

End-of-Year Update for State & Local Government

PBMares | Michael A. Garber and Betsy L. Hedrick | December 2025

As 2025 comes to a close, many state and local governments are working within a more predictable operating environment than they've had in recent years. Revenues and budgets are relatively stable, and analysts say municipalities are entering a period of normalization. With federal stimulus funding now phased out, however, most departments are adjusting to tighter budgets and a greater reliance on recurring revenue.

On the administrative side, the 2025 OMB Uniform Guidance was only recently released, adding new compliance expectations at a busy point in the year. As state and local leaders look ahead to 2026, the focus is turning to essential services, workforce needs, and the process improvements required to maintain stability for their communities.

Current Conditions

Revenues have stabilized after several years of volatility. From 2020 through 2025, many budgets relied on federal stimulus and other one-time funds, but that support has largely ended. With inflation near 3%, agencies are feeling the effect in routine purchases and service contracts.

To back that up, state and local investment grew by only 2.1% in 2025, and the pace is expected to slow to under 0.7% a year through 2030 (ISIBWorld, September 2025). That will likely affect work such as building renovations, road and bridge repairs, water and sewer upgrades, major equipment orders, and technology improvements.

Many governments are also preparing for demographic changes, including aging populations, urbanization, and rising demand for healthcare and infrastructure upgrades. As a result, municipalities are generally focused on maintenance, modernization, and risk mitigation instead of discretionary projects.

As for compliance updates, the 2025 OMB Uniform Guidance arrived in late-November, months later than expected. The revisions introduce new compliance and audit requirements for 2025 federal awards; this includes changing the testing requirements for 17 programs and deleting seven other programs. Because such dramatic changes were released so late in the year, many finance teams are reviewing grant files and coordinating with auditors as they complete year-end reporting.

A separate update already in effect is the higher \$1 million Single Audit threshold, which applies to fiscal years beginning on or after October 1, 2024. The increase from \$750,000 may reduce audit requirements for smaller governments, while those managing larger federal awards may want to prepare for more focused scrutiny on internal controls and grant oversight.

Key Issues Heading Into 2026

What do state and local leaders need to watch heading into 2026? There are several key areas:

Federal Funding

State and local governments started the year with notices of thousands of terminated grants. This included grants for transportation projects, public health, and other community programs. Many cities and counties adjusted mid-year budgets and paused all non-essential projects. Many also moved staff to the most immediate needs. Governments are still working to identify replacement funding where possible and scaling community plans to match available resources. This work will likely continue into 2026.

Then, in mid-2025, the One Big Beautiful Bill Act (OBBBA) introduced major changes to Medicaid financing and eligibility rules. The law cuts roughly \$900 billion in federal Medicaid spending over the next 10 years, and analysts expect states to take on a larger share of program costs. This affects local governments because Medicaid supports public health operations like EMS, behavioral health providers, and many social-service programs. Counties, municipalities, and rural hospitals are preparing for more locally funded costs. Many are updating revenue forecasts to prepare for long-term impacts.

Cybersecurity and Technology

Cyber incidents are trending upward with no sign of slowing down. During the first half of 2025, researchers recorded 208 ransomware attacks on government agencies worldwide. That's a 65% increase from the same period the year before. Local governments are especially vulnerable. A cybersecurity breach can shut down utilities, public records, or emergency dispatch.

This is causing many departments to replace outdated systems and require multi-factor authentication. At the same time, some are also testing AI tools to manage routine tasks such as document processing and customer requests. A word of caution. While AI tools may be able to reduce backlog and improve response times, they require careful vetting and staff training to avoid introducing new risks.

Workforce Planning

Recruitment efforts are paying off. The most significant change here is in the use of mobile apps to submit and track an application. In 2024, only 10% of local government agencies used this type of technology; that number is up to 17% in 2025. This likely improves the applicant experience and hastens the hiring process. However, it's still somewhat challenging to attract talent and retirements are accelerating. Some municipalities are taking creative action by hosting same-day hiring events and offering signing bonuses. Many are also finding success with internal training programs that show clear pathways for career advancement.

Strategic Takeaways

State and local governments have several opportunities to strengthen operations and manage uncertainty heading into 2026:

- Update administrative systems to reduce manual work and improve financial reporting accuracy.
- Inventory all federal grants and review compliance requirements, especially considering the new OMB guidance.
- Look for simple process improvements to increase efficiency and stretch existing funds.
- Prioritize cybersecurity; trends are showing an uptick in cyberattacks, which are costly in terms of downtime and overall budget.

Looking Ahead

The outlook for 2026 shows a more stable environment. But the challenges are there as well. Costs are up, revenue is limited, and compliance requirements are expanding. The focus now is on strengthening internal systems and developing solutions to meet the needs of a changing community. Leaders who plan ahead will be better positioned for the next year.