



Memorandum

To: Joint Budget Committee Members
From: Craig Harper, JBC Staff (303-866-3481)
Date: February 20, 2026
Subject: Budget Stress Test as of February 2026

Summary

The last several budget processes have included extensive discussions of the State's structural deficit, with ongoing expenditures exceeding annual General Fund revenues. The deficit and shortfall persist for FY 2026-27, as evidenced by the Governor's proposals to both reduce expenditures across many agencies (particularly for Medicaid) and to access hundreds of millions of dollars in one-time funds. The Committee has already approved numerous reductions to Medicaid funding through the FY 2025-26 supplemental process, with many proposals seeking to "bend the cost curve" to make Medicaid funding sustainable.

However, even with those reductions, the Governor's balancing plan for FY 2026-27 uses more than \$1 billion in one-time funding over two years (FY 2025-26 and FY 2026-27) to balance, including:

- \$400.0 million from the conversion of Pinnacol in FY 2026-27 (Statewide request R1).
- \$334.2 million in spending from the General Fund reserve by reducing the reserve requirement from 15.0 to 13.0 percent for FY 2025-26 and FY 2026-27.
- \$249.8 million in additional cash fund transfers between FY 2025-26 (\$222.8 million) and FY 2026-27 (\$38.7 million). This amount adds to extensive cash fund transfers approved during the past two sessions.
- Roughly \$181.5 million made available through proposed reductions to the projected TABOR refund from FY 2026-27 revenues, with a similar amount in FY 2027-28 (primarily through Statewide Request R2).

If feasible, the proposed one-time changes would help with the gap for FY 2025-26 and FY 2026-27 but not the underlying structural issues. Similar to the stress test presented in [February 2025](#), this year's modelling shows the State spending down the reserve each year, with the reserve completely depleted by the end of FY 2029-30 under the "baseline" scenario.

Addressing the ongoing shortfall will require significant structural change to expenditures, revenues, or both. Given the scale of the deficit, closing the gap by reducing expenditures would require *ongoing* reductions equating to hundreds of millions of dollars per year. The Governor's request for FY 2026-27 focuses on Medicaid appropriations in the Department of Health Care Policy and Financing. Staff agrees that constraining the growth in Medicaid will be a necessary component. However, staff's analysis indicates that closing the gap will almost certainly require significant reductions to other "big six" departments with large General Fund appropriations.

2026 Stress Test

Given the ongoing nature of the shortfall, legislative staff have sought to provide longer-term projections of the health of the General Fund. JBC Staff and Legislative Council Staff (LCS) first presented a budget “stress test” in February 2025. The tool allows one to visualize the budget over a longer period (five years rather than three under the standard revenue forecast) and under multiple economic scenarios. It is a useful tool to assess the stress on the State’s fiscal health – but it cannot replace the detailed revenue forecasts and General Fund overviews used for budget balancing.

The test allows for visualizations under three scenarios through FY 2029-30:

- *Baseline:* Models revenues and expenditures *without a recession*.
- *Moderate Recession:* A 6.6 percent decrease in General Fund revenues hitting in FY 2026-27. This scenario reflects roughly half the impact of the severe recession.
- *Severe Recession:* A 13.2 percent decline in General fund revenues in FY 2026-27. This scenario mirrors the revenue contractions and inflationary pressures following the 2001 recession. **Staff has not included modeling for the severe recession scenario in this document.**

JBC Staff and LCS have updated the stress test for the 2026 session to include:

- The December 2025 LCS revenue forecast.
- The Committee’s decisions for FY 2025-26 through the supplemental package.
- The Governor’s request for FY 2026-27, including changes to revenues (transfers in and out of the General Fund), appropriations, and the balancing proposals impacting Pinnacol and the TABOR refund.

As was the case in the 2025 stress test, the State budget cannot sustain its current trajectory. The State continues to spend more General Fund than it is taking in each year, relying on one-time revenues to prop up the expenditures. Assuming adoption of the Governor’s request for FY 2026-27 and then projecting forward with the assumptions discussed in the following section, the 2026 stress test shows the General Fund reserve gone by FY 2029-30 *even without a recession*. Under the moderate recession scenario, the reserve is essentially gone by the end of FY 2026-27. Sustaining a viable reserve will require structural change to revenues and/or obligations.

General Fund Obligation Assumptions

Assumptions for FY 2025-26 and FY 2026-27 align with current law as adjusted by the supplemental package and the Governor’s request. For the outyear projections, all scenarios assume the following expenditure increases. These are not predictions; the goal is to illustrate plausible scenarios based on reasonable assumptions.

