



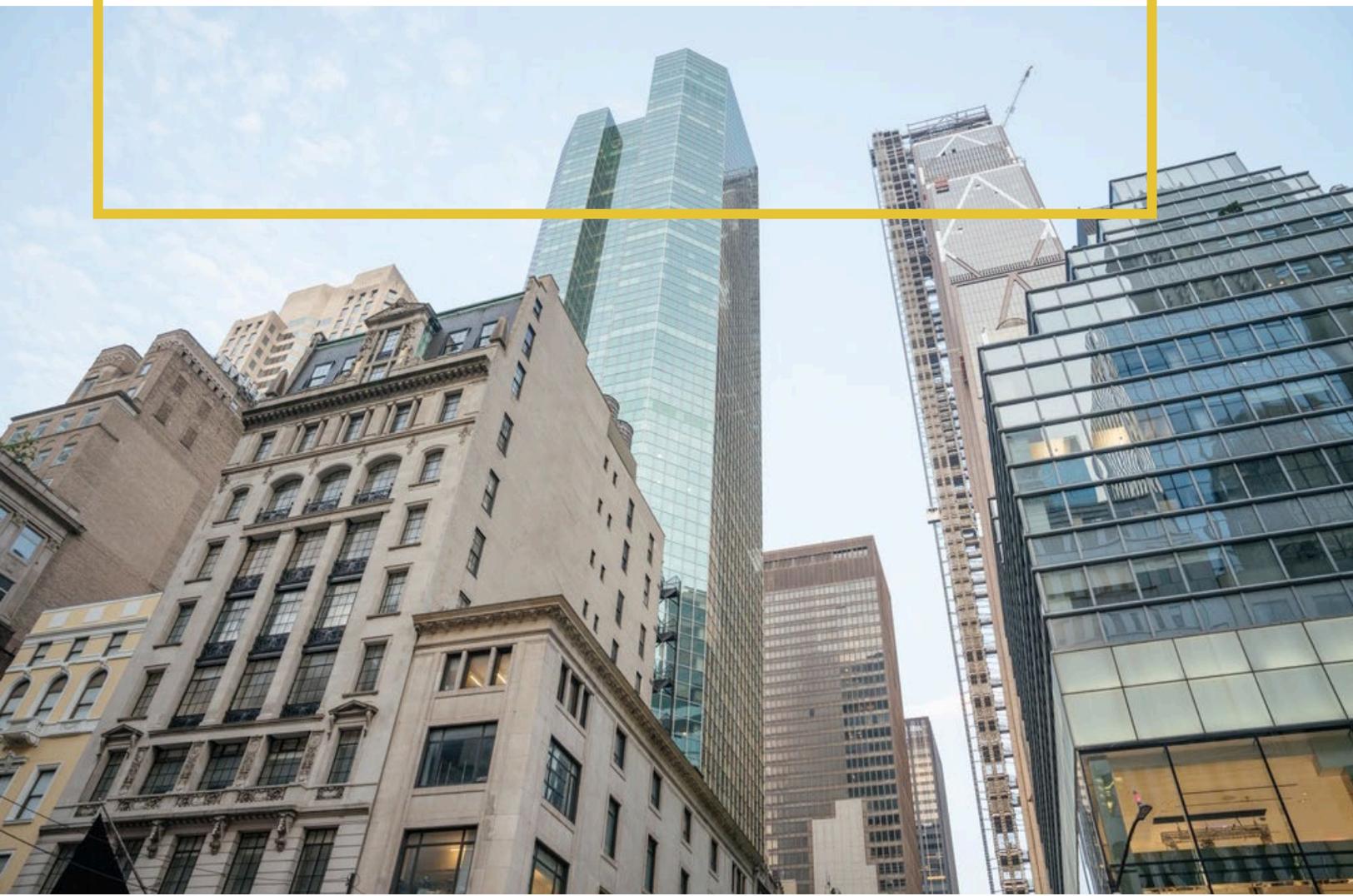
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The Risks to the City's Credit Ratings

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Introduction

Since the release of the FY 2027 Preliminary Budget and Financial Plan on February 17, three of the four rating agencies that evaluate New York City's General Obligation bonds have revised the City's outlook from stable to negative. That is an important warning sign, though it is not the same as a ratings downgrade. Credit ratings measure the likelihood that a borrower will repay debt on time and in full, and higher ratings generally translate into lower borrowing costs. Because New York City borrows at very large scale to fund capital projects, even modest increases in borrowing costs can have meaningful budget implications.

