms.gov/data-research/statistics-trends-and-reports/national-health-expenditure-data/projected>

disenrollments are due to members no longer meeting the income eligibility requirements, which generally indicates that they are healthier than the average (people who are less healthy are less likely to remain gainfully employed due to their health issues). These disenrollments have thus, in general, left less healthy individuals enrolled with higher health care needs, increasing the average expense per member. The AHCCCS actuaries developed acuity adjustment factors for inclusion in the CYE 25 capitation rates to recognize that the members that disenrolled during the unwinding were healthier on average than those that remained eligible for Medicaid after redetermination. The impact of further disenrollments of healthy individuals on the capitation rates for CYE 26 is expected to have a range of 0.4%-1.0% increase over the final CYE 25 capitation rates.

Minimum Wage Initiatives

HCBS and NF provider rates increased January 1, 2025, in order to address continued increases to the minimum wage under Proposition 206 and Proposition 414. The current statewide hourly minimum wage is \$14.70. The Tucson minimum wage increased to \$15.00 on January 1, 2025. 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 \$17.40 to \$17.85 per hour effective January 1, 2025. Wage increases effective in 2026 will have an impact on CYE 26 capitation rate development. In accordance with A.R.S. § 35-113, AHCCCS delineates specific costs related to that wage increase in its budget requests.

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 25 and CYE 26 rates show some definitive increases in per capita costs, some portion of which is directly attributable to provider rate increases for nursing and home and community-based services while other portions are attributable to changing acuity and increased behavioral health services for autism among other diagnoses; 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 continuing increasing 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 Kavanagh, Vice Chairman, Joint Legislative Budget Committee
Richard Stavneak, Director, Joint Legislative Budget Committee
Ben Henderson, Director, Governor's Office of Strategic Planning and Budgeting
Meaghan Kramer, Health Policy Advisor, Office of Governor
Cameron Dodd, Budget Manager, Governor's Office of Strategic Planning and Budgeting