Preliminary Summary of the Governor's Revised May 2025 Budget Proposal

Overall Budget Picture

Governor Proposes Revised Budget, Which Will Evolve Before Finalization — On May 14, the governor released his revised budget proposal for 2025-26, kickstarting work by state policymakers to have a legislatively approved budget in place by the time the fiscal year starts on July 1. The Legislature will now consider the governor's proposal and will likely approve an alternative budget framework within the next month, which will be followed by a budget agreement satisfying both the Administration and Legislature. Recent history shows that may not occur until right around July 1. However, given the extraordinary uncertainties related to changes in federal funding under consideration by Congress, state lawmakers may have to revisit the approved 2025-26 budget soon after its passage. The governor's proposal — and whatever is finalized following negotiations with the Legislature — may be provisional and not include significant and difficult budget responses to federal policy changes.

Budget Proposal Aims to Solve a $12 Billion Deficit — The revised budget reflects a significantly more pessimistic budget picture than the one presented in January. As a result, the budget recognizes and includes policy changes to solve a $12 billion deficit next year, and to address deficits projected in future years as well. The governor attributes much of the budget problem to Medi-Cal, where most of the budget solutions are proposed.

Budget Assumes a Lagging Economy, But Not a Recession — Major economic assumptions for the revised budget proposal were locked down in mid-April. As a result, the budget does not incorporate several of the latest federal trade deals that reduced tariffs below their peak levels. Additionally, the budget generally assumes mildly worsening economic fundamentals on employment, income, inflation, and more. If actual trends significantly outperform budget assumptions, revenues could be higher than projected, improving the state's fiscal condition. However, if the economy worsens, revenues could be lower, necessitating additional budget solutions.

Budget Does Not Incorporate Major Federal Funding Risks — The House of Representatives is currently considering a budget package that would cut federal funding of $715 billion from Medicaid over the next 10 years. The budget does not assume the enactment of any cuts in federal funding currently under consideration by Congress or proposed by federal regulators. Should these reductions be adopted, the state would lose tens of billions of dollars for Medi-Cal. These proposed federal reductions would affect eligibility, methods of financing, provider payments, and benefits, and create huge new

Medi-Cal budgetary pressures. Additional revisions would be needed to the state's 2025-26 budget to address the challenges created by federal funding cuts.

Overall Budget Solutions

To address the projected budget deficit of $12 billion for FY 2025-26, the governor proposes the following solutions. These solutions include reductions to ongoing programs that the Administration projects will result in greater savings in future years.

- **Reductions —** $5 billion in total spending reductions in FY 2025-26, growing to $14.8 billion by FY 2028-29. The reductions fall largely in the health and human services areas, specifically to Medi-Cal eligibility and benefits, as well as the In-Home Supportive Services program.
- **Revenue Shifts and Borrowing —** $5.3 billion in total in FY 2025-26, including shifting $1.3 billion in FY 2025-26 from Proposition 35 revenues to support baseline spending increases in Medi-Cal managed care.
- **Fund Shifts —** $1.7 billion in total fund shifts, primarily from the Greenhouse Gas Reduction Fund in FY 2025-26.
- **Trigger Reductions —** The May Revision places two human services policy items totaling $456.1 million in a 'trigger' — these policies would trigger on in FY 2027-28 if it is determined that sufficient funds will be available to support these policies.

Medi-Cal Budget Solutions

Of the governor's $5 billion in proposed spending solutions for 2025-26, 75% are spending reductions in the Medi-Cal program.

Redirects a Significant Portion of Managed Care Organization (MCO) Tax Dollars — The revised budget proposes to allocate $4.7 billion in MCO tax revenue each year in calendar years 2025 and 2026, as authorized by Proposition 35, the Protect Access to Health Care Act. Regrettably, this proposal diverts much of the Proposition 35 funds from their intended purpose: provider payment increases. The proposal utilizes $1.6 billion in Proposition 35 funds to support increases to managed care plans' base capitation payment rates relative to calendar year 2024 for primary care, specialty care, hospital outpatient, and ground emergency medical transportation services. This offsets costs that would otherwise be borne by the general fund, in lieu of enhancing payments to providers.

Upon initial review, the proposal dedicates the following funding to hospitals:

- For emergency department facilities, the proposal dedicates $255 million in each of 2025 and 2026 to support the nonfederal share of hospital directed payments, increasing participating hospitals' net financial benefit.
- For community outpatient services, the proposal diverts the full $245 million in funding in 2025 and 2026 to cover baseline program costs.

- For designated public hospitals (DPH), the proposal dedicates the full $150 million in 2025 and 2026 to support the nonfederal share of existing DPH directed payment programs, increasing participating hospitals' net financial benefit.
- For graduate medical education, the full $75 million is directed to the University of California to expand programs.

In addition, for behavioral health throughputs, the budget proposes to use $200 million in each of 2025 and 2026 to improve data sharing, consent management, and care coordination among behavioral health providers and $100 million in each of 2025 and 2026 for flexible housing subsidy pools.