This Fiscal Note explains why the City's current financial plan has raised concern among the rating agencies. The central issue is the weakening of the City's fiscal cushion. In particular, the agencies are focused on the sharp decline in reserves and end-of-year surplus projected for FY 2026, as well as the lack of a clear strategy in FY 2027 to rebuild those resources. The Preliminary Budget reflects the long-overdue recognition of recurring costs that had previously been underbudgeted or deferred. But once those costs are fully recognized, the City's fiscal flexibility appears much thinner than before.

The Fiscal Note includes the analysis of the revisions to the FY 2026 revenues and expenses submitted to the City Council on March 25th. The changes appear, if anything, to be more adverse for the City's rating assessments than those contained in the financial plan.

This does not mean that a downgrade is inevitable. Stronger-than-expected tax revenues, additional savings, or favorable developments in the State and City budget process could improve year-end results. But as the budget is currently structured, FY 2026 appears to be the year in which the City's credit metrics are most vulnerable to deterioration. The concern is whether the City can restore a meaningful fiscal cushion in FY 2027. As of now, the budget provides little evidence of that. Instead, it relies on reduced reserves and one-time resources, raising broader questions about the City's structural fiscal position.

Our Office's detailed analysis of the FY 2027 Preliminary Budget and Financial Plan is available [here](#).

Why Rating Agencies Matter

The City can borrow long-term only to fund capital projects, and the size of its capital program and outstanding debt is substantial (see our [annual report on capital debt and obligations](#) for a detailed overview). While it is difficult to pinpoint how much ratings affect borrowing costs, given the size of the City's borrowing needs, even a difference of a few basis points can have meaningful cost implications.

Rating agencies assign letter grades to borrowers to assess their creditworthiness. Each agency independently assesses a borrower's financial health and willingness to pay, and assigns a grade that signals the likelihood the borrower will repay their debts on time and in full. The scales differ slightly by agency, but the logic is the same: the higher the rating, the lower the perceived risk, and the lower the interest rate the borrower must pay to attract investors.

In evaluating the City's creditworthiness, the rating agencies review a broad set of factors. These include the size and diversity of the economy, the stability of the tax base, the quality of financial management, the burden of debt and other long-term liabilities, the adequacy of reserves and liquidity, and the quality of governance. Since the fiscal crisis of 1975, New York City has rebuilt its credit standing through decades of disciplined financial management under the [NYS Financial Emergency Act](#). That long record of fiscal control, together with the scale and diversity of the City's economy, has supported strong ratings.

The New York City economy remains exceptionally large and varied. With a gross domestic product of nearly \$1.4 trillion in 2024, it is larger than all but three U.S. states (excluding New York State), and its labor market, financial sector, and institutional anchors — universities, hospitals, cultural institutions — give it a revenue-generating capacity unparalleled among U.S. local governments.

The City's General Obligation (GO) bonds are currently assigned the following ratings: Moody's Ratings Aa2, S&P Global Ratings AA, Fitch Ratings AA, and Kroll Bond Rating Agency (KBRA) AA+. These are all near the top of the investment-grade spectrum.

What the Ratings Agencies Are Seeing and Saying

The ratings agencies are focused on a common underlying concern: whether the City is permitting its fiscal shock absorbers to erode too far. Their recent credit analyses were published before the revision to FY 2026 expenses and revenues included in the March 25th budget modifications transmitted by the Mayor to the City Council. Therefore, the sections that follow are based on the financial plan as released on February 17th. The revised budget modifications and their implications for the rating assessments are described at the end of the fiscal note.

The agencies use fund balance and reserves metrics (in short “fund balance” metrics) to capture the amount of fiscal flexibility and capacity to absorb shocks. With differences across rating agencies, these are based on the end-of-year budget surplus and the amount of reserves available to face unforeseen economic shocks. These are, in general, the Revenue Stabilization Fund (RSF, the City’s rainy-day fund), and the balance of the Retiree Health Benefit Trust (RHBT), which was created to fund the health and welfare benefits of retired City employees but has in the past been used as a *de facto* rainy-day fund. The fund balance metrics are central to how rating agencies are evaluating the FY 2027 preliminary budget and financial plan.

