



FEATURE

Medicaid Block Grants and the Prospective Effect on Providers

Obamacare repeal has become a zombie. It won't die, but it's not exactly living either. The fact that it won't completely die is telling, however, and signals that the possibility of repeal will likely linger as an issue through the next several election cycles. Of the many difficult aspects of reforming health care, perhaps the most debated is what to do with Medicaid spending and block grant proposals. And no matter what form the zombie resurfaces in down the road, be it repeal or reform, there will be big questions regarding the future of Medicaid. Below, we take a close look at Medicaid spending trends and detail what recent block grant proposals might look like if they were to become reality.

The ACA and Federal Medicaid Expansion

Signed by President Obama in 2010, the Patient Protection and Affordable Care Act (ACA), also known as Obamacare, expanded Medicaid eligibility to nearly all adults with family incomes below 138% of the federal poverty line (\$15,856 for an individual, \$26,951 for a family of three in 2014). In addition, the ACA simplified Medicaid application and enrollment and increased the federal match rate for the newly eligible to 100% of costs of care through 2019 (90% in 2020 and beyond). The ACA's major provisions were set to come into force by 2014 across the country. However, this widespread implementation was derailed by a Supreme Court

decision in the case of the National Federation of Independent Business (NFIB) v. Sebelius. In NFIB v. Sebelius, the Supreme Court upheld the constitutionality of the ACA but gave states the choice on whether or not to opt into the program. To date, 32 states (including Washington, D.C.) have expanded their Medicaid programs by opting into the ACA. Nineteen states have yet to approve Medicaid expansion, and many continue to debate the topic today.

As expected, total Medicaid spending grew significantly in the states that opted into Medicaid expansion. Spending growth was driven by rapid growth in federal Medicaid spending due to the 100% match for newly eligible patients. On average, Medicaid expansion states saw a 61% increase in federal Medicaid spending from 2013 to 2016, while non-expansion states saw federal spending grow by only 18% over the same time period (Figure 1). Both expansion and non-expansion states experienced 1% growth in spending per enrollee from 2013 to 2016, on average.

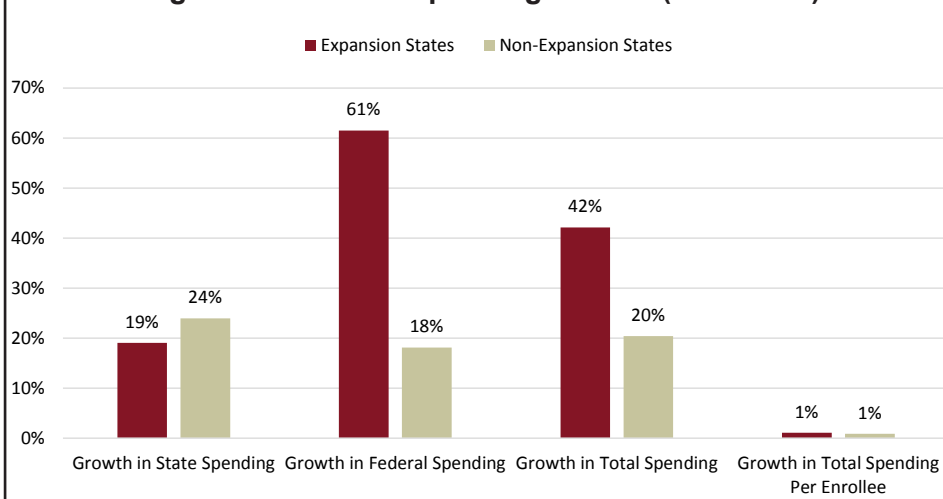
Due to the rapid inflow of federal Medicaid funding for states opting into the ACA, Medicaid programs in expansion states have become more reliant on federal funding than Medicaid programs in non-expansion states.

Block Granting and Current Proposals

Under the current Medicaid system, the federal government agrees to pay a portion of a state's total Medicaid expenditures based on the state's average personal income. This means that federal funding is open-ended and is based on a state's total Medicaid spending levels.

