California Hospital Association

Summary of 2025-26 Budget Agreement

Overview

In the aftermath of the COVID-19 pandemic, California saw an unprecedented influx of new revenue — which prompted significant new spending commitments. Now, the state faces financial challenges and uncertainties as revenues have failed to keep pace with climbing spending. While the governor's 2025-26 budget proposal released in January continued an agreement to use reserves to help maintain a balanced budget, circumstances have since changed dramatically. In May, California was projected to face a $12 billion budget shortfall, driven by three primary factors:

- **Federal Policy Impacts and Economic Risk**: New federal tariffs have contributed to a downgraded global and state economic outlook. The Newsom administration estimates that, absent these federal policies, General Fund revenues would be $16 billion higher.
- **Rising Baseline Costs**: Some programs, such as Medi-Cal, have seen baseline cost increases that outpace previous projections.
- **Natural Disaster Costs**: Recent destructive wildfires in Los Angeles have led to higher state spending and economic disruption.

The governor's May Revision budget proposal included a mix of spending reductions, borrowing, and funding shifts to solve the budget problem. The Legislature passed its own version of the budget on June 13, and now the governor and Legislature have reached agreement on the final Budget Act of 2025.

The 2025-26 budget totals $321.1 billion in spending, including $228.4 billion from the General Fund. It helps address the shortfall through a range of solutions and leaves the state with $15.7 billion in total reserves in 2025-26. However, it does not assume the enactment of any cuts in federal funding currently under consideration by Congress or proposed by federal regulators; if enacted, these would affect eligibility, methods of

financing, provider payments, and benefits — and create tens of billions of dollars in Medi-Cal budget pressures for the state. Additional revisions could be needed to the 2025-26 budget to address the challenges created by federal funding cuts. Even without cuts at the federal level, the budget projects significant structural deficits for future years, making it nearly certain that additional actions to stabilize the state budget will be needed next year and beyond.

The final budget agreement makes significant changes to Medi-Cal and health care financing. While the agreement includes difficult decisions aimed at addressing the state's budget shortfall, the final package includes several changes to the Governor's original January and May proposals — including changes that affect hospitals and health care providers. Below is a summary of the key components of the agreement relevant to hospitals and the communities they serve.

Key Provisions

Managed Care Organization (MCO) Tax

The agreement approves the governor's proposal to sweep Proposition 35's MCO tax funds that were intended for enhancing payments to primary care, specialty care, hospital outpatient, and ground emergency medical transportation providers; this tax is estimated to generate $1.3 billion in 2025-26. While this is a significant redirection of hospital-supported revenue, CHA continues to advocate for the appropriate use of the emergency department funding not swept as part of the final budget agreement.

Key Medi-Cal Budget Solutions

- **Medi-Cal Asset Limit Restoration**: The budget includes a Medi-Cal asset limit of $130,000, an increase from the governor's proposal of $2,000. This change results in General Fund savings of $45 million in 2025-26, growing to $510 million in future years.
- **Undocumented Medi-Cal Enrollment Changes**: Starting January 1, 2026, undocumented residents over the age of 19 would be subject to a Medi-Cal enrollment freeze; this includes a six-month re-enrollment grace period and specifies that children will not age out. Savings grow to **$3.3 billion annually** when fully implemented in future years.
- **Premiums for Undocumented Adults**: Premiums for undocumented adults aged 19-59 will begin July 1, 2027, at $30 per month (lowered from the governor's proposal of $100 per month). Net savings begin in 2027-28 and are projected to reach $675 million annually.

- **Prescription Drug Rebates and Exclusions**: The budget adjusts the prescription drug rebate aggregator to include undocumented populations, generating $370 million in 2025-26. Additionally, coverage for specialty weight loss drugs will be excluded from Medi-Cal, resulting in savings reaching $680 million by 2028-29.

Delays and Preserved Funding

- **Delay Repaying Current Year Medi-Cal Overage**: The final budget agreement includes the delay of a loan repayment to cover 2024-25 Medi-Cal costs. This loan totals $4.4 billion and is assumed to be repaid in 2034.
- **Proposition 56 Supplemental Payments**: The final budget rejects the elimination of $172 million in Proposition 56 payments for family planning and women's health services, and delays cuts to dental supplemental payments and benefits for undocumented individuals until July 1, 2026.
- **Health Centers and Clinics**: Reductions to health centers and rural health clinics totaling $1.1 billion annually are delayed until July 1, 2026.
- **Public Health Investments Preserved**: The Legislature rejected nearly $60 million in proposed cuts to public health initiatives, including LGBTQ+ health equity, reproductive health, sexually transmitted disease prevention, and public health workforce programs.

Other Important Proposals

- **Diaper Initiative:** The budget agreement includes the governor's $7.4 million diaper initiative, as well as a separate equivalent augmentation for diaper banks. Distribution pathways, including around hospitals' potential role, will continue to be developed as the Department of Health Care Access and Information implements the program.
- **Pharmacy Benefit Manager Licensure:** The budget includes statutory changes requiring pharmacy benefit managers contracting with health plans or insurers to obtain licensure from the Department of Managed Health Care.

Future Policy Development

The Senate has indicated that it will begin work on a new policy to require large employers whose workers are enrolled in Medi-Cal to contribute to the cost of that coverage. This policy is not yet finalized and would require future legislation and budget action.