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Fitch: US Public Finance Issuers Broadly Resilient to Federal Policy Pressure

Fitch Ratings-San Francisco/New York-08 May 2025: Federal policies on tariffs and immigration, program and funding reductions effected through executive orders, and likely federal budget cuts could negatively affect U.S. public finance (USPF) and public infrastructure issuers' operating environment and finances, Fitch Ratings says. While most issuers have the resources to handle revenue and cost stresses, those with less financial flexibility may experience ratings pressure.

If there is a significant reduction in the federal government's share of Medicaid expenses in the pending reconciliation bill in Congress, states and not-for-profit (NFP) hospitals would be hit the hardest. Medicaid is an average of 20% of the payor mix for NFP hospitals. Lower revenues and higher unreimbursed expenses from self-pay patients would slow hospitals' financial recovery, particularly for hospitals with a relatively large share of Medicaid patients and narrower margins.

Federal revenues make up 30%-60% of most states' total revenues, with approximately two-thirds coming from Medicaid funding. States are bound by federal statutory and regulatory Medicaid requirements but may reduce spending by lowering provider rates and limiting covered services. States generally have the fiscal capacity and flexibility to endure cuts and maintain financial performance, albeit with narrower margins and potential reserve draws.

Tariffs impacts depend on the severity and duration of the trade war. State and local governments with large agricultural and manufacturing sectors are particularly vulnerable to trade disruptions. NFP hospital supply costs would increase, although those with strong operating margins will be able to absorb costs without affecting their credit ratings. Academic hospitals face dual challenges from both tariffs and federal research funding recissions.

Vertically integrated publicly owned utilities and generation and transmission cooperatives are vulnerable to tariffs given the specialized construction of generation and transmission assets. Effects on public power utilities will be delayed as issuers typically secure major components a few years in advance.

Issuers with planned or existing capital projects are particularly exposed to higher tariffs and labor constraints and may defer, downsize or cancel projects. Debt metrics will weaken for issuers without contractor-guaranteed price caps or contingencies, or those with limited cash flow flexibility to offset rising costs. Mass transit agencies face significant construction cost risks due to capital funding gaps.

USPF and public infrastructure credits have low to moderate exposure to the effects of mass deportations. A reduced labor supply could drive wage inflation, with construction, agriculture, and hospitality services among the most impacted sectors. Population declines may reduce tax revenues. Pressures will be greatest on school districts with large immigrant populations that lose ancillary workers and students, reducing school revenues that are typically based on per-pupil funding formulas. Fewer student visa approvals or the chilling effects of international student deportations may reduce higher education enrollment.

An economic slowdown would compound the effects of federal actions. State and municipal budget pressures could lead to lower funding for community colleges and public universities. Housing lenders might experience higher delinquency rates. USPF issuers’ costs of funds will remain elevated if the Fed maintains higher rates to address inflation and would increase if issuers lose tax exemption.

Financial market volatility is a risk for public pensions, endowments, investment income and tax revenues. States are broadly well positioned to withstand steep market declines given revenue volatility control measures, robust reserve levels, and changes to pension system actuarial assumptions and contribution practices. Life plan communities may struggle to pass costs through fee increases, and demand may erode with declines in prospective residents’ net worth.

Executive orders that freeze funding and downsize federal departments can affect program operations, funding disbursement or delays in approvals, with higher education and affordable housing and community development among those targeted.

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