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2025 MUNICIPAL MARKET OUTLOOK



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Key Takeaways

- The municipal market enters 2025 with strong but ebbing credit fundamentals, tighter credit spreads, and the potential for higher Municipal/Treasury (M/T) ratios, as issuance increases and demand weakens due to tax policy uncertainty.
- Federal policy risk, in general, is likely to influence market behavior. This includes potential changes to tariff rules, immigration, administrative regulations impacting grant payments, Medicaid reform, proposals to alter the municipal interest exemption, raising the \$10,000 state and local tax (SALT) deduction cap, and other changes associated with the approaching expiration of the 2017 *Tax Cuts and Jobs Act (TCJA)*.
- Credit themes to watch include delayed financial disclosures, growing K-12 public and higher education sector stress, budget gaps for select issuers, and rising debt burdens.
- **Technical:** Supply seems likely to outpace demand in 2025, as issuance picks-up, both on concern that Congressional changes the muni tax exemption and fundamental factors. Municipal/Treasury (M/T) ratios could widen, in a reversal of the pattern witnessed since the Great Financial Crisis (GFC).
- **Valuations:** Though currently low, spreads could widen at points throughout the year based on a combination of increased issuance and diverging credit fundamentals. The potential for tax changes could also affect the slope of the yield curve and increase the value of active duration management, from time to time.

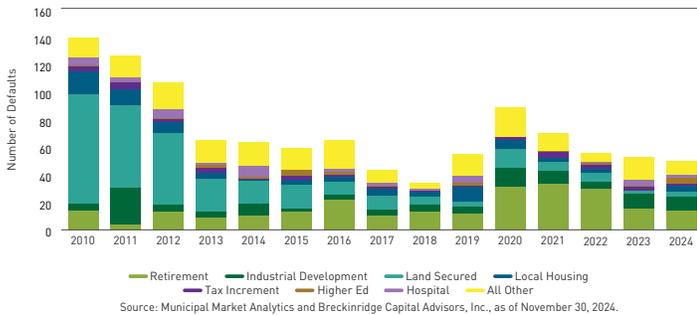


MARKET STRENGTHS

Low default rates.

Through early December, issuers had reported 59 monetary defaults in a market of over 37,000 issuers.¹ Impaired bonds represented 1.2 percent of the market, and only two governments had filed for Chapter 9 bankruptcy, the lowest figure since 2008.^{2,3} Defaults remain concentrated in less essential sectors, with the most frequent delinquencies arising in the nursing home, industrial development bond, charter school, and single site housing bond sectors. The increasingly stressed higher education sector reported five defaults in 2024 (See Figure 1).

FIGURE 1: MUNI DEFAULTS REMAIN INFREQUENT & CONCENTRATED IN NON-ESSENTIAL SERVICE SECTORS



Positive ratings trends.

Upgrades continue to exceed downgrades at both *Moody's Investors Service (Moody's)* and *S&P Global Ratings (S&P)* entering 2025. At *Moody's*, only two sectors had an upgrade/downgrade ratio below 1.0x in 2024 (hospitals: 0.5x and higher ed: 0.17x).⁴ At *S&P*, five sectors had a ratio below 1.0x (charter schools: 0.4x, higher ed: 0.7x, hospitals: 0.3x, public power: 0.9x, and water/sewer utilities: 0.5x).⁵

Mostly strong fundamentals.

The low default rate (See Figure 2) and upward ratings bias across the market reflects generally sturdy credit conditions.

For perspective:

- **Liquidity is up across most major sectors.** Tax-backed issuers like cities, counties, and school districts are particularly liquid (See Figure 3). State reserve balances (not included below) are expected to reach a record 13 percent of general fund expenditures when the books are closed for fiscal year 2024 (FY 24).⁶

FIGURE 2: UPGRADES CONTINUE TO OUTPACE DOWNGRADES, MARKETWIDE

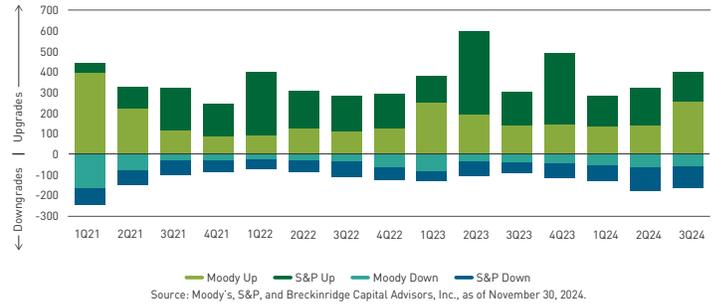
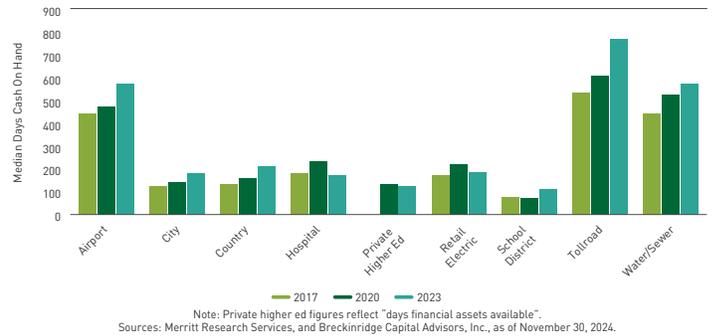
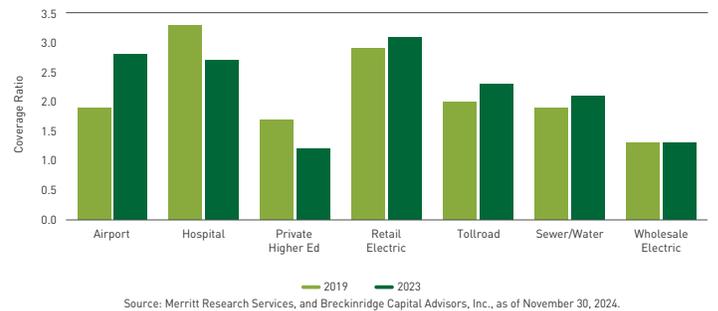