- *Medicaid/Health Care Policy and Financing (HCPF):* General Fund obligations grow by inflation plus population plus 2.0 percent, resulting in growth of 5.6 to 5.8 percent per year. As the largest annual use of General Fund, Medicaid growth is a key variable in this analysis. Growth has far exceeded that assumption in recent years. Staff is concerned that the baseline assumption may be overly optimistic.
- *K-12 Education:* Appropriations for the baseline scenario align with current law for the implementation of H.B. 24-1448, as modeled by LCS and JBC Staff. Under the moderate recession scenario, staff assumes a two-year pause in the implementation of the new school finance formula enacted in H.B. 24-1448.
- *Higher Education:* General Fund appropriations grow by inflation plus 1.0 percent (roughly 4.0 percent per year through FY 2029-30). Higher Education funding is more discretionary than many of the caseload-driven

appropriations in the other “big six” departments. The General Assembly often reduces higher education funding during revenue shortfalls. However, General Fund growth has averaged far higher than that in recent years. Annual growth was above 10.0 percent per year for FY 2021-22 through FY 2024-25, decreasing to 2.9 percent in FY 2025-26.

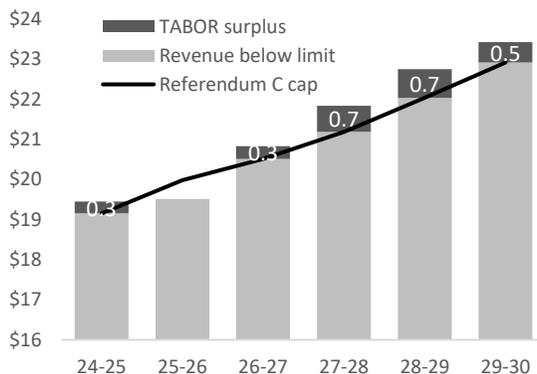
- *Human Services:* General Fund appropriations grow by inflation plus population plus 1.0 percent (averaging 4.6 to 4.8 percent per year). JBC Staff agrees that the rate appears reasonable based on recent years (with 4.9 percent growth in FY 2025-26 and 4.7 percent proposed for FY 2026-27).
- *Corrections:* General Fund appropriations grow by inflation (3.0 percent per year). This mirrors recent growth, with Corrections having grown just below the inflation rate since FY 2021-22. However, increasing prison population caseload is exerting upward pressure on the budget at this point.
- *Judicial:* General Fund appropriations grow by inflation plus population growth (3.6 to 3.8 percent per year). That approximates the growth in FY 2025-26 (3.9 percent) and the FY 2026-27 request (3.7 percent).
- *All Other Appropriations:* General Fund appropriations to all other departments increase by inflation plus population growth (3.6 to 3.8 percent)

Each of these assumptions appears reasonable (if not overly optimistic in the case of Medicaid) given recent growth. However, annual General Fund obligations already exceed annual General Fund revenues. The assumptions outlined above require obligations to increase faster than the Referendum C cap would allow for revenues. In short, total expenditures cannot grow at that rate without additional revenue.

Baseline Scenario

Revenue: The baseline scenario assumes a 5.0 percent annual increase in General Fund revenues in FY 2028-29 and FY 2029-30, prior to the application of the EITC and FATC tax credits. The baseline scenario assumes that the tax credits are triggered on throughout the forecast period, which reduces the rate of growth to 3.5 percent in FY 2028-29 and 3.1 percent in FY 2029-30. Because state revenue is constrained by TABOR in the baseline scenario, the revenue growth rate has a muted effect on the budget situation if a recession does not occur.

Figure 1: Under baseline scenario, TABOR revenues exceed the cap after FY 2025-26 (\$ in billions).



TABOR: 3.0 percent rate of inflation for FY 2028-29 and FY 2029-30 and 1.0 percent population growth, resulting in a 4.0 percent annual increase in the TABOR/Referendum C limit. With the exception of the current year, total TABOR revenues (including General Fund and cash funds) exceed the TABOR/Referendum C cap throughout the modelled period, with refunds ranging from \$319.3 million in FY 2026-27 (December LCS Forecast as adjusted by the Governor’s request) to \$712.9 million in FY 2028-29 (see Figure 1).

