ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

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

Dear Senator Farnsworth:

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%." Due to an administrative oversight, this letter as originally drafted in February was unfortunately not delivered to JLBC.

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) 2027 are currently being developed and will begin on October 1, 2026. The actual capitation rates and accompanying actuarial certifications will be provided to JLBC for review in advance of implementation on October 1, 2026.

Preliminary Estimates for Capitation Rate Growth

Based on reviews of historical medical cost and utilization trend data, AHCCCS estimates a statewide weighted average capitation rate increase of 3.0% to 4.0% for contract year ending CYE 2027 across all Medicaid programs. The Centers for Medicare and Medicaid Services (CMS) Office of the Actuary annual growth projection of the National Health Expenditures Accounts for Medicaid in 2027 is 5.8% nationally. The AHCCCS high end estimate of 4.0% is below the national projection, reflecting the continued focus within Arizona of bending the cost curve, even during environments of increasing acuity within the

membership and increased HCBS services utilized by our ALTCS DD and EPD members, made possible by federal and state workforce development initiatives, including proposed provider rate increases.

AHCCCS' mid-point estimate for capitation rate growth is slightly higher than the FY 2027 appropriated amount of 3.0%, which may result in a need for supplemental funding. However, there are many variables that impact the potential supplemental funding needs including caseload growth, HR1 impacts, and medical policy implementations.

Nationally, the CMS Office of the Actuary projects annual growth rates averaging 5.4% in the period 2026 through 2033. 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	2026	2027	2028	2029	2030	2031	2032	2033
Forecast	5.4%	5.8%	5.5%	5.7%	5.2%	5.3%	5.3%	5.3%

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 (proposed 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

As Arizona's annual minimum wage changes are now tied statewide to the same inflation factor (CPI-U) used for determining the annual updates to the federal poverty limit, there is a somewhat stable relationship between the Arizona minimum wage and the federal poverty limits that govern Medicaid eligibility each year. Variability occurs when there are significant changes between the August CPI-U factor (which drives Arizona's minimum wage update) and the following January CPI-U factor (which drives the federal poverty limit update). The lower relative levels of unemployment in the state of Arizona compared to national averages decreases the overall population eligible for Medicaid within the state. The continuing growth in AHCCCS disenrollments is primarily 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).

[1] Table 17, "Health Insurance Enrollment and Enrollment Growth Rates, Calendar Years, 2014-2033". "NHE Projections 2024-2033." Annual Growth Rates (%), Spending per Enrollee (Medicaid). Accessed January 26, 2026. https://www.cms.gov/data-research/statistics-trends-and-reports/national-health-expenditure-data/projected

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 initial acuity adjustment factors for inclusion in the CYE 26 capitation rates which were updated in December 2025 based on increased disenrollments continuing beyond what was originally assumed in the CYE 26 capitation rate development. The impact of further disenrollments of healthy individuals on the capitation rates for CYE 27 is expected to have a range of 1.0%-1.5% increase over the final CYE 26 capitation rates.

Minimum Wage Initiatives

HCBS and NF provider rates increased January 1, 2026, in order to address continued increases to the minimum wage under Proposition 206 and Proposition 414. The current statewide hourly minimum wage is $15.15. The Tucson minimum wage increased to $15.45 on January 1, 2026. Under Proposition 414, the Flagstaff minimum wage increases annually by the August consumer price index, mirroring the state minimum wage annual CPI-U increase, and increased from $17.85 to $18.35 per hour effective January 1, 2026. Wage increases effective in 2027 will have an impact on CYE 27 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 26 and CYE 27 rates show some definitive increases in per capita costs, some portion of which continues to be attributable to changing acuity and increased behavioral health services for autism among other diagnoses along with increased home and community based services among the ALTCS populations. The preliminary review of changes in base data is pointing to a significant driver of increases being pharmacy cost growth, and it is expected that both retail prescription drug prices as well as specialty drug prices will 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,

Roberta Harrison
Interim Director

cc: The Honorable David Livingston, Vice Chairman, Joint Legislative Budget Committee
Richard Stavneak, Director, Joint Legislative Budget Committee
Meaghan Kramer, Health Policy Advisor, Office of the Governor
Ben Henderson, Director, Governor's Office of Strategic Planning and Budgeting
Cameron Dodd, Budget Manager, Governor's Office of Strategic Planning and Budgeting