FIGURE 3: LIQUIDITY IS UP ACROSS MOST SECTORS



- **Coverage ratios have improved.** Water, sewer, and electric utility debt service coverage ratios are better than they were before the pandemic (See Figure 4). Transportation sector coverage is also better. Notably, toll road traffic in 2024 was 106 percent of its 2019 level.⁷ Airport revenue-passenger-miles were up 5 percent through August 2024 compared to the same period in 2023.⁸

FIGURE 4: REVENUE SECTOR COVERAGE RATIOS HAVE ALSO IMPROVED

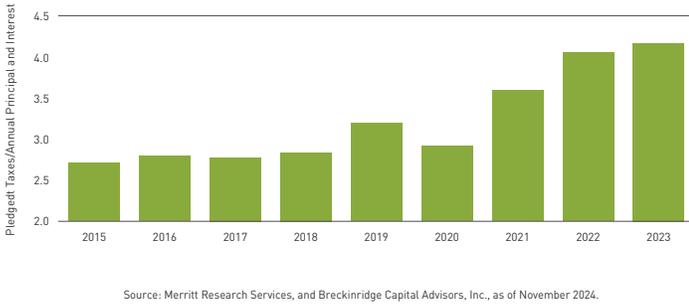


1. Per Bloomberg, December 2024.
2. "Impaired" refers to markers of distress such as covenant violations and draws against reserve funds per Municipal Market Analytics' default database. Source: Breckinridge analysis of Municipal Market Analytics' and Bloomberg data, November 2024.
3. Chapter 9 is available solely to municipal governments. Per data available via the federal court at uscourts.gov.
4. *Moody's* figures for higher education include both private and public higher education upgrades and downgrades through 9/30/2024.
5. *Standard & Poor's* data is through 10/30/2024.
6. National Association of State Budget Officers (NASBO), Fiscal Survey of the States, Spring 2024 (p. 71). The conclusion that the FY 24 median will meet the Spring forecast is based on recent state revenue collections. Per NASBO Association, most states are meeting or exceeding revenue forecasts. Those that are missing forecasted revenue numbers are doing so by 1 percent or less. See: "[Budget Blog: Most States End Fiscal 2024 Near Forecast](#)".
7. Fitch Ratings, "[Airport and Toll Road Traffic Monitor](#)," November 2024.
8. However, the airport figure remains 10 percent below its pre-Covid trend. Breckinridge analysis of Bureau of Transportation Statistics data.



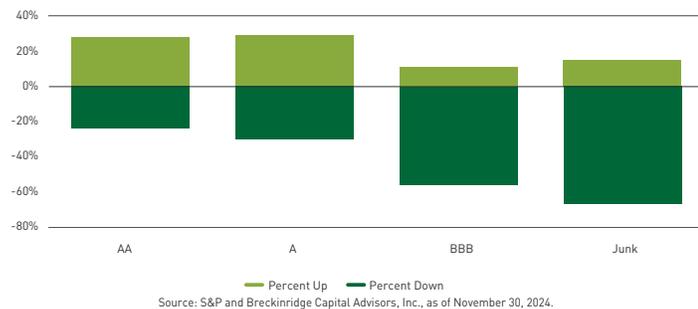
- **Dedicated tax coverage also looks healthy.** Solid consumer spending amid several years of rising prices has increased pledged taxes relative to principal and interest payments (See Figure 5).⁹ Even mass transit bonds backed by dedicated taxes are now in better shape.¹⁰

FIGURE 5: RISING COVERAGE ON DEDICATED TAX BONDS



- **The hospital sector is more stable.** Nationally, hospital margins exceeded 4 percent year-to-date (YTD) through October 2024, up from 2 percent over the same period in 2023.¹¹ Higher-rated hospital names exhibited more ratings stability in 2024, a pattern we believe will continue in 2025 (See Figure 6).¹² Higher-rated systems exhibit stronger service area market shares, are less exposed to government payers that might suffer federal budget cuts (Medicare and Medicaid), and better ability to attract and retain staff.

FIGURE 6: HIGHER-QUALITY HOSPITALS EXHIBIT STRONGER RATINGS STABILITY



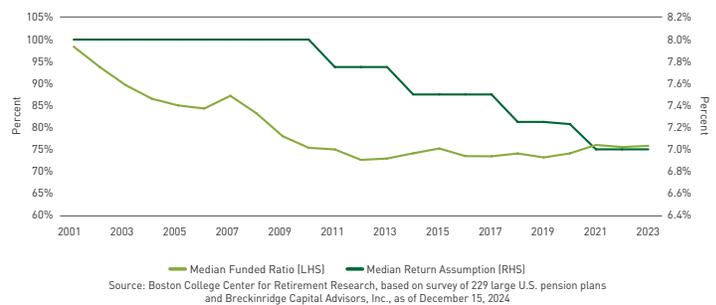
- **The muni debt burden continues to fall in most states.** The municipal bond market grew by 4 percent in 2024 to \$4.2 trillion.¹³ Record issuance contributed to the increase.¹⁴ However, economic growth *outpaced* the net increase in debt in 29 states, including several “specialty” states known for above average debt burdens (See Figure 7). Economically healthy, fast-growing areas of the country are leading the surge in new issuance (e.g., FL and TX).