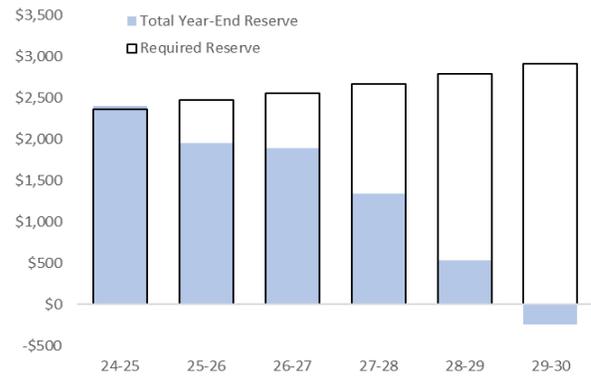
However, using the expenditure assumptions outlined above, obligations continue to exceed annual revenues each year. For FY 2026-27, the Governor’s request proposes to fill the gap with a variety of one-time revenues as well as the use of more than \$300 million from the General Fund

reserve. For FY 2027-28 through FY 2029-30, the model assumes that the reserve will cover the entire shortfall each year. Under that scenario, the reserve is exhausted entirely by FY 2029-30 (see Figure 2).^{1, 2}

As a percent of appropriations, the reserve would fall to 11.6 percent of appropriations in the current year. Under the model, the balance of the reserve decreases by hundreds of millions of dollars per year beginning in FY 2026-27.

Staff knows the General Assembly would not allow this scenario to play out this way but offers an illustration of the challenges ahead under reasonable “business as usual” assumptions, even in the absence of a recession.

Figure 2: Projected General Fund obligations would deplete the reserve without a recession (\$ in millions).



Changing Assumptions – Pinnacol, Statewide R2, and Medicaid

Staff is including two variations of the baseline scenario to illustrate the impact of changes to two prominent assumptions.

Figure 3 (at right) shows the projected General Fund reserve if one excludes the revenues from Statewide R1 (Pinnacol Conversion) and Statewide R2 (TABOR Over-Refund). That change eliminates \$548.0 million in revenue in FY 2026-27 and \$148.0 million in FY 2027-28. Holding expenditures at the assumed levels depletes the reserve much faster under this scenario. The reserve is “negative” in FY 2028-29.

Figure 3: Eliminating Statewide R1 and Statewide R2 accelerates the depletion of the reserve.

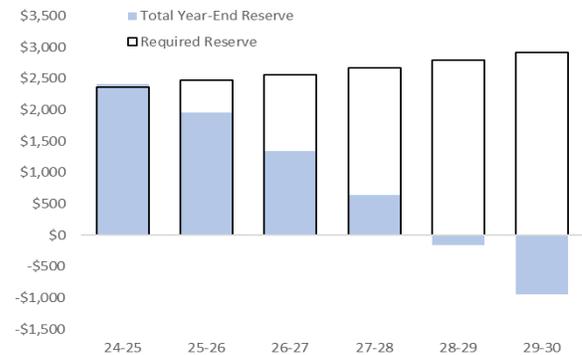
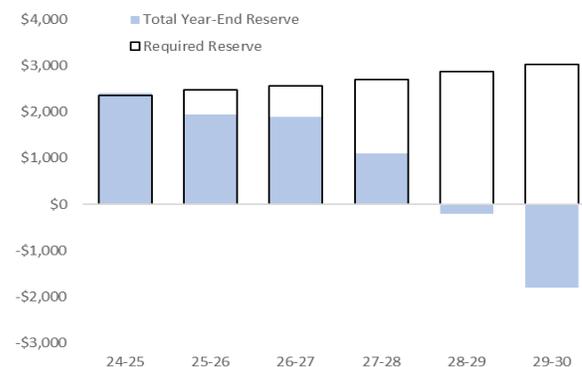


Figure 4 (bottom right), on the other hand, leaves Statewide R1 and R2 in place but increases the growth rate for General Fund in Medicaid (total General Fund appropriations to the Department of Health Care Policy and Financing) to 9.6 percent per year for FY 2027-28 through FY 2029-30. JBC Staff calculated that percentage based on the compound average annual growth rate (CAAGR) for the past ten years. The reserve is gone in FY 2028-29 with those assumptions.

Figure 4: If General Fund for Medicaid grows by 9.6 percent per year, the reserve is gone in FY 2028-29.



¹ For simplicity, these scenarios ignore the fact that the reserve currently includes \$500.0 million transferred to PERA through S.B. 25-310 that would not actually be accessible. The “accessible” reserve balance is \$500 million lower in any given year.

² The reserve cannot go negative as depicted in the various figures. Graphics are simply an illustration of the shortfall.

Moderate Recession Scenario

Consistent with the 2025 test, the moderate recession scenario reduces General Fund revenues by 6.6 percent in FY 2026-27, with a further reduction of 1.4 percent in FY 2027-28, before rebounding with 8.0 percent growth in FY 2028-29. Inflation also decreases each year relative to the baseline scenario, staying below 2.0 percent for FY 2026-27 through FY 2028-29 before returning to the baseline assumption of 3.0 percent in FY 2029-30. As a result, both General Fund revenues and the Referendum C cap decrease relative to the baseline scenario. The tax credits trigger off under this scenario, mitigating some of the revenue impact. Still, revenues stay below the Referendum C cap through FY 2029-30 (see figure 5 at right).

