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Municipal market update

June 2025

As of 31 May 2025

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Volatility can create opportunity

Investment grade municipals have underperformed the US Agg by 341 bps YTD through May, creating an attractive entry point for patient investors.

Municipals have underperformed YTD

- Tax-exempt issuance is up 12.5% YoY vs. last year (record levels in 2024).[1]
- May reinvested capital increased considerably compared to April, helping drive relative outperformance for municipals during the month.
- Reinvested capital is forecasted to outpace new issuance in the summer months, which could be a catalyst for stronger performance.
- Pressure on liquidity from ETFs impacted municipals during April:
  - The fund industry must learn to co-exist better with this growing municipal wrapper

Fundamentals remain strong

- Property tax, individual income tax and sales tax collections increased in 2024.
- While some reserves are being spent down, overall reserves are anticipated to account for nearly 15% of spending in FY 2025, up notably from 8% in FY 2019.
- Upgrades continue to outpace downgrades, with the first quarter seeing 124 upgrades vs 68 downgrades.
- Municipal credit remains strong, especially for essential service monopolies.

Changes in tax code can lead to opportunity

- The Republican party is looking to extend existing TCJA ($4.5T) and additional tax cuts ($1.5T) to help offset tariff costs.
- Tax-exempt status of municipals is not part of the most recent proposed Tax Bill, a favorable development for municipal investors.
- If reconciliation efforts change, the Private Activity Bond (PAB) segment of the market could be impacted.
- Threats to individual entities losing their tax-exempt status should remain idiosyncratic.

Data source: Bloomberg, L.P., 31 May 2025. **Performance data shown represents past performance and does not predict or guarantee future results.** Bloomberg Municipal Bond Index Yields are yield to worst. Yield to worst is the lowest potential yield that can be received on a bond without the issuer defaulting. **Representative indexes: Investment grade municipals:** Bloomberg Municipal Bond Index. **1** Data source: Bond Buyer, as of 31 May 2025. **2** Data source: Morningstar, as of 30 Apr 2025. **3** Data source: JPM/LSEG Lipper, as of 30 Apr 2025.

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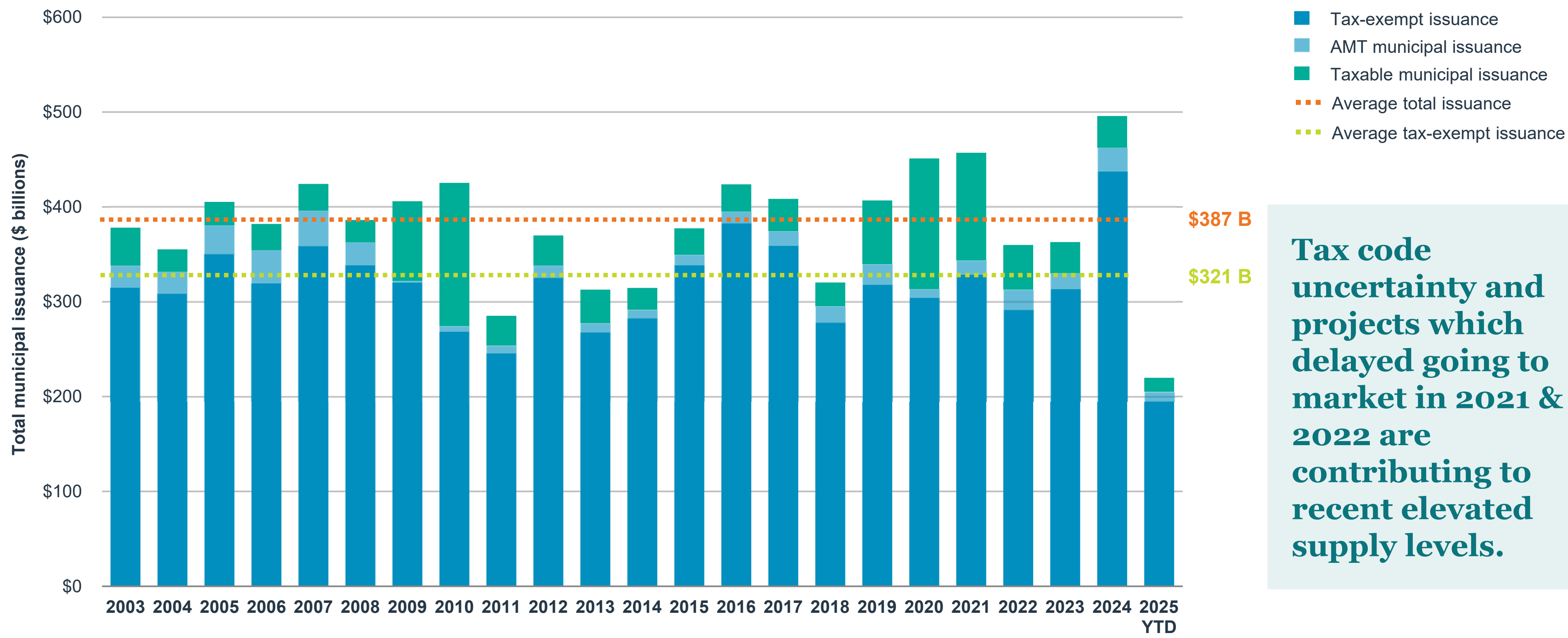
OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