FIGURE 7: MUNI DEBT/GROSS STATE PRODUCT RATIO RISES IN TEXAS & FLORIDA, WHILE FALLING ELSEWHERE



- **Falling pension debts.** Unfunded public pension liabilities have declined by \$3 trillion since 2020.¹⁵ Higher interest rates and a fast-rising stock market have enabled public funds to lower investment-return assumptions, while increasing their funding ratios (See Figure 8). Some plans remain meaningfully stressed, and it is likely that some governments will increase cost-of-living adjustments in budget negotiations in 2025.¹⁶ But for most issuers, contribution levels in the near-term are unlikely to change meaningfully.

FIGURE 8: PENSION STRESS CONTINUES TO STABILIZE



9. Of note, the database from Merritt Research Services includes over 100 large, dedicated tax bonds comprising \$150 billion-plus in debt.
 10. Ongoing tax growth is expected to offset the sector’s slow ridership recovery and should insulate issuers from potential cuts to federal aid. See: “U.S. Transportation Infrastructure Transit Update: Sector View Now Stable as Dedicated Tax Growth Mitigates Lower Ridership Revenue,” *Standard & Poor’s*, September 11, 2024.
 11. *KaufmanHall National Hospital Flash Report*.
 12. *Moody’s* and *S&P* each have a stable outlook on nonprofit hospitals.
 13. Breckinridge analysis of Bloomberg data, December 2023 and 2024. Figures exclude pre-refunded bonds.
 14. *Bond Buyer* data, as of December 23, 2024.
 15. *Moody’s Investors Service*, Public Pension Dashboards – 2025, November 19, 2024.
 16. “Reversals of Pension Benefit Actions Could Pressure State Liabilities,” Fitch Ratings, October 21, 2024.

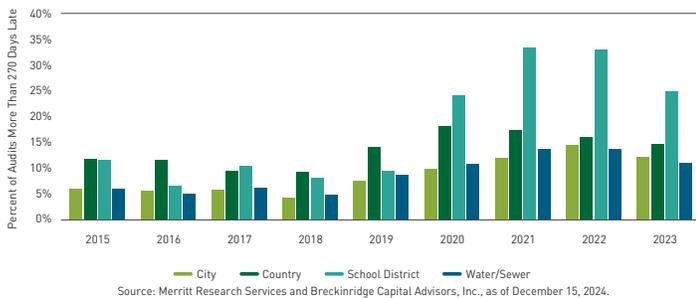


MARKET CHALLENGES

(Un)timely disclosure.

Stale financial audits have become more prevalent since the pandemic (See Figure 9) and driven a four-fold increase in ratings withdrawals from S&P since 2018.¹⁷ The current shortage of public finance professionals may exacerbate the problem in the near-term.¹⁸

FIGURE 9: DELAYED FINANCIAL STATEMENTS HAVE BECOME MORE COMMON SINCE THE PANDEMIC



A sustained increase in late financial statements could negatively impact the market. Demand might weaken for bonds issued by smaller, less affluent obligors who are less able to attract public finance talent and who may become vulnerable to a withdrawn rating.

The inability of some issuers to timely file financials suggests weaker fiscal controls, generally. Widespread reporting delays might also renew calls for heightened oversight of municipal disclosure.¹⁹ Federal regulation could chill issuance and redirect some borrowing to the private placement or bank loan markets.

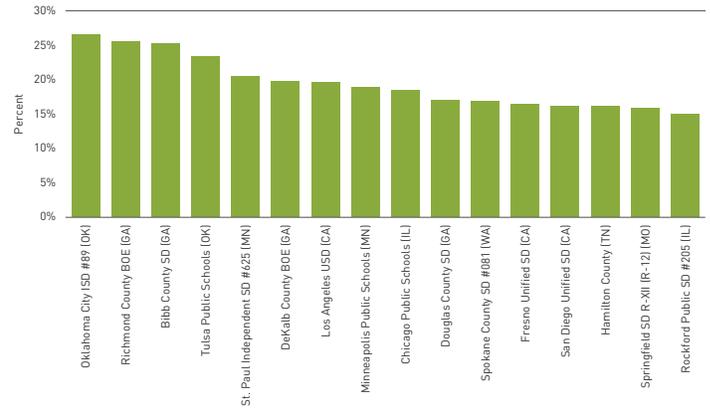
Weaker credit fundamentals in traditional education sectors.

Moody's recently assigned a negative outlook to the public K-12 school district sector, long among the safest within municipals.²⁰ Many districts face pressure from rising costs, enrollment declines, reductions in federal aid, and increased competition from charter and private schools.

Breckinridge highlighted these risks as early as 2022 in "Is it time to go back to school on school credit?." We anticipate more public school district downgrades in 2025. Risks seem highest for districts with many high-needs students and exposure to competition via school choice programs. Districts that cannot

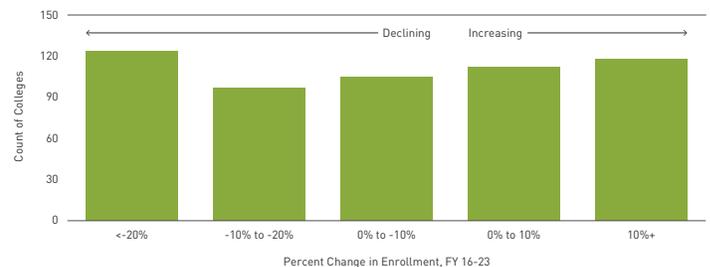
adjust their spending once federal pandemic aid is depleted are also more vulnerable. Some large-county and urban districts that come to market regularly exhibit meaningful reliance on federal support (See Figure 10).²¹

FIGURE 10: FEDERAL AID AS PERCENT OF GENERAL FUND REVENUE IN SEVERAL LARGE U.S. SCHOOL DISTRICTS*



Higher education bond issuers are also under pressure. Private universities and colleges continue to face increased competition from lower-cost providers, growing deferred maintenance, and declining enrollment. Public confidence in higher education has declined consistently over the past decade, and universities are now vulnerable to federal budget cuts or endowment taxes in the next Congress.²² Private colleges' access to the tax exemption may also be at risk.²³ Among private colleges with debt, a majority have experienced a decline in enrollment since 2016. One-fifth (20 percent) have experienced a decline of over 20 percent (See Figure 11).

