
S&P: U.S. Local Governments Are Mostly Insulated From Federal Funding Reductions Amid Ongoing Operating Stress

Key Takeaways

- Federal funding cuts to U.S. local governments are ongoing, but the timing of financial impact is unclear given legal challenges and uncertain implementation.
- Furthermore, the magnitude of funding across the 10 largest cities is relatively modest — ranging from less than 1% to about 3% of operations.
- Pressure on fiscal federalism, coupled with other risks we're watching for the sector including economic and demographic trends, could lead to uncertainty, distraction, and potential operational disruption.

New Funding Cuts Loom

In both Trump administrations, the federal government reduced, or threatened to reduce, revenue to LGs, frequently focusing on sanctuary cities. Proposals announced already in 2026 would cut federal funding to this cohort as well as the U.S. states where the cities are located that resist federal immigration enforcement.

S&P Global Ratings does not expect this issue will lead to rating changes–in isolation. This is due partly to the limited amount of federal revenues that make up LG budgets: on average, LGs receive less than 5% of their revenues from the federal government. However, a smaller magnitude does not necessarily preclude disruption to operations, especially if there are reductions to U.S. states' federal funding since states receive more than 30% of their operating revenue from the federal government

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