Tax-exempt issuance begins 2025 at elevated levels

Overall issuance through May was 16.1% higher than 2024 levels, placing pressure on performance.

Municipal issuance



Tax code uncertainty and projects which delayed going to market in 2021 & 2022 are contributing to recent elevated supply levels.

Data source: Securities Industry and Financial Markets Association (SIFMA.org), *U.S. Bond Market Issuance and Outstanding*, 03 Jun 2025 for period ending 31 May 2025. The average total issuance and average tax-exempt issuance shown are for the period 01 Jan 2003 – 31 Dec 2024. AMT municipal issuance is part of the tax-exempt municipal market.

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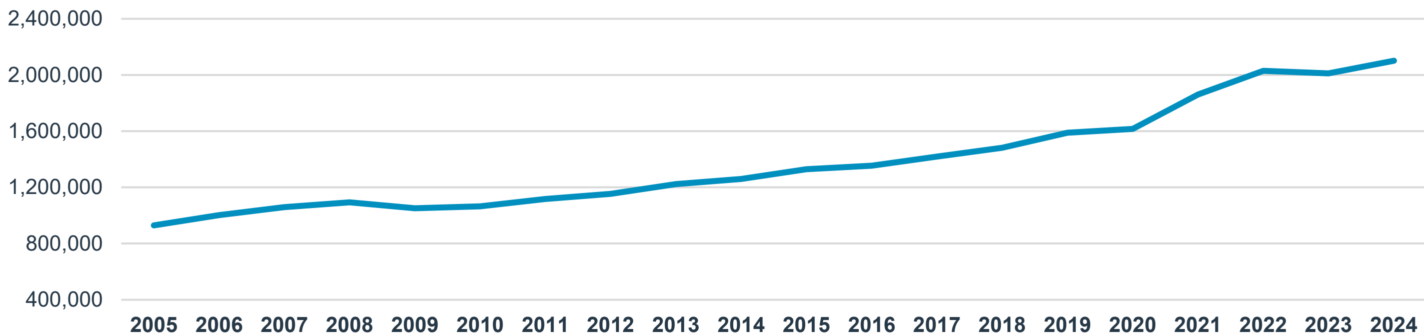
Municipalities are in a strong financial position

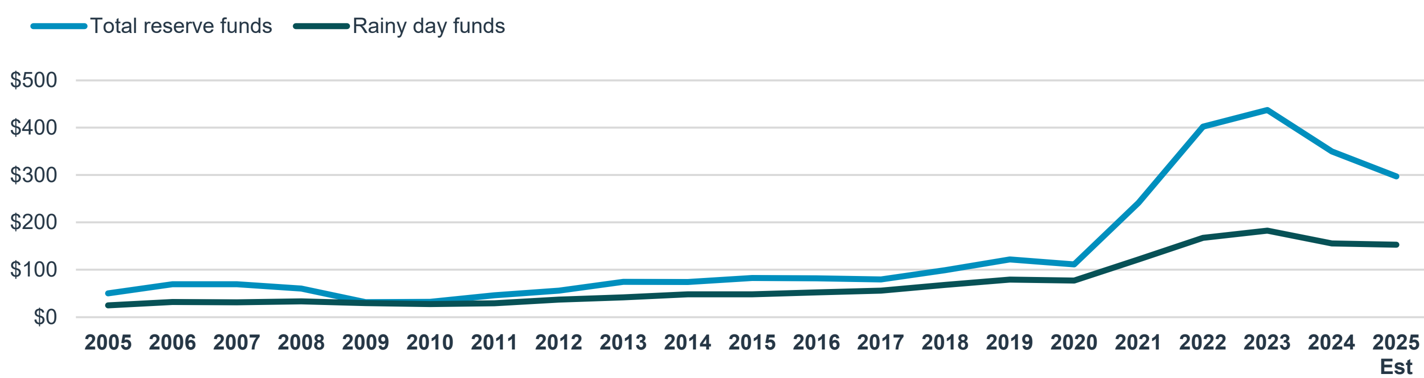
Revenue collections and reserves are near the highest levels in more than 40 years.