FIGURE 11: MOST PRIVATE COLLEGES & UNIVERSITIES HAVE EXPERIENCED ENROLLMENT DECLINES SINCE 2016



17. "Public Finance is still figure out repercussions of accountant shortage," by Keeley Webster, *The Bond Buyer*, June 7, 2024.

18. "Public sector talent shortage: Unique challenges require unique solutions," *Journal of Accountancy*, October 17, 2024.

19. Notably, two well respected public finance attorneys have recently argued that market participants should reconsider opposition to the Tower Amendment, a 1970s-era law that prohibits the Securities and Exchange Commission (SEC) from directly regulating municipal issuers out of federalism concerns. Caitlin Devitt, "Muni disclosure: Time to bring in SEC?" *The Bond Buyer*, November 1, 2024.

20. "2025 Outlook – Negative as revenue growth slows and compensation costs rise," *Moody's Investors Service*, December 4, 2024.

21. Nationwide, federal revenue comprises only 13 percent of K-12 school district funds (U.S. Census data). U.S. Census, Annual Survey of School System Finances, 2022.

22. The percentage of Americans who have "a great deal/quite a lot" of confidence in U.S. higher education has declined from 57 percent in 2015 to 36 percent in 2024, per Gallup: "U.S. Confidence in Higher Education Now Closely Divided," Gallup, July 8, 2024 For the proposition that Congress may cut federal aid for higher education issuers, see "Financial Aid's Foggy Future," *Inside Higher Ed*, November 14, 2024

23. "The politics of higher ed: tax treatment at stake in election," Caitlin Devitt, *The Bond Buyer*, October 9, 2024.



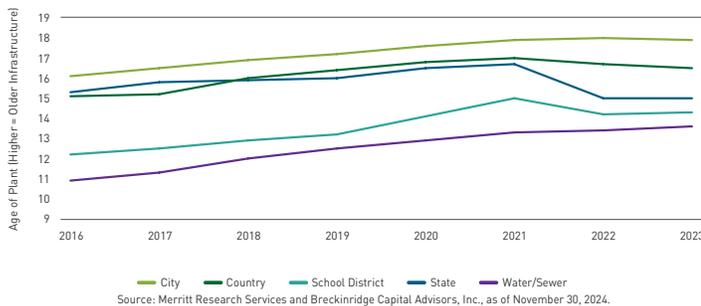
Growing budget stress for some prominent issuers.

Illinois' fiscal office anticipates a \$3 billion shortfall in FY 26 (next year).²⁴ Chicago's new budget is unbalanced by roughly \$1 billion (greater than 5 percent of revenue).²⁵ Several of California's largest cities, including Los Angeles, Oakland, San Francisco, and San Diego are reporting budget stress.²⁶ Even AAA names like Maryland and Washington State anticipate large budget gaps.²⁷ The geographic variation and distinct reasons for each issuer's deficits suggests that the credit environment will be less robust next year, especially among full service governments.

Increased debt issuance.

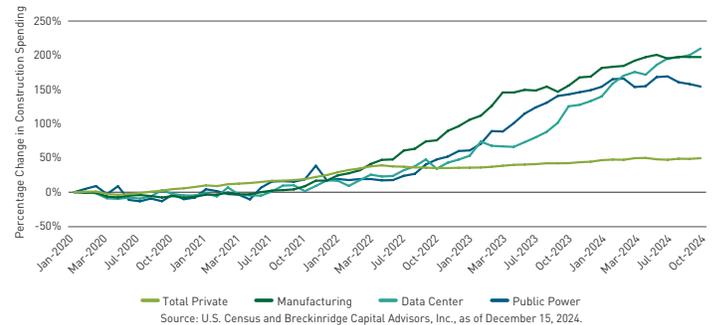
Waning federal support and slower revenue growth at the state and local level portends more borrowing for capital needs. Inflation has also increased the cost of infrastructure projects, and most sectors still face a backlog of infrastructure needs (See Figure 12).²⁸

FIGURE 12: PUBLIC INFRASTRUCTURE CONTINUES TO AGE



Climate change may also induce more borrowing. As noted in our November 21, 2024, article [Heating Up: The Muni Market Inches Closer To Pricing Climate Risk](#), adaptation-related capital spending is likely to increase over the medium-term. Electric utilities seem especially likely to issue more debt. Demand in this sector is growing on account of clean energy mandates, artificial intelligence investments, and manufacturing-related projects. (See Figure 13).²⁹

FIGURE 13: PUBLIC POWER ISSUANCE IS LIKELY TO RISE ALONGSIDE GROWING DEMAND FOR AI-DRIVEN INVESTMENTS & MANUFACTURING

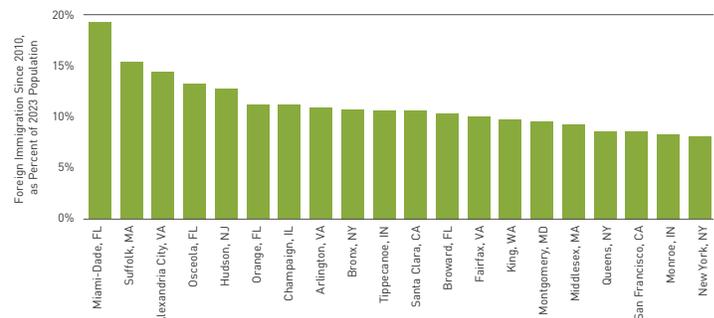


Federal policy risk.