The long-overdue recognition of previously misrepresented expenses in the preliminary budget makes clear the extent to which the City’s fiscal flexibility may deteriorate by year’s end, despite tax revenues reaching new records.¹ **The effective elimination of the end-of-year budget surplus and the use of RSF to balance the FY 2026 budget, mean that the fund balance metrics used by all rating agencies could be meaningfully weakened in FY 2026.**

This is not to say that we expect or predict adverse rating actions. Negotiations for the State and City budget, as well as better-than-expected tax revenues and additional spending reductions, could improve the fund balance metrics by the time the budget is adopted and by the time the FY 2026 financial reports are

¹ Our office has for years called attention to the practice of significantly and systematically under-budgeting known costs. Budget reports since at least [March 2024](#) contain expense re-estimates under the “underbudgeting” category.

available. However, potential tax increases are only going to have relatively small impacts on FY 2026, the year when the fund balance metrics are most at risk to erode sharply.

As to the outlook for FY 2027 and beyond, credible plans to rebuild the City's fiscal cushion quickly and sustainably in FY 2027 and beyond will prove crucial to maintaining the City's ratings. As presented, the FY 2027 budget is balanced but it contains little indication that the City's end-of-year surplus will improve, in part because the City's reserves for contingencies have been all but eliminated in FY 2027: the General Reserve was lowered from \$1.2 billion to its statutory minimum of \$100 million and the Capital Stabilization Reserve of \$250 million was completely removed. These two reserves, when not needed to cover unforeseen costs or drops in revenues, contribute to the fund balance and have essentially been zeroed out. In addition, the FY 2027 budget is balanced by lowering the balance of RHBT. **The implication is that the City would need to find substantial additional savings or revenues to be able to rebuild its surplus by the end of FY 2027 and to avoid the planned draw from the General Reserve, the Capital Stabilization Reserve, and the Retiree Health Benefit Trust by the time the FY 2027 budget is adopted.**

Moody's Ratings

On March 11, Moody's Ratings reaffirmed the City's ratings but shifted the outlook from stable to negative for the City and all its related credits (an across-the-board change that may have been less noticed).²

The change in outlook identifies "large and persistent imbalances under still-favorable economic and revenue conditions" in the budget and financial plan. The imbalances were made evident by the long-overdue funding of billions in chronically underbudgeted costs, fiscal cliffs for recurring programs, and previously unaccounted-for obligations. All factors that have been consistently documented in detail by this Office and other fiscal monitors.

Our reading of Moody's Ratings narrative is that closing the imbalances with structural and recurring revenue and spending measures could lift the outlook to stable "over the next 12 months." In our view, the drawdown of the City's rainy-day fund in FY 2026 may not be in and of itself a reason for a rating downgrade. However, RSF is a component of the fund balance. In a [credit opinion](#) published the following day, Moody's Ratings lists the following factors that could lead to a downgrade:

1. Forecast budget gaps, excluding one-time solutions, that drive them closer to 10% of city funds revenue.
2. Return to negative available fund balance, or use of OPEB assets to balance the budget.
3. Economic events such as sustained declines in equity prices, or trends that create significant persistent structural budget imbalances.
4. Divergence from well-established fiscal practices and strong budgetary management.

² The credits are New York City (General Obligation bonds), Transitional Finance Authority (Moody's tied the ratings of GO and TFA in 2024 – see the [October 2024](#) newsletter), the Educational Construction Fund, H+H, Hudson Yards Infrastructure Corporation, and the City's subject-to-appropriation debt issued by the Dormitory Authority of the State of New York and the NYC Industrial Development Agency.

In our view, the factor posing the greatest risk of downgrade is #2, particularly the available fund balance at the close of FY 2026.³ In Moody's Ratings' definition, "the ratio of available fund balance and net current assets to revenue provides a useful indication of whether a city's or county's resources would be sufficient to bridge temporary budget imbalances." The metric gradually deteriorated before the preliminary financial plan was presented and we have paid special attention to it metric (see the [March 2024](#) and [December 2025](#) economic newsletters, as well as our [2025 annual report](#)).

Moody's Ratings' available fund balance ratio was 2.5% in FY 2021, 2.7% in FY 2022, 0.8% in FY 2023, -0.6% in FY 2024, and just barely positive (0.01%) in FY 2025. Keeping a positive ratio is important because, in Moody's Ratings scorecard, the ratio receives a 20 percent weight if positive but 50 percent weight if negative, and could result in a lower scorecard rating and a wider gap between the scorecard-indicated outcome (currently A3) and the assigned rating, which stands four notches above it for GO bonds (currently Aa2).