State & local government tax revenue collections ($ millions)[1]



Total tax collections increased modestly in 2024.

State government funds ($ billions)[2]



While excess reserves are being spent down, reserves remain near all-time-high levels.

1 Data source: census.gov, 31 Dec 2024; updated annually.

2 Data sources: National Association of State Budget Officers (NASBO), *The Fiscal Survey of States*, Spring 2022. Pew Charitable Trust, *States Build Their Reserves Amid Growing Uncertainties*, 31 Jan 2025.

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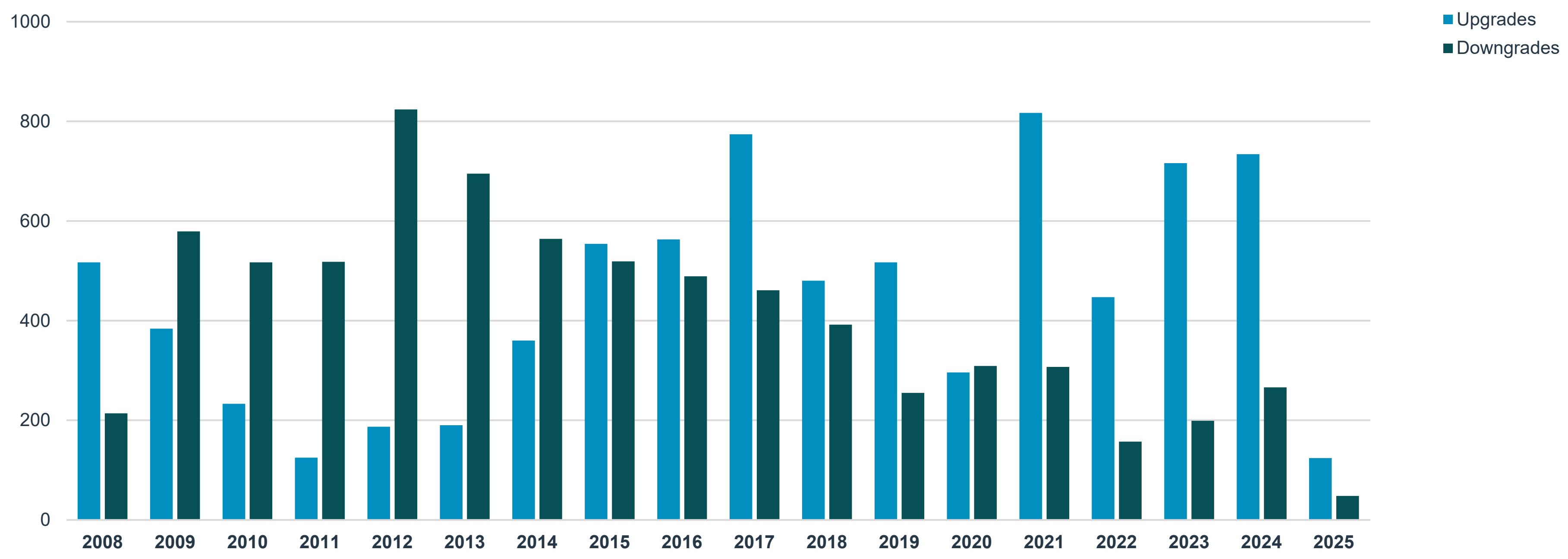
Rating upgrades have continued to exceed downgrades in recent history

Upgrades outpaced downgrades by nearly 2.75:1 in the first quarter of 2025.