Under a block grant system, each state receives a fixed amount of federal funds for Medicaid expenses based on historical and expected Medicaid spending in the state. Proponents of block granting claim that it will limit federal government spending, incentivize states to control Medicaid costs, and allow for state innovation within Medicaid programs. Critics of

Figure 1: Medicaid Spending Growth (2013-2016)



block granting argue that it will squeeze Medicaid funding, lead to less or lower-quality care for those in need, and give states the power to loosen state coverage requirements.

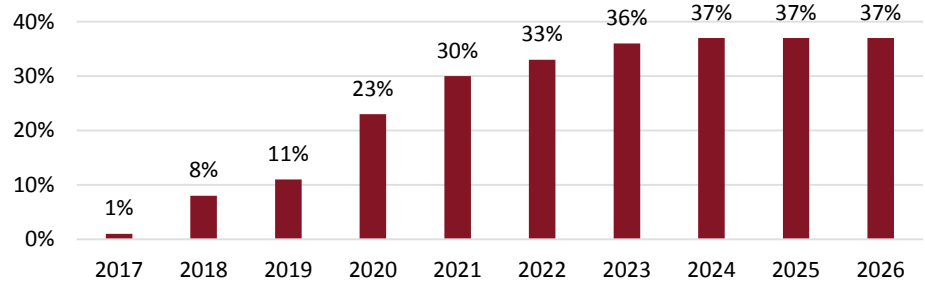
The most recent block grant proposals in the American Health Care Act (AHCA), the GOP's leading Obamacare repeal proposal in the first half of 2017, would decrease federal Medicaid spending by \$839 billion over the next ten years according to estimates from the non-partisan Congressional Budget Office (CBO). These federal spending cuts represent almost one third of current federal Medicaid funding and would place the burden on state budgets to maintain the current program. CBO estimates indicate that state Medicaid funding would need to increase by 37% by 2024 in order to make up for the funding gap, which is seemingly insurmountable within state budgets that are already under financial pressure (Figure 2). In addition, Medicaid is already a lean program and has demonstrated cost growth of only 2.8% from 2000 to 2013, while Medicare and private health insurance costs grew by 4.8% and 6.2%, respectively. This suggests that further cost-cutting in the Medicaid program is unlikely to be significant without changes to state coverage requirements and/or an increased risk to quality of care.

Debt Finance under a Block Grant System

Were block grants to become a reality, there are a few key considerations health care facilities looking for capital, as well as capital providers, will be focused on:

- Changes in operator behavior. Block grants may further incentivize large health care providers to chase private pay revenues by targeting high-reimbursement states. In addition, providers may be further incentivized to invest in facilities that have the potential to serve large numbers of private pay patients.
- The U.S. Department of Housing and Urban Development (HUD) financing eligibility requirements. The institution of block grants would likely lead to declines in Medicaid spending across the board. This, in theory, may create a “new normal” of provider profitability as a result of fewer Medicaid reimbursements. HUD’s Sec. 232 and 242 health care financing programs have base-line performance standards that facilities must meet in order to be considered for financing. Close attention will be paid to how HUD leadership may need to adapt to industry changes that are potentially caused by block grants, and perhaps adjust its performance standards to reflect this “new normal.” If not, the group of facilities that fall below the performance standards of HUD due to declining federal Medicaid reimbursements will likely increase.

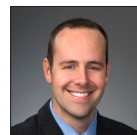
Figure 2: Percentage Increase in State Funds Needed to Maintain Current Medicaid Program, With AHCA Cuts to Federal Funds, 2017-2026



Source: Health Management Association, based on CBO letter to House Speaker Paul Ryan, March 23, 2017

- Forward-looking underwriting standards. If the likelihood of block granting begins to increase, forward-looking underwriting standards for some states may be different than others based on the state’s ability to maintain reimbursements in the face of decreased federal Medicaid funding. While provider profitability is likely to suffer in all states as a result of block grants, some state Medicaid programs have little room to decrease reimbursement rates without potentially driving providers out of business.

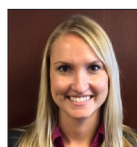
Clearly, block grants would radically change Medicaid and its reimbursement structure, while also changing industry dynamics for health care providers. In the next edition of *The Capital Issue*, we will explore the effects of block granting on states in general while also providing a detailed analysis focused on three specific states—Ohio, Indiana and Illinois.



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