As we outlined in our September 3, 2024 [Election Outlook 2024: Tax Risk Rising](#), the Republicans sweep of the presidency, House, and Senate presents the muni market with a variety of risks. These fall into three broad categories: executive branch regulation, budget cuts, and changes to tax policy.

- Executive branch regulation.** New immigration restrictions could shrink the pool of available workers for state and local employers and dampen the vibrancy of local economies (See Figure 14). Over time, these negatives would likely outweigh near-term savings from reduced social services spending. Tariffs could raise prices and might fall disproportionately on residents in lower-income areas.³⁰

FIGURE 14: TWENTY COUNTIES COMPRISING 13% OF U.S. GDP ARE HOME TO MANY NEW IMMIGRANTS



24. Illinois Economic and Fiscal Policy Report, p. 9, November 1, 2024.

25. "Mayor Johnson's \$17 billion budget passes, but Challenges loom for Chicago," by Tacuma Roeback, *Chicago Defender*, December 17, 2024.

26. Breckinridge analysis of each city's intra-year, periodic budget estimates, as well as third party budget monitors.

27. "Washington state budget faces broad revenue gap," by Keeley Webster, *The Bond Buyer*, December 18, 2024. Bryan Sears, "Five-year state budget projection foresees 'enormous gap' not seen in two decades," *Maryland Matters*, November 12, 2024.

28. The producer price index (PPI) for government construction costs (final demand) has risen by 31 percent since January 2020. By comparison, the Consumer Price Index (CPI) is up 22 percent over the same period (Breckinridge analysis of Bureau of Labor Statistics data, through October 2024).

29. Public Power 2025 Outlook—Stable as rate flexibility helps utilities contend with load growth, *Moody's* (December 2024).

30. As mentioned in our September 3, 2024, article on the implications of the U.S. elections. For more see [Election Outlook 2024: Tax Risk Rising](#).



Regulatory changes could also interrupt or reduce the flow of federal aid to state and local governments via creative legal maneuvers. For example:

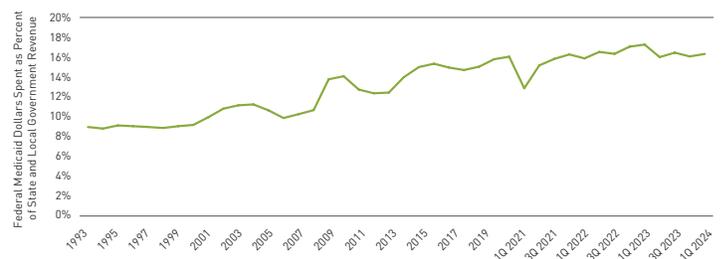
- President-elect Trump may assert authority to “impound” (refuse to spend) funds appropriated by Congress. Though legally questionable, President Nixon claimed impoundment authority in the 1970s and refused to spend money intended for state and local governments.³¹
- Certain federal grant aid may be conditioned on acceptance of restrictive immigration policy.³² At least one federal appeals court has ruled that the federal government can withhold certain public safety-related grants when a state or local government adopts a “sanctuary city” policy.³³
- New personnel rules might reduce headcount, slow the flow of federal funding, or weaken program effectiveness. The incoming administration will likely reclassify some federal civil service employees as at-will political appointees, making them easier to fire.³⁴ It may eliminate a work-from-home option for certain federal workers, and some federal offices seem likely to be relocated away from the District of Columbia.³⁵ The Department of Government Efficiency (DOGE) initiative led by Elon Musk and Vivek Ramaswamy might complement these efforts.

In our view, the above actions are likely to have limited material credit impact, but they are worth monitoring. Large cities seem particularly vulnerable to all three efforts. Nixon used impoundment to withhold housing aid and community development funds.³⁶ Cities that support “sanctuary” policies might experience cuts to grant aid. Uniquely, the District of Columbia and its suburbs in Maryland and Virginia may be vulnerable to mass layoffs or resignations of federal employees.³⁷

- **Federal budget cuts.** We anticipate the Republican Congress will pass fiscal legislation that modestly reduces or slows the increase in spending on various programs that benefit municipal issuers. This includes potential changes to Medicaid, Affordable Care Act (ACA) subsidies, mass transit funding, community development block grants (CDBG), K-12 education aid, Inflation Reduction Act incentives, and housing subsidies, among other programs.³⁸ However, eliminating entire departments or radically changing key programs may prove beyond Congress’ reach given the small 220-215 Republican majority in the House of Representatives.

While the risk is low, a significant Medicaid reform poses the most obvious long-term credit risk to the market. Medicaid funding comprises a significant portion of state and local revenue (See Figure 15). It is often a large portion of hospitals’ revenue. Communities in which a hospital is a major employer can also suffer when Medicaid reimbursements fall (slowing employment growth). In 2017, using the reconciliation process, Republicans nearly passed a bill that would have converted Medicaid to a less generous per capita or block grant program.³⁹ Similar proposals have been proffered by conservative think tanks. However, implementation may prove more challenging today given Republicans’ current coalition, which comprises less affluent voters who are generally supportive of the program.⁴⁰

FIGURE 15: MEDICAID REFORMS COULD IMPACT MUNI REVENUES



Source: Bureau of Economic Analysis and Breckinridge Capital Advisors, Inc., as of August 31, 2024.

