Provider Policy 2026 Preview

PROVIDER PRESSURE

The Looming Headwinds for Medicaid Exposed Providers

CAPSTONE

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Provider Policy 2026 Preview:

THE BOTTOM LINE

Capstone expects Medicaid-exposed providers to face incremental, rather than severe, headwinds in 2026. While rate growth is likely to remain constrained, we see broad reimbursement cuts as unlikely given relatively strong state budget conditions and political pressure to protect providers serving vulnerable populations. However, as the Centers for Medicare & Medicaid Services (CMS) Medicare market basket growth slows, providers may remain exposed to ongoing inflationary pressures.

Outlook at a Glance

- DESPITE PRESSURE ON MEDICAID BUDGETS, CAPSTONE CONSIDERS THE RISK OF BROAD-BASED CUTS TO BE LOW, AS OVERALL STATE BUDGETS ARE HEALTHY
- DECLINING MEDICARE MARKET BASKET UPDATES RISK UNDERESTIMATING PERSISTENT OR SHARP INCREASES IN INFLATION
- PROVIDERS SERVING VULNERABLE POPULATIONS ARE PARTICULARLY WELL-POSITIONED TO AVOID TARGETED RATE REDUCTIONS OR COST CONTAINMENT MEASURES

Despite Pressure on Medicaid Budgets, Capstone Considers the Risk of Broad-based Cuts to be Low, as Overall State Budgets Are Healthy

Winners	None
Losers	Community Health Systems Inc. (CYH), Tenet Healthcare Corp. (THC), HCA Healthcare Inc. (HCA), LifePoint Health Inc.

State Medicaid budgets are under mounting pressure heading into 2026. The expiration of enhanced federal funding implemented during the COVID-19 emergency has removed a significant funding cushion just as states confront a projected 8.5% increase in non-federal Medicaid expenditures for FY26. Meanwhile, enrollment is stabilizing after two years of post-pandemic unwinding. Two-thirds of state Medicaid directors see at least a 50-50 chance of Medicaid budget shortfalls in FY26, up slightly from FY25.

Despite these pressures, Capstone believes broad-based provider cuts are unlikely. Overall, state budgets remain healthy despite slowing revenue growth and rising costs, with "rainy day funds" near all-time highs. At the same time, Capstone believes states are reluctant to further squeeze Medicaid providers amid uncertainty around Affordable Care Act (ACA) subsidies. However, policy uncertainty about work requirements, provider tax restrictions, and state-directed payments will likely constrain growth rates rather than drive active rate cuts.

Federal policy changes will increase uncertainty in 2026. The One Big Beautiful Bill Act (OBBBA) will cut federal Medicaid outlays by ~$911 billion over the next decade, adding to the fiscal stress of states already operating under constrained budgets (see One Big Beautiful Bill Act Healthcare Overview, July 25, 2025). While the bulk of these changes will not impact state Medicaid budgets until 2027 and beyond, initial impacts are expected to emerge in 2026 through spending on work requirement verification programs and managed care organization (MCO) tax revenue losses in affected states (see Medicaid Tax Quick Take: Impact of CMS Rule Closing Tax Loopholes Primarily Limited to Managed Care-Focused Taxes, Limited to 7 States, May 13, 2025).

At least two states have already implemented Medicaid cuts in response to anticipated shortfalls. However, we believe these cuts reflect idiosyncratic circumstances, rather than broader trends. Idaho's 4% provider rate and MCO payment cuts (through 2027) address a $58 million projected state budget shortfall. North Carolina cut provider rates by 3%-10%, and capitated MCO payments by 1.5%, after the state General Assembly failed to appropriate sufficient funding. Capstone believes the political dynamics in North Carolina appear significant (see North Carolina Medicaid Outlook Call: Conversation with State Rep. Sarah Crawford, November 5, 2025).

Many provisions in the OBBBA may yield modest state savings starting in 2027. Capstone believes net savings from work requirements and the increased eligibility checks on expansion populations should partially offset provider tax revenue declines (beginning 2028) and new state-directed payment ceilings.

Capstone believes that the anticipated compression of state Medicaid budgets and the resulting cost containment measures that may be necessary are incrementally negative for healthcare providers. This impact may be especially severe for providers with disproportionate concentration in "first-mover" states such as North Carolina (e.g., LifePoint Health) and California (e.g., Prime Health). However, we expect healthy overall state budgets to defer the need for broad-based Medicaid rate cuts.

Providers Serving Vulnerable Populations Are Particularly Well-Positioned to Avoid Targeted Rate Reductions of Cost Containment Measures

Winners	Providers treating vulnerable populations under mandated coverage or in low-cost-of-care sites, such as Aveanna Healthcare Holdings Inc. (AVAH)
Losers	Providers covered under optional benefits (e.g., adult dental)

Since 1967, the Early and Periodic Screening, Diagnostic, and Treatment (EPSDT) benefit has required states to provide comprehensive, medically necessary services to Medicaid beneficiaries, specifically the pediatric population under 21. The benefit focuses on early intervention and preventive services, including vision, hearing, dental, and applied behavioral analysis (ABA) and personal care services (PCS) when medically necessary.

