

Industry Update

Ups and Downs in the President’s Proposed FY 2026 Budget

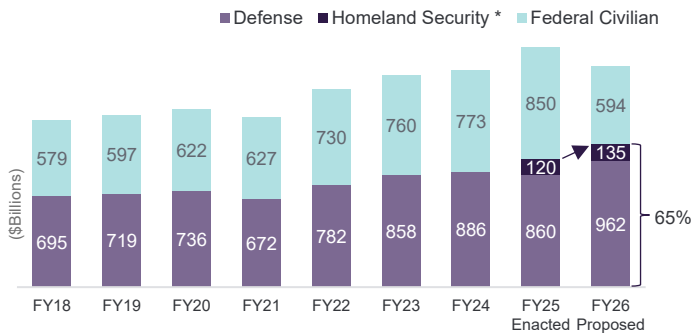
The President’s proposed FY 2026 budget reflects a shift in priorities toward national security and homeland security, and away from many domestic programs, a move that will cause the government contracting industry to adjust to these changes.

A direct correlation exists between discretionary federal spending and how much is outsourced to government contractors. In FY 2025, the defense and homeland security departments accounted for 54% of the discretionary budget. They are projected to rise to 65% in FY 2026.

In FY 2024, the government outsourced \$769 billion (\$B) – 46% of its \$1.66 trillion discretionary budget – to government contractors. Nearly \$474B (62%) of that went to defense contractors, and an even greater amount of ~75% went to the combination of those in national security sectors such as the Department of Defense (DoD), intelligence, and nuclear programs as well as homeland security contractors.

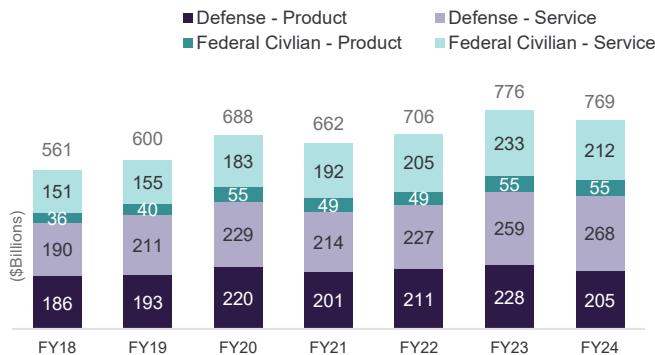
Contractors aligned with the DoD, the intelligence community, and Department of Homeland Security (DHS) are likely to see sustained opportunities and funding. Meanwhile, contractors that support federal civilian agencies may face reductions as funding for those agencies tightens.

U.S. Federal Government Discretionary Budget



* Prior to FY2025, Homeland Security previously included in chart under Federal Civilian

U.S. Federal Government Contracting Obligations



FY 2026 Proposed Budget Overview

The President’s FY 2026 budget proposal outlines \$1.7 trillion in total discretionary spending—a decrease from FY 2025’s \$1.83 trillion but higher than the \$1.66 trillion enacted for FY 2024. The proposal reflects a sharp prioritization of national security (defense, intelligence, nuclear) and homeland security while cutting many domestic programs.

- Department of Defense (DoD) funding is proposed to grow by 12% to nearly \$1 trillion, marking one of the largest increases in recent years.
- Homeland Security would see a 13% boost, rising to \$135 billion, largely for immigration enforcement and border security.
- Federal civilian (“FedCiv”) agencies are slated for a 30% reduction, from \$850.9 billion in FY 2025 to \$594.5 billion—their lowest level since 2017.

The Administration’s proposed FY 2026 budget calls for an overall reduction of 7.6% from 2025 levels. However, national security and homeland security priorities will receive more funding while federal civilian agencies are proposed to receive less.

73%

of spending areas will see
FY 2026 budget increases

27%

of spending areas will see
FY 2026 reductions

2026 Discretionary Budget Request by Major Agency (in billions of dollars)

Cabinet Department/Major Agency	YoY \$ Change	Total Funding 2026 Request	Total Funding 2025 Enacted	YoY % Change
Defense (including reconciliation resources)	\$101.50	\$961.60	\$860.10	12%
Homeland Security (including reconciliation resources)	\$15.40	\$134.90	\$119.50	13%
Veterans Affairs	\$5.40	\$134.60	\$129.20	4%
Commerce	\$4.30	\$8.50	\$4.20	102%
Changes in Mandatory Program Offsets	\$2.00	-\$34.00	-\$36.00	-6%
General Services Administration	\$1.40	\$.50	-\$.90	-156%
Social Security Administration (SSA)	\$.50	\$14.80	\$14.30	4%
Housing and Urban Development	-\$49.10	\$33.20	\$82.30	-60%
State and International Programs (includes USAID)	-\$49.10	\$9.60	\$58.70	-84%
Agriculture	-\$45.10	\$25.70	\$70.80	-64%
Health and Human Services	-\$33.50	\$95.30	\$128.80	-26%
Energy	-\$18.10	\$42.60	\$60.70	-30%
Education	-\$12.00	\$66.90	\$78.90	-15%
Transportation	-\$10.70	\$59.40	\$70.10	-15%
Environmental Protection Agency	-\$8.80	\$17.80	\$26.60	-33%
Interior	-\$8.20	\$14.40	\$22.60	-36%
Other Agencies	-\$8.10	\$21.10	\$29.20	-28%
National Aeronautics and Space Administration (NASA)	-\$6.00	\$18.80	\$24.80	-24%
National Science Foundation	-\$4.90	\$3.90	\$8.80	-56%
Labor	-\$4.60	\$9.00	\$13.60	-34%
Corps of Engineers	-\$3.50	\$6.70	\$10.20	-34%
Justice	-\$2.80	\$33.50	\$36.30	-8%
Small Business Administration (SBA)	-\$2.80	\$.70	\$3.50	-80%
Treasury	-\$2.70	\$11.50	\$14.20	-19%
Total	-\$139.50	\$1,691.00	\$1,830.50	

Important Note: Historically, Congress has tempered the President’s proposed budget, both increases and decreases. Recently, the One Big Beautiful Bill was passed and subsequently both the Senate Armed Forces Committee produced their draft FY 2026 National Defense Authorization Act (NDAA) and the DoD issued their proposed FY 2026 budget, all of which reinforces the planned increase in spending on national security, including a near \$1 Trillion DoD budget.

