STATE OF NORTH CAROLINA
DEPARTMENT OF HEALTH AND HUMAN SERVICES

JOSH STEIN
GOVERNOR

DEVDUTTA SANGVAI
SECRETARY

August 11, 2025

Dear Legislative Leaders,

Thank you for your ongoing partnership and support for the health and well-being of North Carolinians. The North Carolina Department of Health and Human Services (NCDHHS) is proud of the NC Medicaid program we have built together, which now serves over 3 million people.

On July 16, we shared updated projections with the General Assembly for the State Fiscal Year (SFY) 2025–26 Medicaid rebase – the funding needed to maintain current services and provider payments. We shared that following a recent review of updated projections, new forecasts (based on SFY 2026 capitation rates from our contracted actuaries) have indicated that the rebase need is now $819 million, an increase from the $700 million in the Governor's budget, which was developed based on older data from January. We also noted that without full funding for the rebase, we would have to make cuts to the Medicaid program. On July 30, the NC General Assembly passed H125, which includes $600 million for both the Medicaid rebase and the Medicaid Oversight Fund. Given the program's administrative requirements, this appropriation results in only $500 million for the rebase, leaving a $319 million shortfall.

The Medicaid rebase has fallen short in recent years, but the state was able to compensate for that underfunding by using federal COVID (and other) funding. Those funds and options are no longer available. Therefore, the current underfunding of the Medicaid rebase by the General Assembly requires painful cuts to Medicaid. By the end of this month, NCDHHS will begin to cut $319 million from Medicaid by implementing rate reductions of 3% across all providers, as well as rate reductions of 8% or 10% for select providers, and elimination of certain services altogether – all with an effective date of October 1, 2025. These reductions carry serious and far-reaching consequences. Most immediately, reduced rates and the elimination of services could drive providers out of the Medicaid program, threatening access to care for those who need it most.

To meet an effective date of October 1, we must begin several administrative steps now, including notifying providers and beneficiaries, updating contracts and systems, and informing our federal partners at the Centers for Medicare and Medicaid Services (CMS). We have attempted to make these cuts reversible in the event that additional funding is approved. Absent additional appropriations by the General Assembly, however, NCDHHS will proceed with the reductions described herein.

The attached spreadsheet provides additional details about the service and rate cuts that will be required.

Background on Rebase and Guiding Principles for Determining Reductions
Medicaid rebase is the amount of funding required to maintain current service levels for beneficiaries. The primary drivers of the rebase amount are largely medical cost inflation, scheduled changes in the federal medical assistance program (FMAP), and increased service utilization. The request accounts for costs of enrollees in Medicaid Direct (Fee for Service), enrollees in Standard, Tailored, and Medicaid Direct Behavioral Health prepaid health plans, and the Children and Families Specialty Plan (planned to launch in December 2025). Medicaid expansion is not part of the Medicaid rebase funding because it does not utilize state general funds

NCDHHS established principles to guide the approach to cuts that aimed to minimize direct impact on beneficiaries and providers where possible; however, with financial limitations of this magnitude, that is impossible to avoid. NCDHHS prioritized the following principles:

- Minimizing impact to services for vulnerable populations like children and people with disabilities
- Minimizing impact to critical behavioral health services so the state can continue making progress in addressing the current behavioral health crisis
- Minimizing impact to providers who have not had rate increases for over a decade
- Minimizing impact to home and community-based services, as the alternative is higher cost care in institutional settings
- Making reductions that are more easily reversible, such as implementing provider rate cuts versus eliminating whole service lines, so that if more funds are appropriated to NCDHHS, or utilization pointed to a more favorable forecast over time, the reductions could be more easily reversed.

Unfortunately, these principles conflicted with each other at times, or it was unavoidable to impact a prioritized service or population. When that was the case, NCDHHS worked hard to minimize the reduction as much as possible.

Planned Rate and Service Reductions
In a managed care environment, NCDHHS is required by federal regulations to provide actuarially sound capitation rates to managed care organizations. Therefore, there are only two ways to address a shortfall from an insufficient rebase: reduce optional services and/or reduce provider rates. The significant size of the funding gap ($319 million) requires a broad-based approach. Every provider will sustain a minimum of a 3% rate cut, with some services absorbing substantially larger cuts. The attached spreadsheet details the reductions, and key points are below.

- **Enhanced Rate Reductions:**
    - Institutional settings: Inpatient and residential services make up a significant share of the overall Medicaid service expenditures. It is impossible to fill the funding gap without making reductions to acute care hospitals, nursing homes, psychiatric residential treatment facilities (PRTFs), and intermediate care facilities (ICFs). They will have rate reductions of 10%, except ICFs which will have an 8% reduction.
    - Curbing excessive utilization growth: Researched-based Behavioral Health Therapy/Applied Behavior Analysis (RB-BHT/ABA) is a service primarily for individuals with autism and other related diagnoses. Across the country, utilization of this service in North Carolina has grown much faster than expected. To ensure children who truly need this care can get timely access and high-quality treatment, NCDHHS is more closely evaluating the reasons for rapidly growing utilization of this service. A rate reduction is being implemented to help control costs while exploring and implementing other controls to manage the program. Consequently, this service will have a rate reduction of 10%.
- **Pre-paid Health Plans (PHPs)**: The managed care organizations that operate the Standard Plans will sustain a reduction to their capitation rate of 1.5%. CMS requires NCDHHS to pay PHPs an actuarially sound rate. NCDHHS uses the lowest rate possible within an actuarially sound rate range, however, CMS allows states the

flexibility to adjust rates up or down by 1.5% without requiring additional actuarial certification. This gives NCDHHS the flexibility to make the reduction and still comply with federal requirements. This reduction will be retroactive to July 1, 2025. Based on federal managed care requirements, there are no other financial adjustments that can be made that would be directly borne by the PHPs.

