CMS Guidance Overview: 1115 Medicaid Demonstration Budget Neutrality

On June 11, 2026, the Centers for Medicare & Medicaid Services (CMS) released a State Medicaid Director Letter outlining how it intends to implement the new statutory budget neutrality requirements for Medicaid section 1115 demonstrations under H.R.1.

Beginning Jan. 1, 2027, CMS may not approve a new Medicaid section 1115 demonstration, renewal, or amendment unless the CMS Chief Actuary certifies that demonstrations will not increase federal expenditures relative to what Medicaid would otherwise spend. This new requirement applies to Medicaid demonstrations in all states, Washington, D.C., and all U.S. territories. Notably, the requirement does not apply to Children's Health Insurance Program (CHIP) 1115 demonstrations.

CMS is shifting toward a prospective certification, requiring states to provide more rigorous actuarial analysis and financial modeling regarding their 1115 demonstration waivers. States will now need to demonstrate –upfront, and in greater detail, how each component of their demonstrations affects federal spending.

Key Implications for States

- **Budget neutrality will become a gating requirement**. Demonstrations must be prospectively shown not to increase federal Medicaid expenditures in order to be approved.
- **Reduced reliance on long-term savings.** States will have less ability to rely on long-term savings to support demonstrations, with fewer activities to generate savings.
- **More activities will require detailed financial justification.** CMS is narrowing the definition of baseline spending, and programs that can't demonstrate meaningful progress toward their original goals may need to be reworked.
- **Stricter renewal standards.** Existing demonstrations will face tighter scrutiny and higher thresholds for continued approval.

Key Provisions

- **Two Categories for Section 1115 waivers**
    - CMS categorizes all demonstration activities into two groups, which will influence how activities are treated for budget neutrality.
        - *Medicaid Authorizable Populations and Services (MAPS):* Activities involving populations and services that could otherwise be covered under the Medicaid State Plan. These activities are treated as baseline spending and do not generate cost savings.

        - *Section 1115-only activities:* Activities not coverable under the Medicaid State Plan will need detailed, activity-level financial modeling.
    - To qualify as MAPS, the specific population–service combination must be allowable under the State Plan.
- **No expenditure caps**
    - There will no longer be formal expenditure caps or budget neutrality limits under this new framework. Instead, CMS will determine upfront whether a proposal increases federal Medicaid expenses. If it does, CMS will not approve the demonstration, amendment, or renewal.
- **Significant limitations on savings rollover**
    - States may now only use savings generated within the current demonstration period (up to 5 years), compared to the previous allowance of carrying up to 10 years of savings. CMS acknowledges that this approach would reduce state savings compared to the current framework.
- **Administrative costs included**
    - Previously, only service costs were included in the budget neutrality tests. Moving forward, states must include both service costs and administrative costs in their budget neutrality assessments.
- **Deemed budget neutral authorities eliminated**
    - CMS previously automatically deemed certain authorities as budget neutral (territories, Traditional Health Care Practices, single managed care plan authority). These activities must now satisfy the new standard under either MAPS or Section 1115-only standards.
- **Shorter demonstration periods**
    - New demonstrations will be limited to 5 years and will face stricter renewal requirements.

Key Threats to Active 1115 Demonstrations

- **Reduced flexibility to support higher cost activities**
    - Infrastructure investments and other higher cost investments must now be fully justified through financial analysis as well, making them more difficult to sustain.
- **Greater scrutiny and uncertainty**
    - The shift from presumed neutral spending to requiring affirmative justification and greater scrutiny will make renewal of demonstrations less certain.
- **Higher approval and renewal risk**
    - Demonstrations will face a greater likelihood of denial or required modification.
- **Increased burden and timelines**
    - States will need to provide more detailed information about eligibility criteria, service coverage, payment methodologies, and payment rates. This will likely result in longer approval timelines and risk of discontinuation of demonstration programs.