Figure 5: In a moderate recession, revenues remain below the Referendum C cap (\$ in billions).

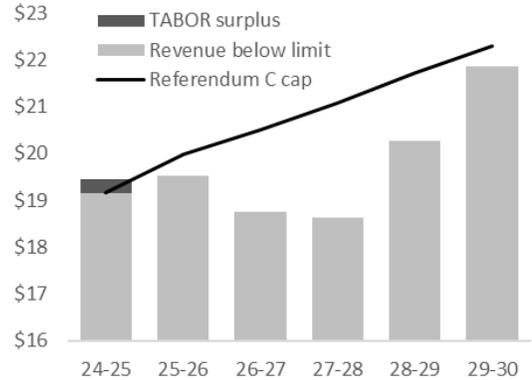
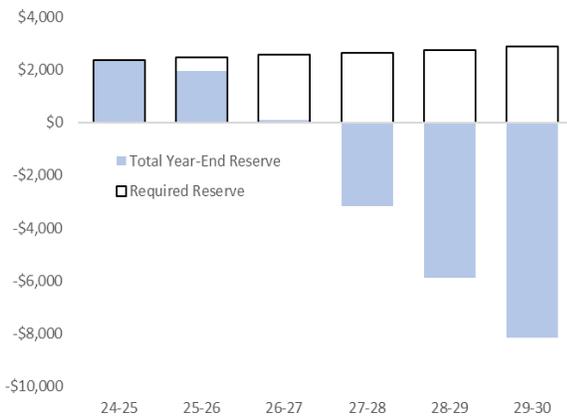


Figure 6: Maintaining projected expenditures in the moderate recession scenario depletes the reserve in FY 2026-27.



Expenditures do actually fall relative to the baseline scenario because the model indexes growth to inflation. So, for example, General Fund appropriations for Medicaid grow by 4.6 percent in FY 2027-28 and 4.3 percent in FY 2028-29 rather than by over 5.0 percent. Still, trying to maintain the assumed expenditures with this drop in revenues depletes the reserve much faster than the baseline scenario. The reserve is nearly gone in FY 2026-27 (Figure 6 at left).

The combination of the underlying structural issues (visible in the baseline scenario) and the projected revenue reductions from the recession mean that the State cannot sustain a reserve beyond the first year of the recession.

Conclusions

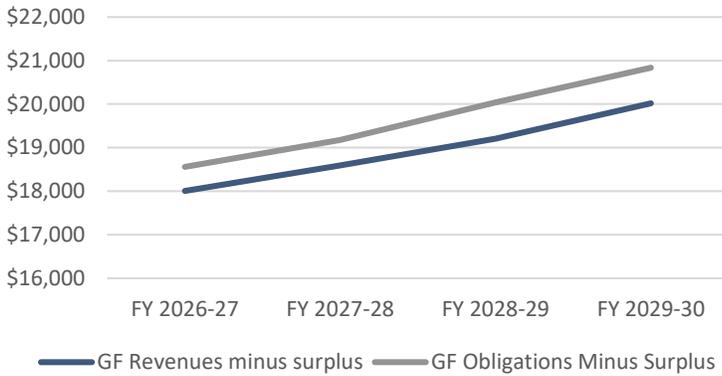
The 2026 stress test is little changed from the 2025 version because of the persistent structural deficit between revenues and expenditures. As a straightforward measure, excluding the TABOR surplus from both revenues and obligations allows for the comparison of *annual* General Fund revenues and obligations.

- To avoid spending the reserve and stay within annual revenues, obligations excluding the TABOR refund cannot exceed revenues excluding the surplus.
- To refill the reserve using annual General Fund revenues would require revenues to exceed obligations.
- Applying this metric to the Governor’s FY 2026-27 request under the December LCS forecast, General Fund obligations are roughly \$552 million higher than revenues. Excluding the impact of Statewide R2 on the TABOR refund increases the deficit to \$700 million. (The deficit would be wider under the OSPB forecast.)

Figure 7 on the following page shows the projected gap between annual General Fund revenues and obligations for FY 2026-27 through FY 2029-30 under the baseline scenario. Both values exclude the TABOR surplus for each year, providing a comparison of *available* General Fund and obligations. Under the assumptions outlined above,

the gap grows from \$552.1 million in FY 2026-27 to more than \$800.0 million in in FY 2028-29. These values also do not account for any reserve requirement attached to the increasing obligations.