- **Optional pharmacy coverage**: NCDHHS will end the optional coverage of GLP-1 drugs for obesity/weight loss. This benefit was added in 2024 with the expectation that by treating obesity, which affects more than one in three North Carolinians, we can reduce future costs because these individuals are less likely to suffer from chronic conditions that are costly to treat (such as diabetes, hypertension, and heart disease) and harmful for their health. This expectation has not changed, but NCDHHS cannot continue to cover these drugs for this purpose at current appropriation levels. GLP-1s would still be covered for other clinical needs like diabetes and heart disease as required by the federal government.

Administrative Reductions

NC Medicaid is also facing significant challenges due to inadequate operational and administrative funding. The allocation provided by H125 fell short of what is needed to support essential Medicaid operations and critical technology investments. As a result, substantial cuts are being made to the operations of the Medicaid program, including ending or reducing contracts, reducing temporary employees who perform critical permanent functions, halting key projects, and scaling back compliance and quality activities. These cuts will significantly impair NC Medicaid's ability to be responsive to emerging needs and inquiries, monitor services for quality and compliance, and continue making timely operational improvements. North Carolina will no longer be able to depend on the level of service that providers and individuals have come to expect – service that is foundational to the success of the intentionally designed managed care program.

Additional Pressures on NC Medicaid

In addition to the Medicaid rebase shortfall, NC Medicaid is confronting several other significant challenges. With multiple fiscal uncertainties and programmatic changes unfolding simultaneously, the full impact of these variables this year and in future years is difficult to predict with certainty. NCDHHS is committed to closely monitoring these developments to understand their effects on the state budget, program operations, and the individuals we serve. We will continue to engage regularly with state leadership, providing timely updates and communicating what resources are necessary to prioritize the health and well-being of North Carolinians.

Key additional budgetary and administrative challenges include:

- The federal reconciliation law (H.R.1) introduces new requirements, including Medicaid work requirements and increased frequency of eligibility determination, without providing sufficient funding for implementation and creating significant administrative strain on counties.
- H125 did not fund the Healthy Opportunities Pilots (HOP), and as a result, DHHS has ended this program. HOP has reduced medical spending by $1,000 per member per year. Without HOP, NC Medicaid loses a critical tool to improve health and generate cost savings to the Medicaid program in future years.
- NC Medicaid had planned to begin working on the re-procurement of Standard Plan contracts and Tailored Plan contracts, which was an opportunity to ensure program sustainability, provide additional value for the state, and most importantly, improve the member and provider experience in ways that lead to better clinical outcomes. However, lack of necessary administrative funding and the scale of ongoing changes makes it impossible to responsibly rewrite the requirements for those contracts now given the uncertainty of what the NC Medicaid program will look like after the implementation of federal and state cuts. NCDHHS will delay these re-procurements by two years.

The below outlines the requested funding for NC Medicaid that was included in the Governor's budget and the funding that was ultimately allocated in H125.

	Requested Funding	Funding in H125	Shortfall
Medicaid Rebase	$819 million*	$600 million *$500 million for Rebase $82 million for Oversight $18 million for missing LME/MCO transfer***</br>	$319 million (=819-500)
Medicaid Managed Care Oversight Fund	$115 million		$33 million (=115-82)
Technology for NC Medicaid	$13 million	$0	$13 million

*Notice sent to the General Assembly of revision on July 16, 2025. Initial request from the Governor's budget was $700 million.
**By not including this item, H125 effectively reduces $18 million in receipts from the Medicaid budget. Subtracting this $18 million from the $100 million for operations leaves $82 million, approximately the amount that was funded for Medicaid oversight in the earlier House and Senate budget bills.

Conclusion

Over the past decade, NCDHHS has worked in partnership with the North Carolina General Assembly to transform the NC Medicaid program into a national model that comprehensively and strategically addresses the health needs of over 3 million North Carolinians. We remain committed to access, quality, safety, and whole-person health and well-being.

Despite careful efforts to minimize harm, the reductions now required carry serious and far-reaching consequences. Most immediately, reduced rates and the elimination of services could drive providers out of the Medicaid program, threatening access to care for those who need it most. Over time, the combination of underfunding, the loss of key multi-year infrastructure investments like the Healthy Opportunities Pilots, federal mandates that increase administrative burden without necessary resources, and administrative budget shortfalls risks a fundamental erosion of the NC Medicaid program.

NCDHHS remains hopeful that additional appropriations can be made to prevent these reductions. In the absence of additional funding, however, we must take the necessary steps to implement the legislative reductions by October 1, 2025. The NCDHHS team is available to discuss the details of these plans at your convenience.

Sincerely,

Devdutta Sangvai, MD, JD, MBA
Secretary