31. The president-elect has promised to “challenge the *Impoundment Control Act* in court”. This law affirmed the understanding that presidents cannot ordinarily withhold Congressionally authorized funds. However, emerging legal theories (still representing a minority view among scholars) suggest the *Impoundment Control Act* may be unconstitutional. Prior to passage of the *Impoundment Control Act*, President Nixon claimed authority to impound appropriations, including appropriations intended for state and local governments. Note that in lieu of impoundment-by-executive-fiat, the *Impoundment Control Act* expressly permits the president to request that Congress rescind prior appropriations. President-elect Trump might make such a request for some programs, though it is unclear whether Congress would acquiesce. See: Christian I. Bale, “Note: Checking the Purse: The president’s Limited Impoundment Power,” 70 *Duke L.J.* 607 (December 2020); Robert H. Bradner et al, “*Potential Implications of a Trump Presidency for Unspent Out-year Federal Appropriations*,” Holland & Knight (July 16, 2024); Richard Kogan, “FAQs on Impoundment: Presidential Actions Are Constrained by Long-Standing Constitutional Restrictions,” Center on Budget and Policy Priorities, November 2024.
32. “Making Federalism Great Again: How the Trump Administration’s Attack on Sanctuary Cities Unintentionally Strengthened Judicial Protection for State Autonomy,” by Ilya Somin, *Texas Law Review*, Vol. 97, pp. 1247-1294 (June 2019).
33. *New York v. United States DOJ*, 981 F. 3d 84, February 26, 2020. See also, p. 566 of Heritage Foundation’s “Mandate for Leadership” publication, also known as “Project 2025.”
34. Some federal workers would likely retire, resign, or be fired under such a policy. Significant swaths of employees who carry out certain functions could be reclassified under Schedule F to frustrate or slow program implementation that benefit municipal issuers. Donald P. Moynihan, “Public Management for Populists: Trump’s Schedule F Executive Order and the Future of the Civil Service,” *Public Administration Review*, Jan/Feb 2022.
35. “The man with a plan to upend government, and what it entails,” Krawzak and Cohn, *Roll Call*, December 2, 2024.
36. “Item Veto and Expanded Impoundment Proposals: History and Current Status,” *Congressional Research Service*, June 8, 2010.
37. Non-city federal workers comprise 25 percent of the District’s payrolls. Breckinridge analysis of Bureau of Labor Statistics data.
38. Jared Brey, “What Drives Republican Opposition to Transit,” *Governing.com*, March 13, 2024; Allison Orris and Gideon Lukens, “Medicaid Threats in the Upcoming Congress,” *Center on Budget and Policy Priorities*, December 13, 2024; David Reich and Sonali Master, “House Republican Bills Deeply Cut Programs That Help Low-Income People and Underserved Communities,” *Center on Budget and Policy Priorities*, November 22, 2024.
39. “*Medicaid Changes in Better Care Reconciliation Act (BCRA) Go Beyond ACA Repeat and Replace*,” Robin Rudowitz, Larisa Ntonisse, and MaryBeth Musumeci, *Kaiser Family Foundation*, July 21, 2017. Available at:
40. As mentioned in our September 3, 2024 article on the implications of the U.S. elections. For more see [Election Outlook 2024: Tax Risk Rising](#).



- **Tax policy.** A major goal of the incoming Congress is to extend the provisions of the 2017 *TCJA*, which expires at the end of 2025.⁴¹ Republican leaders are also exploring additional tax cuts. This includes lowering the corporate income tax rate, restoring (in whole or in part) the state and local tax deduction, eliminating social security taxes, and making tip-income tax-free. Extending provisions in the *TCJA* would increase federal deficits by \$4 trillion over 10 years.⁴² Additional tax breaks would grow them further.

Here again, Republicans' slim House majority may limit their tax-reform ambitions. Some members may balk at the cost of extending existing tax breaks or cutting additional taxes. Others may refuse to eliminate popular exemptions to pay for the extensions (such as the exclusion for municipal bond interest). We expect Congress will come to a fiscal agreement only toward the end of 2025 when faced with the possibility that the *TCJA* might expire (and individual tax rates go up).

Nonetheless, tax reforms that implicate muni investments are likely to be *considered* throughout the year. The possibility that lawmakers tinker with the municipal tax exemption cannot be ruled out. There is momentum to restore the SALT deduction, at least in part.⁴³ Figure 16 summarizes key tax considerations for muni investors. More thoughts on tax-related risk are available in our September 3, 2024, article, [Election Outlook 2024: Tax Risk Rising](#) and in the “technical” section below.

FIGURE 16: CURRENT TAX RATES & POTENTIAL CHANGES TO ADDRESS EXPIRING TCJA

	If TCJA Expires			
	Current	(Congress Does Nothing)	Potential "Fix"	Likelihood
TOP RATES				
Individual	37%	39.6%	37%	High
Interest	37%	39.6%	37%	High
Dividends	20%	20%	20%	High
Capital Gains	20%	20%	20%	High
Corporate	21%	21%	21%	High
MUNI-RELATED				
Advance Refundings	Prohibited	Prohibited	Prohibited	High
SALT Deduction	Capped at \$10k	Unlimited	Cap Lifted to ≈\$20k, Cap Lifted Entirely	High, Low
Muni Interest	Untaxed	Untaxed	Left Untaxed, Surtax Imposed*	High, Low
Private Activity Bonds (PABs)	Untaxed	Untaxed	Subject to Tax	Medium
AMT Bonds	Subject to AMT	Subject to Lower AMT	AMT Threshold Increased	Medium
Private Higher Education PABs	Untaxed	Untaxed	Subject to Tax	Medium

*“Surtax” could take the form of a cap on the amount of interest income excluded from income (e.g., Obama’s 28 percent cap) or a straightforward surtax (e.g., 10 percent of interest).

Sources: Internal Revenue Service, Tax Policy Center and Breckinridge Capital Advisors, Inc., as of December 15, 2024.