Proposed Solutions Affecting Undocumented Immigrant Beneficiaries — These proposed solutions are projected to save combined general fund savings of $2.4 billion in 2025-26, rising to $7.6 billion by 2028-29. Those changes include:

- Enrollment freeze for full-scope (state-only) Medi-Cal expansion, adults 19 and older starting Jan. 1, 2026.
- State-only Medi-Cal premiums for adults with unsatisfactory immigration status. Introduces $100 monthly premiums for undocumented adults beginning Jan. 1, 2027.
- Elimination of state-only prospective payment system rates to clinics, switching to "standard Medi-Cal rates" and fee-for-service payment methodologies for undocumented patients.
- Elimination of state-only long-term care for undocumented individuals.
- Elimination of state-only dental benefits for undocumented adults.

Proposed Pharmacy-Related Budget Reductions — Solutions total $638 million in general fund savings for 2025-26, with ongoing annual savings rising to over $1.55 billion by 2028-29. Those changes include the following:

- **Pharmacy Drug Rebates —** Implements a rebate aggregator and secures minimum rebates for HIV/AIDS and cancer drugs.
- **Elimination of Over-the-Counter Drug Coverage —** Ends coverage for select over-the-counter items like COVID-19 tests, vitamins, and some antihistamines.
- **Prescription Drug Utilization Management —** Introduces prior authorization and management protocols for prescription drugs.
- **Step Therapy Protocols —** Requires patients to try cost-effective drugs before progressing to more expensive ones.
- **Prior Authorization for Continuation of Drug Therapy —** Removes automatic continuation of existing prescriptions if drugs are removed from the Medi-Cal Rx list.
- **Eliminate GLP-1 Coverage for Weight Loss —** Discontinues Medi-Cal coverage of GLP-1 drugs used for weight loss.

Health Plan and Provider Payment-Related Reductions — These total $711.2 million in general fund savings for 2025-26, with ongoing savings reaching $920 million annually by 2028-29. Those changes include:

- **Medi-Cal Minimum Medical Loss Ratio —** Raises the minimum medical loss ratio for managed care plans starting Jan. 1, 2026.
- **Proposition 56 Supplemental Payments —** Eliminates $504 million in 2025-26 and $550 million ongoing in supplemental payments to dental, family planning, and women's health providers.
- **Suspension of the Proposition 56 Loan Repayment Program —** Suspends the final cohort of the loan repayment program.
- **Skilled Nursing Facilities —** Ends the Workforce and Quality Incentive Program and suspends the 96-hour backup power requirement.
- **Program of All-Inclusive Care for the Elderly (PACE) Organization Capitation Payments —** Limits PACE capitation payments to the midpoint of actuarial rate ranges, with exceptions for newly enrolled providers.

Eligibility and Benefit Reductions — The proposal makes Medi-Cal eligibility and benefit reductions totaling $124 million in general fund savings for 2025-26, increasing to $854 million in ongoing annual savings. Those changes include the following:

- Elimination of Acupuncture Optional Medi-Cal Benefit.
- Reinstatement of asset-based eligibility limits for certain Medi-Cal applicants effective Jan. 1, 2026.
- Addition of prior authorization requirements for hospice services.

Other Health and Human Services Budget Solutions

Pharmacy Benefit Managers (PBM) Licensure —The revised budget proposes statutory changes to establish licensure and oversight of PBMs by the Department of Managed Health Care, including data reporting requirements for PBMs to increase transparency in the pharmacy supply chain, understand cost drivers, and develop approaches to improve the affordability of prescription drugs in California.

CalRx Expansion — The revised budget also expands the authority of the CalRx program to purchase brand-name drugs, providing more tools for the state to respond to supply chain disruptions, market manipulation, or politically motived restrictions that threaten access to essential medications, including medication abortion.

Human Services Reductions — The largest reductions in the human services area are within the In-Home Supportive Services (IHSS) program:

- **Provider Overtime and Travel Hours —** A reduction of $708 million from the general fund (ongoing) to cap IHSS provider overtime and travel hours at 50 hours per week beginning in FY 2025-26.

- **Reductions Associated with May Revision Changes to Medi-Cal Coverage for Undocumented Individuals:**
    - A reduction of $111 million in FY 2025-26 to conform the IHSS Residual Program coverage with the timing of Medi-Cal coverage.
    - A reduction of $158.8 million in FY 2025-26 (ongoing) to eliminate IHSS benefits.
    - A reduction of $25.5 million in FY 2025-26 to conform IHSS with the reinstatement of the Medi-Cal asset limit.
- Additionally, the proposed budget eliminates funding for the following policies, unless it is determined that there are sufficient revenues to support these policies in FY 2027-28:
    - California Food Assistance Program (CFAP) Expansion Implementation ($117 million in FY 2027-28).
    - Foster Care Tiered Rate Structure Implementation ($339 million in FY 2027-28).