Figure 7: Annual General Fund obligations exceed annual revenues by at least \$500 million per year under the baseline scenario.



As with previous charts, FY 2026-27 and FY 2027-28 reflect the December 2025 LCS forecast for revenues. FY 2026-27 reflects the Governor’s request for obligations, including the TABOR refund reduction associated with Statewide R2 in both FY 2026-27 and FY 2027-28.

While the scenario is simply an illustration of reasonable assumptions, it is clear that addressing the ongoing structural issue will require the General Assembly to close that gap. In order to add to the reserve (or even maintain it as a fixed percentage of

appropriations), annual revenues would have to exceed annual obligations.

FY 2026-27 Budget

For the FY 2026-27 budget process, JBC Staff continues to present balancing options related to virtually every department. For the purposes of the stress test discussion, staff offers the following broad points to consider.

- Addressing this degree of shortfall will require large scale changes to expenditures and/or revenues.
- Staff assumes that changes will be spread across all departments, or at least all departments that receive General Fund appropriations.
- However, addressing the shortfall by reducing expenditures will require large reductions that are only possible in Departments with a lot of General Fund.

The “big six” departments (HCPF, Education, Higher Education, Human Services, Corrections, and Judicial) account for roughly 90.0 percent of the current FY 2025-26 General Fund appropriation. **Barring the elimination of General Fund for entire divisions or departments elsewhere, staff assumes that the vast majority of reductions will have to come from the big six.**

Health Care Policy and Financing

Including the net increase appropriated in the FY 2025-26 supplemental bill, the Department of Health Care Policy and Financing (HCPF) accounts for \$5.7 billion General Fund in FY 2025-26, or 32.8 percent of the total General Fund appropriation in the current year. The Governor’s request for FY 2025-26 and FY 2026-27 focuses on reductions to Medicaid, and JBC Staff agrees that bending the cost curve for Medicaid will be essential to closing the gap. However, staff believes that even the baseline scenario of the stress test may be overly optimistic with regard to constraining Medicaid growth. As noted above, that scenario has General Fund appropriations for HCPF growing by less than 6.0 percent per year, while the CAAGR for the last 10 years is 9.6 percent. Keeping growth below 6.0 percent ongoing would require major ongoing change – and would still require large reductions elsewhere to close the overall gap (as shown in the baseline scenario).

- The Committee is already addressing a large number of proposed reductions to HCPF through supplemental adjustments.
- Figure setting presentations are scheduled for March 6, March 9, and March 11.

Education

Education is the second largest recipient of General Fund, with 27.6 percent of current appropriations. The vast majority of that amount is in school finance. Another large share is in categorical programs – but the General Assembly cannot reduce total appropriations to the categorical programs. The Committee will hear a number of reductions and staff balancing proposals outside of school finance, which could equate to significant ongoing savings. However, getting larger savings would require adjustments to school finance. Within school finance, reducing the state share of funding requires either increasing the local share or reducing total program funding (with multiple options available).

- The Committee heard the figure setting presentation for school finance and categorical programs on February 19.
- Figure setting for all other programs is scheduled for February 25.

Higher Education

Higher Education accounts for 9.9 percent of the current FY 2025-26 General Fund appropriation (including adjustments in the supplemental package). Higher Education funding has grown rapidly in recent years, with General Fund appropriations increasing by more than 60.0 percent since 2018. Higher Education also frequently sees significant General Fund reductions during downturns, in part because it is the one member of the big six that can offset reductions with tuition increases.

- Figure Setting for Higher Education is scheduled for March 10.

Human Services, Corrections, and Judicial

Staff is grouping Human Services, Corrections, and Judicial because the General Fund appropriations to all three departments are largely driven by State FTE. In these agencies, large General Fund reductions will require much more direct impact on state staffing. For example, large General Fund reductions are likely to require layoffs in sensitive facilities (Human Services and Corrections) or Judicial Branch operations (courts, public defense, etc.).

To the extent that the Committee balances through changes to employee compensation, these Departments are where the large General Fund changes show up simply because of the number of State FTE. Changes to compensation would be a mechanism to constrain the growth of costs in these agencies. On the other hand, if the departments are unable to fill essential positions because of compensation issues then costs can actually increase (e.g., contract nurses in the State Hospitals).

- The Committee received the first Human Services figure setting presentation on February 12. Subsequent presentations are scheduled for February 24 and 27.
- Figure setting for the Department of Corrections is scheduled for March 5.
- All figure setting for Judicial is scheduled for March 12.