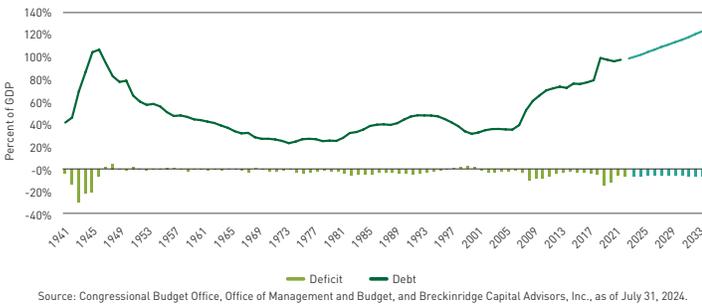
41. “Tax Cuts Take Lead Over Deficit Worries in GOP’s Internal Fight,” by Richard Rubin, *Wall Street Journal*, December 16, 2024.

42. Estimate from the Committee for a Responsible Federal Budget, December 2024.



- **The deficit.** As we have outlined in prior *Outlooks*, the federal government’s unsustainable fiscal trajectory creates ongoing risks for municipal bonds, as an asset class. This year’s heightened federal-grant and tax risk underscores this reality, as the potential for fiscal consolidation grows (See Figure 17). Investor jitters in some developed sovereign bond markets, including the U.K., France, and Japan, hint at growing potential for a fiscal-disciplining event in the Treasury market, as well.

FIGURE 17: DEBT AND DEFICITS ARE RISING



Source: Congressional Budget Office, Office of Management and Budget, and Breckinridge Capital Advisors, Inc., as of July 31, 2024.

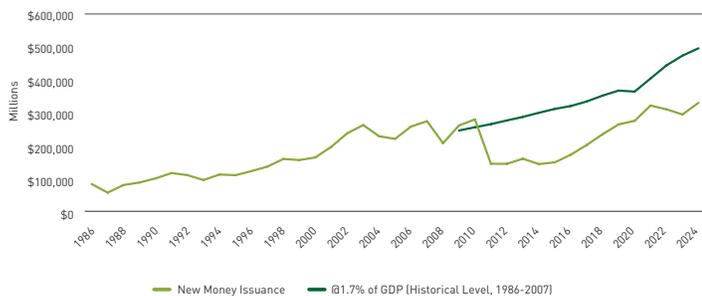
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Supply seems likely to outpace demand in 2025, creating the potential for higher ratios, spreads, and volatility compared to the past two years.

Supply.

We anticipate increased issuance in 2025, driven mostly by an uptick in new money bonds. As noted above, fundamentals support this view. Issuers are likely to debt-finance more infrastructure, as unusually strong pandemic-era revenue performance wanes. Inflation has increased the cost of projects. Deferred maintenance remains a challenge in most sectors, and climate adaptation efforts will likely add to issuers’ capital plans. An uptick in supply in 2025 would build on 2024’s record \$500+ billion in issuance, which hinted at a return to pre-2008 borrowing behavior (See Figure 18).⁴⁴

FIGURE 18: NEW MONEY ISSUANCE MAY BE RETURNING TO ITS HISTORICAL PATTERN



Source: Bureau of Economic Analysis, Bond Buyer, and Breckinridge Capital Advisors, Inc., as of December 15, 2024.

There is also the possibility that Congress considers altering the tax exemption. This could spur additional issuance. For example, we anticipate that some private activity bond (PAB) issuers will pull forward transactions out of concern that Congress curtails their access to the exemption after 2025. (Private activity bonds often include airport, hospital, housing, private college, and industrial development financings, among others.) For perspective, issuers rushed to market in December 2017 before the *TCJA* eliminated the option to advance refund securities. Historically, tax changes, elections, and idiosyncratic risks have driven large months of issuance (See Figure 19).

FIGURE 19: TAX, ELECTION, & IDIOSYNCRATIC RISKS EXPLAIN THE HIGHEST MONTHS OF MUNI ISSUANCE

Month	Issuance (\$)	Rank	Notes
10-2020	\$73,448	1	2020 Election
12-2017	\$69,827	2	Last Month Before Congress Bans Advance Refundings
10-2024	\$64,642	3	2024 Election
10-2019	\$55,775	4	Taxable Advance Refundings Take Off
9-2020	\$53,513	5	Taxable Advance Refundings + COVID Borrowings
10-2016	\$53,447	6	2016 Election
6-2020	\$52,390	7	Taxable Advance Refundings + COVID Borrowings
4-2008	\$51,722	8	GFC-Related Refinancings
6-2008	\$50,788	9	GFC-Related Refinancings
8-2024	\$50,612	10	2024 Election + Secular Return to Issuance

Sources: *Bond Buyer* and Breckinridge Capital Advisors, Inc., as of December 15, 2024.

43. “Tax Cuts Take Lead Over Deficit Worries in GOP’s Internal Fight,” by Richard Rubin, *Wall Street Journal*, December 16, 2024.

44. Per Bloomberg (\$525 billion across new money and refundings), December 18, 2024.

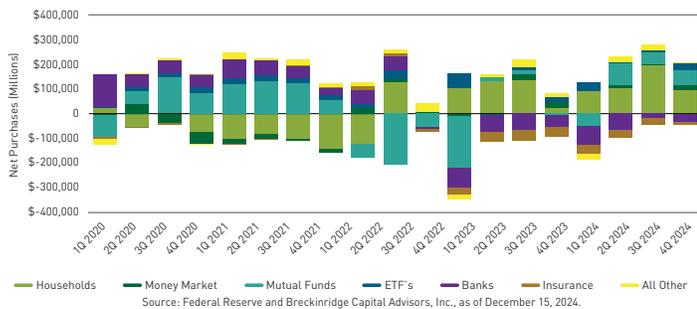


Demand.

Demand for munis is likely to slow slightly in 2025 relative to 2024, at least while tax risk remains elevated. Inflows could pick up later in the year when (and if) tax risk abates.

In 2024, the market grew more reliant on retail demand via separately managed accounts (SMAs), exchange-traded funds (ETFs), and mutual funds. Banks and insurers continued to be net sellers of municipal securities (See Figure 20).

