

CMS Releases 2026 IPPS Final Rule

On July 31, 2025, the Centers for Medicare & Medicaid Services (CMS) released its finalized payment and policy updates for the Medicare Inpatient Prospective Payment System (IPPS) and the Long-Term Care Hospital (LTCH) Prospective Payment System (PPS) for fiscal year (FY) 2026.¹ The final rule authorized Medicare inpatient reimbursement increases for 2026 and moved forward with improvements to quality measurement, and provided more information on a new value-based payment model. This Health Capital Topics article will discuss the IPPS final rule and stakeholder reactions.

CMS reimburses acute care hospitals prospectively determined rates per inpatient stay under the IPPS for two different payments: (1) the operating payment; and, (2) the capital payment.² The operating payment covers labor and non-labor (i.e., supplies) costs, while the capital payment covers costs for depreciation, interest, rent, and property-related insurance and taxes.³ The capital base payment rates under the IPPS have grown minimally, if at all, each year for the past decade. Growth rates in the operating base payment rates have been higher for FYs 2020 through 2022, likely due to the COVID-19 pandemic, but before this period, the rate typically exhibited relatively slow growth. After adjusting the base payment rates for regional wage variations and the patient's Medicare Severity Diagnosis Related Group (MS-DRG) classification, the IPPS payment may be further modified by several factors that account for each hospital's specific characteristics. CMS annually updates the IPPS payment rates, including "updates to the base rates, wage indexes, MS-DRG definitions and weights, and the outlier fixed loss amount."⁴ The base rates are updated, similar to the other Medicare payment programs, based on the applicable market basket index and productivity adjustments.⁵

CMS reimburses LTCHs (which are differentiated from acute care hospitals by their average length of stay – typically in excess of 25 days) similarly, paying a per-discharge rate that is meant to cover the operating and capital costs of "efficient providers" and are adjusted geographically and for case mix.⁶ CMS annually updates LTCH PPS payment rates similar to the IPPS, based on the applicable market basket index and productivity adjustments.⁷

The final rule includes a 2.6% payment increase for hospitals that report quality data through the Hospital Inpatient Quality Reporting (IQR) Program and are

meaningful users of electronic health records (EHRs).⁸ This rate increase, which is 0.2% higher than the proposed payment rate,⁹ is comprised of a projected hospital market basket percentage increase of 3.3%, reduced by a 0.7% productivity adjustment.¹⁰ CMS estimates hospital payments to increase by an adjusted total (after various decreases) of \$5 billion in FY 2026 (including an increase in payments to disproportionate share hospitals of \$2 billion).¹¹

Additionally, CMS finalized LTCH-PPS payment increases of approximately 2.7%, comprised of a projected LTCH PPS market basket percentage increase of 3.4%, reduced by a 0.7% productivity adjustment.¹² This is expected to increase LTCH PPS payments by approximately \$72 million.¹³ CMS also increased the LTCH outlier threshold for FY 2026, based on updated data; this is in response to "the statutory requirements that estimated outlier payments are approximately 8% of total payments."¹⁴

The IPPS/LTCH Final Rule ends CMS's low wage index hospital policy, in response to a federal court ruling that HHS lacked authority to adopt the policy.¹⁵ The policy, which began in FY 2020, provided additional reimbursement to hospitals in certain low-wage areas (largely rural hospitals).¹⁶ CMS will phase out the policy via a transitional year for FY 2026 for low wage index hospitals significantly impacted by the policy discontinuation.¹⁷

Beyond payment changes, the IPPS/LTCH Final Rule includes numerous changes to quality reporting programs. The Hospital Inpatient Quality Reporting (IQR) Program and Long-Term Care Hospital Quality Reporting Program (LTCH QRP) are pay-for-reporting quality programs that require the submission of certain quality data to CMS and reduces payments to hospitals that do not meet program requirements.¹⁸ In the Final Rule, CMS modifies four current Hospital IQR Program measures (largely technical updates and reducing the performance period sought) and removes the following four measures:

- Hospital Commitment to Health Equity;
- COVID-19 Vaccination Coverage among Health Care Personnel;
- Screening for Social Drivers of Health; and
- Screen Positive Rate for Social Drivers of Health.¹⁹

CMS also revises the LTCH QRP measures, modifying one reporting requirement and removing four social determinants of health patient assessment data elements.²⁰

In addition to not reporting under the Hospital IQR Program or the LTCH QRP, Medicare payments can also be reduced for hospitals that:

- Have excess readmissions (Hospital Readmissions Reduction Program);
- Have a relatively high incidence of hospital-acquired conditions (Hospital-Acquired Condition [HAC] Reduction Program); or
- Otherwise do not perform well relative to other hospitals on certain value-based measures (Hospital Value-Based Purchasing [VBP] Program).²¹

The IPPS/LTCH Final Rule made changes to all three of these programs. For FY 2027, the Hospital Readmissions Reduction Program will, among other changes add Medicare Advantage data to the six readmission measures and shorten the performance period from three years to two years. The HAC Reduction Program will update the CDC National Healthcare Safety Network (NHSN) healthcare-associated infections (HAI) chart-abstracted measures with the new 2022 baseline.²² The VBP Program will remove the health equity adjustment from the program scoring methodology, as well as modify and make technical updates to certain quality and mortality measures and establish performance standards for FYs 2027 through 2031.²³