Relevant reforms have focused on expanding EPSDT coverage and enhancing state oversight of the benefit to protect medically necessary services for Medicaid-eligible individuals under 21. Recent bipartisan federal action has increased oversight of state EPSDT programs to ensure proper compliance. Furthermore, despite significant cuts to the Medicaid program made under the OBBBA, continued bipartisan support and state protections lead us to believe that EPSDT benefits will remain protected relative to other coverage and services. However, we warn that other optional Medicaid benefits, such as adult dental, could be targeted for cost savings and are not equally protected by federal statute or codified exemptions.

We also believe that the intellectual and developmental disability (IDD) population will be insulated from major negative impacts resulting from the OBBBA. Individuals with IDD are classified as "medically frail" and are exempted from the Medicaid work requirements implemented during reconciliation. This protects relevant providers from significant enrollment losses under the bill.

Additionally, pediatric IDD populations typically receive services through EPSDT.

The two circumstances outlined above create a protected class of individuals who are exempt from work requirements, have statutorily mandated coverage for certain services, and are politically difficult to target for cuts. Though these benefits are less at risk of elimination or reduction, they may still be affected by across-the-board cuts associated with reconciliation. However, revoking certain benefits and coverage for young and vulnerable Medicaid populations remains extremely unpopular at both the state and federal levels, which encourages our view that both EPSDT and IDD providers will be relatively insulated from deep cuts.

Despite budgetary pressure and policy uncertainty, Capstone believes EPSDT and IDD providers face a lower risk of targeted cuts relative to other service lines. EPSDT's mandated comprehensive services enjoy bipartisan support, while IDD populations are exempted from work requirements as "medically frail," limiting enrollment losses. Though both segments face potential rate stagnation as a cost-cutting measure, statutory mandates and political resistance to cutting benefits to services for vulnerable populations provide relative insulation versus optional benefits.

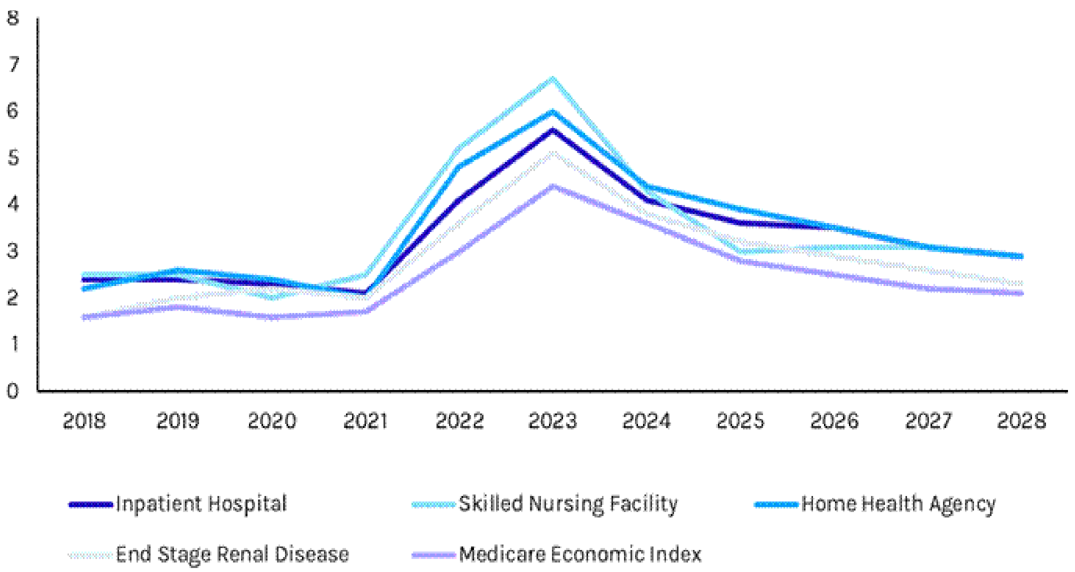
Declining Medicare Market Basket Updates Risk Underestimating Persistent or Sharp Increases in Inflation

Winners	Medicare providers benefit when CMS' prospective market basket estimates exceed actual cost growth. The ~3% 2026 updates provide margin expansion if inflation moderates toward the Federal Reserve's 2% target, as projected.
Losers	These same providers face asymmetrical downside risk. CMS' lag in responding to inflation spikes means sudden cost acceleration leaves them absorbing uncompensated input cost increases.

After finalizing 2026 market basket updates of ~3%, CMS expects that future updates will decline toward pre-pandemic levels by 2029. However, Federal Reserve policy shifts could alter this trajectory. Historical patterns show that CMS lags sudden inflation spikes without retroactive adjustments, creating margin risk for providers if inflation remains elevated. While the agency typically overestimates during stable periods, pandemic experience demonstrates significant downside when cost growth accelerates unexpectedly, leaving providers exposed to uncompensated increases in input costs.

EXHIBIT 1

CMS Market Basket Update Moving Averages for Q1, 2018–2028



Source: CMS