FIGURE 20: RETAIL BUYERS ADDED TO MUNICIPAL EXPOSURE IN 2024 AS BANKS & INSURERS RECEDED



SMA buyers, in particular, have found value in higher all-in yields notwithstanding low ratios (See Figures 21 and 22).

FIGURE 21: HOUSEHOLD DEMAND (A PROXY FOR SMAS) HAS BEEN STRONG AS YIELDS HAVE RISEN...

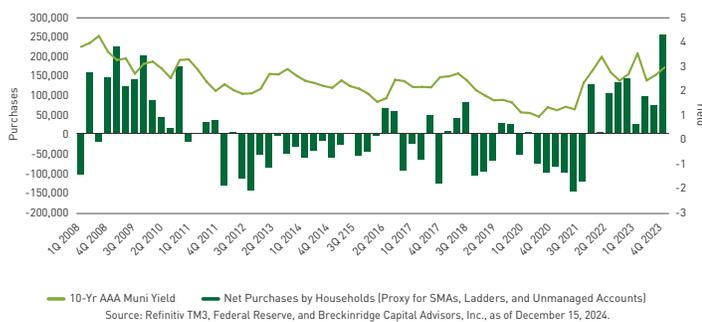


FIGURE 22: ... EVEN AS M/T RATIOS DECLINED



We anticipate weaker muni demand in 2025 based both on periods of elevated supply as well as investor uncertainty over the future of the exemption. Periods of higher supply may dampen total returns and push up M/T ratios, from time to time.

Total return-oriented funds may step away from the market more often, waiting for yields to settle. Likewise, investors who anticipate that Congress might impose a tax on municipal interest might participate in the market less often. Strong asset market performance in 2024 also suggests there may be elevated selling to fund tax payments in Spring 2025. Finally, banks and insurers seem unlikely to increase their muni market participation meaningfully given that the new Congress is unlikely to increase corporate income tax rates and may even try to lower them from the current 21 percent rate.

Later in 2025, if policymakers provide clarity that the exemption will remain untouched (or clarify that only portions of the market become taxed), demand could pick up.

In short, the technical backdrop portends higher ratios, spreads, and volatility at least relative to 2023 and 2024.

VALUATIONS

Entering 2025, credit spreads are low (See Figure 23) and the municipal yield curve is relatively flat (See Figure 24).

FIGURE 23: CREDIT SPREADS ARE VERY LOW AS A PERCENT OF THE AAA MUNI YIELD

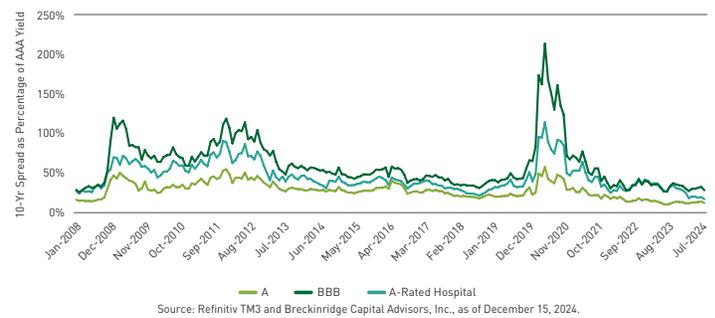
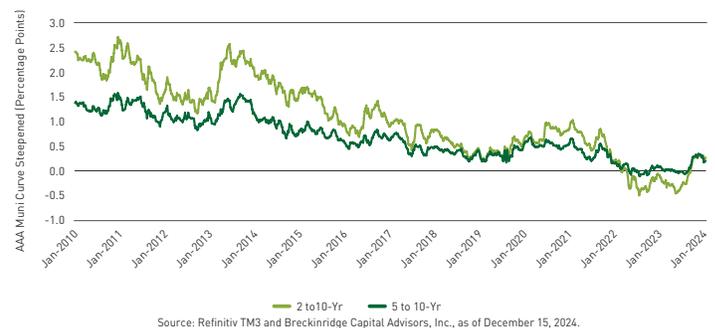


FIGURE 24: A RELATIVELY FLAT MUNI YIELD CURVE COULD STEEPEN ON TAX-RISK CONCERNS



- 45. As reported: “*SF faces dire financial outlook with \$876M budget deficit*,” *NBC Bay Area*, December 4, 2024; “*Illinois faces a \$3 billion shortfall in 2026, a new report shows*,” *Chicago Sun Times*, November 1, 2024, and “*Chicago’s FY 2025 Proposed Budget Exacerbates Structural Imbalance*,” *The Civic Federation*, November 13, 2024.
- 46. As mentioned in our September 3, 2024, article on the implications of the U.S. elections. For more see *Election Outlook 2024: Tax Risk Rising*.



Given that we expect credit quality to diverge and supply/demand risks to push M/T ratios higher and volatility throughout the year, we favor a high-quality ratings bias and neutral approach to duration risk to begin the year.

However, we anticipate opportunities for credit picking. Potential legislation to reform Medicaid or reduce federal higher education grants, coupled with suggestions to limit PAB financings, could result in differentiated hospital and higher education spreads. Renewed deficits among some A and AA-rated tax backed names (e.g., Chicago, Illinois, San Francisco⁴⁵) suggests there may be increased value in more granular high-grade credit assessments, moving forward.

There may also be opportunities to modestly shorten or extend duration during the year to enhance performance. The M/T ratio and yield curves may steepen on proposals to tax municipal interest, in whole or in part. (For example, the Obama administration proposed capping the exemption at a 28 percent tax rate several times during the 2010s; former House Ways and Means Chairman Dave Camp proposed a 10 percent surtax on municipal interest.⁴⁶) The potential for elevated new money issuance may also exacerbate (or lessen) the market's seasonal trends.

Breckinridge anticipates its active approach to credit analysis, understanding of federal policymaking, and ability to manage duration within very disciplined ranges should add value for clients in 2025.

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