The decline in the ratio can be attributed to two main reasons. First is the slow pace of debt issuance relative to capital spending, which drove to a large and increasing deficit in the City's Capital Projects Fund. The increase in debt issuance in FY 2025 was key to improving the ratio. The second reason is the gradual decline in prepaid debt service from its peak of \$5.7 billion in FY 2021 to \$3.8 billion in FY 2025, and further projected to fall to \$238 million in FY 2026.⁴ The last deposit into RSF in FY 2022 increased the fund balance but no other formal deposit has been made since then.

³ In our view, the reduction of the Retiree Health Benefit Trust balance in FY 2027 is not as concerning because it is avoidable, barring adverse changes in tax projections. Since the financial plan was released, the City has changed its expense assumptions to avoid the use of RSF in FY 2026 by primarily lowering the balance of RHBT in FY 2026. This change is explained more fully later in the Fiscal Note.

⁴ The end-of-year surplus in FY 2021 through FY 2023 also included prepayment of PAYGO OPEB costs, with a transfer to the Retiree Health Benefit Trust (RHBT). Total prepayments were at their historical peak of \$6.1 billion in both FY 2021 and FY 2022, but the latter included a higher amount of prepaid OPEB. The total effective budget surplus was even higher in FY 2022, as it was sufficient to fund a long-term deposit of \$750 million into RHBT (in addition to the PAYGO prepayment of \$792 million) and a deposit of \$1.45 billion into RSF.

The starting point for the calculation of Moody's Ratings available fund balance is the Governmental Funds balance sheet (see ACFR FY2025 p.44). The first step is the sum of unassigned balance (principally from the Capital Projects Fund's deficit), committed balance (RSF and prepaid GO debt service), and assigned balance (principally prepaid Transitional Finance Authority debt service).⁵ Drawing down RSF lowers the committed balance and reducing the prepayment lowers the committed and assigned balance. In the FY 2026 budget assumptions, the RSF balance drops by nearly 50% and the prepayment drops by 94%. These actions could push the available fund balance ratio deeply into the negative.

S&P Global Ratings

On March 9, two days before Moody's changed its outlook to negative, S&P published a report (not a rating action) indicating that the combination of one-time measures, reserve draws, and optimistic revenue assumptions question the sustainability of budget balance beyond FY2026 and FY2027. Two conditions, if they persist, would put the AA/Stable rating at risk: continued reliance on nonrecurring budget solutions, and reserve erosion that leaves the city without a meaningful shock absorber.

S&P includes RSF and the end-of-year surplus in the calculation of available reserves as a percentage of revenues. Under this metric, credits are assessed from 1 (best/higher %) to 5 (worst/lower %). The steep drop of reserves and surplus in the FY 2026 preliminary budget assumptions could move the City from category 2 (8%-15%) to category 3 (4%-8%). However, unlike the other rating agencies, S&P decided to keep the City's outlook stable and wait for the City and State budget process to play out.

⁵ The calculation proceeds with other components that have a much smaller influence on the result.

Fitch Ratings

Fitch Ratings changed its outlook from stable to negative on March 20. Fitch Ratings' upgrade/downgrade factors include thresholds for available reserves as a percentage of spending (see the [September 2024](#) newsletter for details). A "sustained erosion of the city's reserve cushion to levels below 7.5%" is a factor that could lead to a downgrade. Because available reserves include both RSF and the end-of-year surplus, Fitch Ratings' ratio would, under the FY 2026 preliminary budget assumptions, drop below the 7.5% threshold.

Fitch Ratings also notes the need to structurally reduce outyear gaps and notes the risks of raising the property tax close to the constitutional tax limit (as highlighted in our [Office's report](#)). In particular, the increase in the property tax would reduce Fitch Ratings' assessment of revenue flexibility given that other tax revenue sources are under State control.

KBRA

KBRA also changed its outlook from stable to negative on March 20. In support of its decision, KBRA noted the materially larger structural imbalance than in earlier plans and the large outyear gaps, the large and uncertain revenue actions, the drawdown of reserves, and the diminished end-of-year surplus.

KBRA monitors several metrics. First is a reserve aggregate that includes the General Reserve, the Capital Stabilization Reserve, RSF, and the balance of RHBT as a share of total revenues. Second is the ratio of General Fund balance to General Fund expenditures. Third, is the ratio of RSF to General Fund expenditures. All these metrics would be significantly lower at the end of FY 2026 based on the preliminary budget assumptions.

The bottom line: FY 2026 and Beyond

All four agencies are focused on whether the City has meaningful fiscal shock absorbers in place. In the FY 2026 and FY 2027 preliminary budgets, those shock absorbers are planned to be meaningfully weakened. Their assessments converge on a common concern: the City's reserves and end-of-year surplus are foundational pieces of strong ratings, and both are poised to erode sharply in FY 2026.