Number of rating changes for public finance



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Data sources: Moody's Ratings, *Quarterly and Annual Municipal Rating Revisions*, 15 May 2025, data as of 31 Mar 2025; most recent data available.

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Larger federal policy shifts are too soon to assess

Tariffs

- **More comprehensive aluminum and steel tariffs** increase capital project and borrowing costs for all issuers. Electric, water and sewer utility sectors in need of capital investment may pass higher construction costs onto customers via rate increases
- **Port volumes** may be pressured. West coast ports considered more vulnerable due to proximity to China
- **Certain U.S. border communities** could be impacted by less commerce. For example, in Laredo, TX, 25% of revenues are derived from charges for services, most of which is bridge toll revenue

Deregulation

- **Deregulation for utilities** may provide longer runway to implement environmentally-mandated capital projects
- **Healthcare M&A** may be easier to execute due to less focus on regulation, which could support smaller, struggling hospitals

Immigration

- **Federal funding at risk** for cities and counties identified as sanctuary jurisdictions. Those governments may see cuts to federal grant funds
- **Potential labor shortfalls** could create inflationary pressures
- **School districts** enrolling undocumented migrant students could see enrollment declines. Large urban districts, like Chicago, may be more vulnerable to losing students and federal K-12 aid cuts

Muni tax exemption

- **Tax-exemption on muni bonds** is not revised in current tax bill. At this time, it doesn't appear that the muni tax exemption would be broadly revised in final legislation
- **The exemption is important to municipals** that help finance local infrastructure
- **No restrictions in private activity bonds** are included in current tax bill. Historically, private activity bond restrictions have been discussed but not enacted (e.g., not-for-profit hospitals and higher education in 2017)

State and Local Tax (SALT)

- **SALT cap deduction increased** in current bill to $40k for individuals earning less than $500k with annual 1% increases through 2033. Deduction cap set at $30k set to expire at year end. High tax states have advocated for increasing the cap to provide tax relief to residents
- **Deduction cap** supports higher federal and state income tax collections. States facing a tougher economic and budget environment next year benefit from compromise that maintains a deduction cap rather than allowing full expiration

Source: Nuveen, 26 Feb 2025.

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Evolving federal policy could have implications for certain sectors and credits

State & local governments	Education	Transportation	Housing	Water & sewer utilities	Health care
• **Cuts to federal agencies** and aid could create service shortfall, leading to budget pressure, depending on circumstances • **Medicaid reimbursement changes** could produce state budget gaps or coverage reductions • **Cuts to federal K-12 aid** could pressure school finances • **FEMA funding changes** may impact disaster-prone states	• **School choice policies** may gain momentum and support charter schools over public K-12 • **Student loan forgiveness** could be rolled back • **Taxes on private higher education endowments** is included in current tax bill, and impact would vary depending on wealth of the institution • **National Institutes of Health grant cuts** may impact less-prestigious, research colleges and universities	• **Large transportation projects** that benefited from federal infrastructure aid (e.g., airports and public transit) may see less support, potentially increasing issuance or extending timelines • **Ports are bracing for declines** in shipping volume amid tariff hikes and uncertainty, although ports did experience record cargo volume during first four months of 2025 to get ahead of tariffs • **Lower demand for air travel** may lead to a reduction in revenues amidst tariff and trade uncertainty	• **Changes to the GSEs** including Fannie Mae and Freddie Mac could result in the removal of the implicit government guarantee and affect ratings for mortgage-backed securities guaranteed by these entities • **Potential downgrades** could negatively impact the credit rating of some state housing finance agencies which hold mortgage-backed securities on balance sheets	• **Relaxed environmental regulations** and enforcement may alleviate near-term cost pressures for utilities • **Fewer mandated capital upgrades** could benefit balance sheets and keep rates lower. Deferring capital may undermine longer-term credit quality	• **Medicaid reimbursement** to states will likely be curtailed in some form, including the possibility of further restrictions on the provider tax mechanisms utilized by most states, the addition of work requirements, and other changes which may reduce eligibility. • **The impact is likely to vary by state**, as Medicaid programs are administered and vary widely by state. It is also possible that changes are delayed into the future

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Source: Nuveen, 26 Feb 2025.

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