Congress is working on its proposed FY 2026 budgets for the government’s various federal civilian departments and agencies, and while some of the President’s proposed budget cuts are included, some departments are seeing flat or only slightly reduced budgets including NASA, FAA, NOAA (weather service), Agriculture/USDA/FDA, and Interior (national parks, fire prevention).

Budget Increases

Areas Expecting Larger Budgets (73% of proposed FY 2026 federal budget)

Several departments and initiatives are expected to receive meaningful increases, reflecting mission-critical national priorities:

- **Department of Defense (DoD):** The largest increase of \$102B (+12%) to nearly a record \$1T budget. Safety of the U.S. is the priority, including missile buildups with the proposed Golden Dome, naval spending focused on the Indo-Pacific region, and investment in space dominance. Expect additional spending on new aircrafts (F-47), more C5ISR systems, UAS & counter-UAS systems, nuclear deterrence, and new defense technologies.
- **Department of Homeland Security (DHS):** The increase of \$15.4B (+13%) to \$135B reflects major boosts for border security and immigration programs (CBP, ICE, CIS, Coast Guard) as well as the TSA and Secret Service. FEMA and CISA may see reductions.
- **Veterans Affairs:** An increase of \$5.4B to \$134B for expanded veteran medical care, modernized records systems, and reduced veteran homelessness.
- **GSA:** Increases \$1.4B as it takes over a greater level of enterprise-wide contracting for the federal government.
- **Social Security:** Receives a modest increase of \$0.5B to maintain current service levels.
- High growth contracting opportunities focus on technology spending including artificial intelligence, C5ISR, cybersecurity, cloud, defense technology products, health IT, and intelligence gathering to replace outdated systems and reduce manual operations.

Budget Reductions

Areas Facing Budget Decreases (27% of proposed FY 2026 federal budget)

Federal civilian agencies are broadly expected to receive reduced funding in line with the Administration's security-focused strategy. These reductions are often driven by staff cuts, program consolidations, or the termination of lower-priority initiatives. Key agencies facing proposed decreases include:

- **State, including USAID:** The largest \$49B decrease is largely in line with the Administration's already implemented reductions to USAID.
- **HUD:** Proposed to be reduced \$49B with cutbacks in community grants.
- **Agriculture:** Expected to be reduced \$45B across a wide variety of programs as non-defense spending is broadly curtailed.
- **Health & Human Services (HHS):** A \$33.5B reduction curbs NIH and CDC budgets, including closing offices nationwide. Reductions to Medicare, Medicaid, SNAP (food stamps), and research programs are planned.
- **Energy:** Reduced \$18B by cancelling various next generation energy infrastructure projects. Increased spending on fossil fuels and nuclear energy is proposed.
- **Education (ED):** Proposed to be cut by \$12B, drastically shrinking K-12 and higher-ed program budgets. Despite efforts to shut down Education, some programs supporting low-income and disabled students and college assistance will continue.
- **Other agencies** (Transportation, EPA, Interior, NASA, NSF, Labor, US Army Corp of Engineers, Justice, SBA, Treasury): Reductions from \$2B to \$10B in each.

Shifts Affecting Government Contractors

At the same time, there are other changes taking place within the U.S. government spending and contracting environment that represent both opportunities and risks for government contractors.

Positive Developments

- Technology upgrades, including artificial intelligence, machine learning, and automation, are being implemented to replace outdated systems, reduce manual work, enhance customer support, and lower costs.
- Continued weapons modernization efforts, considering growing competition from China, are driving demand for new technologies, including increased use of drones.
- Increased focus on better healthcare for veterans and expansion of advanced health technologies.
- Greater use of Other Transaction Authorities (OTAs) is expediting contract awards, allowing more rapid delivery of solutions.
- The Federal Acquisition Regulations (FAR 2.0) is expected to simplify the procurement process, promoting a faster and more efficient acquisition process allowing more commercial bidding opportunities.
- Ongoing efforts to reduce outdated compliance requirements may lighten the regulatory load for contractors.

Challenges and Risks

- Major reductions are proposed in key programs such as Medicaid, SNAP, FEMA, NOAA, CISA, AmeriCorps, and education, as well as funding for public broadcasting and national cultural institutions and parks.
- Layoffs and hiring freezes are reducing the number of federal employees, contributing to contract award delays, especially when agencies face budget or authority uncertainty.
- Decline in oversight stemming from reduced inspectors across the government.
- A significant decline in support for DEI (Diversity, Equity, and Inclusion) programs, sustainability, and green initiatives.
- Mergers and acquisitions in the GovCon space are seeing increased delays as investors wait for clarity on the government's budget decisions and their implications for specific contractors. Smaller M&A transactions are continuing as buyers seek specific growth opportunities.

Looking Ahead

Several structural changes may have long-term implications for contractors, including:

- Long-term impact of the Department of Government Efficiency (DOGE) on staffing levels and contract reviews
- Consolidation of IT and service procurement under the GSA
- Impact from the rewrite of the FAR
- Impact on small business valuations and M&A activity due to new recertification rules starting January 17, 2026