Table 1 below includes estimates made by the Acacia Financial Group based on the metrics discussed earlier in this note.

Table 1: FY 2026 Preliminary Budget Assumptions and Fund Balance Metrics

Rating Agency	Metric	FY 2025	Estimated FY 2026	Estimated Impact on Benchmarks
Moody's	Available Fund Balance Ratio	0.01%	(3.31%)	From positive to negative
S&P	Fund Balance and Reserves as a % of Revenues	9.37%	5.50%	From Category 2 to 3
Fitch	Fund Balance and Reserves as a % of General Fund Expenditures	10.02%	5.67%	From above to below the 7.5% threshold
KBRA	Rainy Day Fund as a % of General Fund Expenditures	1.80%	0.87%	No benchmark available

Source: Acacia Financial Group. Estimates were made by the Acacia Financial Group based on metrics provided in rating reports, and information provided by our Office. The estimates do not constitute a recommendation or expectation on behalf of the rating agencies and are provided by Acacia Financial Group for informational purposes only.

For Moody's Ratings, the available fund balance ratio — which already turned negative in FY 2024 and barely recovered to near-zero in FY 2025 — is the metric most at risk. The projected near-50% drop in the RSF balance and a 94% reduction in the end-of-year prepayment surplus could push that ratio back in the negative, triggering a disproportionate penalty in Moody's scoring model and widening the gap between the scorecard-indicated rating and the City's assigned rating, if not putting downward pressure on the rating itself.

For S&P, the steep decline in reserves and surplus could move the City's credit to a worse assessment category. For Fitch, the combined erosion of RSF and surplus could push available reserves below the 7.5% threshold that the agency has explicitly identified as a potential trigger for a downgrade, if sustained.

The FY 2026 budget includes an assumption of \$922 million in unspecified savings, but the window to meaningfully and credibly increase the target for the current year is closing rapidly. This makes the revenue picture for FY 2026 critically important. In the absence of large infusions of revenues in the current fiscal year — whether from a favorable New York State budget settlement or from stronger-than-projected tax receipts — the City will have little room to avoid the deterioration of the FY 2026 credit metrics.

Equally important is what comes in FY 2027 and beyond. Rating agencies will be watching closely to see whether the City moves deliberately and quickly to rebuild its fiscal cushion. Avoiding draws and replenishing RSF and RHBT, establishing a policy to make regular deposits to RSF (such as the [proposal put forward by this Office](#)), restoring reserves for unforeseen contingencies, and structurally lowering out-year gaps, will all play a role in the rating agencies' assessments.⁶ On the other hand, a sustained period of low or, in the case of Moody's Ratings, negative available fund balance, and the reliance on reserve draws to close gaps, risk a downgrade of the City's ratings — regardless of how the FY 2026 budget is ultimately closed.

⁶ The preliminary financial plan assumes that RSF and RHBT will be replenished in FY 2028. However, we note that the replenishment is scheduled to take place in a year showing a multibillion-dollar gap.

The March 25th Budget Modifications

The Mayor's Office of Management and Budget (OMB) initially submitted to the City Council FY 2026 budget modifications consistent with the assumptions in the February Financial Plan. On March 25th, the OMB submitted to the City Council revised [expense](#) and [revenue](#) budget modifications.

The new revenue modification assumes that the City will not draw \$980 million from RSF at the end of FY 2026, as previously planned. This modification was approved by City Council on March 26th. To cover the gap in FY 2026, **OMB now assumes that the City will instead reduce the RHBT balance by \$816 million and the end-of-year surplus by \$164 million**. The expense modification is expected to lapse into effect after 30 days without an affirmative vote from the City Council.

These changes do not materially affect the extent to which the fund balance metrics used by S&P Global Ratings and Fitch Ratings are expected to deteriorate. This is because both agencies also include the RHBT balance in their metrics. However, the changes cross an additional redline in the Moody's Ratings factors that could lead to a downgrade: the available fund balance ratio is still estimated to be negative at the end of FY 2026 and "OPEB assets" (the RHBT balance) are used to balance the FY 2026 budget.

Because the end-of-year surplus is used to prepay debt service in FY 2027, lowering the surplus by \$164 million effectively means that the FY 2027 budget, as represented in the preliminary financial plan, has now a gap of the same magnitude. The gap will have to be closed in the Executive Financial Plan.

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