In the IPPS/LTCH Final Rule, CMS finalized updates to the mandatory episode-based Transforming Episode Accountability Model (TEAM) that is set to take effect on January 1, 2026.²⁴ TEAM is a five-year mandatory episode-based payment model for selected acute care hospitals treating Traditional Medicare patients who are undergoing one of the following five surgical procedures:

- (1) Lower extremity joint replacement (LEJR);
- (2) Surgical hip femur fracture treatment (SHFFT);
- (3) Spinal fusion;
- (4) Coronary artery bypass graft (CABG); and
- (5) Major bowel procedure.²⁵

The model builds upon prior payment models, including the Bundled Payments for Care Improvement (BPCI) Advanced and Comprehensive Care for Joint Replacement (CJR) Models.²⁶ CMS will provide a “target price” for the entire 30-day episode (both surgery and follow up) for participants to meet.²⁷ TEAM, which aims to “incentivize care coordination, improve patient care transitions, and decrease the risk of avoidable readmission,” will be comprised of three tracks:

- (1) Track 1: no downside risk, less reward for up to three years;
- (2) Track 2: lower levels of risk and reward for years two through five; and
- (3) Track 3: higher levels of risk and reward for years one through five.²⁸

Industry trade groups were largely positive in their response to the IPPS/LTCH Final Rule. The Federation of American Hospitals President and CEO Chip Kahn stated that, “It’s encouraging that today’s [IPPS] rule provides a slightly higher market basket rate and increased support to hospitals that treat a disproportionately high number of uninsured patients, but the anticipated increase is not sufficient to make up for the recent historic levels of inflation nor expected increases in the number of uninsured Americans.”²⁹ Similarly, the American Hospital Association’s (AHA’s) senior vice president of public policy analysis and development stated:

“The AHA appreciates CMS’ recognition of the importance of an appropriate balance of burden and value in quality measurement programs, especially the sunseting of the COVID-19 vaccination coverage among healthcare personnel measure. The AHA is also pleased that CMS’ payment updates and support for hospitals that treat a disproportionately high number of low-income patients are improved in this final rule. However, we are still concerned that these updates are not adequate enough for the many hospitals that are struggling in today’s challenging operating environment, especially those in rural and underserved communities.”³⁰

The FY 2026 final rule will take effect October 1, 2025.³¹

- 1 “FY 2026 Hospital Inpatient Prospective Payment System (IPPS) and Long-Term Care Hospital Prospective Payment System (LTCH PPS) Final Rule — CMS-1833-F” Centers for Medicare & Medicaid Services, July 31, 2025, <https://www.cms.gov/newsroom/fact-sheets/fy-2026-hospital-inpatient-prospective-payment-system-ipps-and-long-term-care-hospital-prospective-0> (Accessed 8/18/25).
- 2 “Hospital Acute Inpatient Services Payment System” Medicare Payment Advisory Commission, Payment Basics, October 2024, https://www.medpac.gov/wp-content/uploads/2024/10/MedPAC_Payment_Basics_24_hospital_FINAL_SEC.pdf (Accessed 8/18/25).
- 3 *Ibid.*
- 4 *Ibid.*
- 5 *Ibid.*
- 6 “Long-Term Care Hospitals Payment System” Medicare Payment Advisory Commission, Payment Basics, October 2024, https://www.medpac.gov/wp-content/uploads/2024/10/MedPAC_Payment_Basics_24_LTCH_FINAL_SEC-2.pdf (Accessed 8/19/25).
- 7 *Ibid.*
- 8 Centers for Medicare & Medicaid Services, July 31, 2025.
- 9 Centers for Medicare & Medicaid Services, April 11, 2025.
- 10 Centers for Medicare & Medicaid Services, July 31, 2025.
- 11 *Ibid.*
- 12 *Ibid.*
- 13 *Ibid.*
- 14 *Ibid.*
- 15 *Ibid.*; Bridgeport Hosp. v. Becerra, 108 F.4th 882, 887-91 & n.6 (D.C. Cir. 2024).
- 16 Centers for Medicare & Medicaid Services, July 31, 2025.
- 17 *Ibid.*
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- 19 *Ibid.*
- 20 *Ibid.*
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- 24 “CMS finalizes updates to the Transforming Episode Accountability Model Program” By Whitney Phelps and Mukta Chilakamarri, Nixon Peabody, August 15, 2025, https://www.nixonpeabody.com/insights/alerts/2025/08/15/cms-finalizes-updates-to-the-transforming-episode-accountability-model-program?utm_medium=alert&utm_source=interaction&utm_campaign=healthcare (Accessed 8/19/25).
- 25 “Transforming Episode Accountability Model (TEAM)” Centers for Medicare & Medicaid Services, <https://www.cms.gov/priorities/innovation/innovation-models/team-model> (Accessed 8/19/25).
- 26 *Ibid.*
- 27 *Ibid.*
- 28 *Ibid.*
- 29 “CMS finalizes inpatient, LTC hospital Medicare payment hikes” By Bridget Early, Modern Healthcare, July 31, 2025, <https://www.modernhealthcare.com/politics-regulation/mh-medicare-pay-inpatient-hospitals-final-2026/> (Accessed 8/19/25).
- 30 “CMS issues hospital IPPS final rule for FY 2026” American Hospital Association, July 31, 2025, <https://www.aha.org/news/headline/2025-07-31-cms-issues-hospital-ipps-final-rule-fy-2026> (Accessed 8/19/25).
- 31 Phelps and Chilakamarri, Nixon Peabody, August 15, 2025.



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