

Mid-Year Municipal Market Outlook 2026

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SUMMARY

- Entering the second half of 2026, municipal market credit is stable with some signs of sector weakness.
- Balanced demand and supply at high levels could moderate on interest rate changes.
- Credit spreads are tight, the 2- to 10-year curve steepened, the 10- to 15-year curve flattened, and tax-equivalent yields are near multi-year highs.

QUICK LINKS:

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Fundamentals:

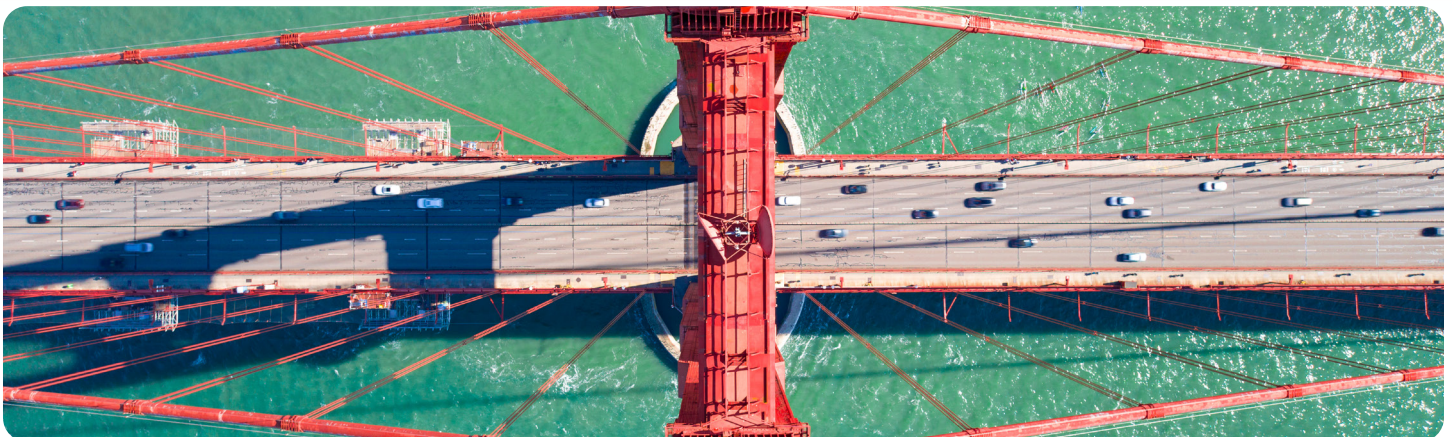
- Municipal credit quality remains stable entering 2H2026, but signs of weakness are emerging across the education space and for some local governments amid a property tax backlash.
- Pension systems remain in solid condition, and the Iran war has had only a limited impact on issuers.
- Interstate tax competition, the artificial intelligence (AI) buildout, and the 2026 midterm elections are top of mind for clients (and we discuss them at length below), but each presents limited actionable credit calls, for now.
- California's wealth tax ballot initiative may not pass, and if it does, would be difficult to implement.

Technical:

- Demand and supply remain in balance. Mutual fund and exchange traded fund (ETF) inflows have been positive each month in 2026 and are close to a year-to-date record, while supply has outpaced the last two years of record volume.
- Supply may slow in the second half of the year if interest rates stay on a higher-for-longer path and the Federal Reserve (Fed) raises rates. Higher rates will impact refunding volume, and issuers may delay borrowing and wait for policy clarity until after the midterm elections (hospitals, higher ed).

Valuations:

- Credit spreads remain tight given strong demand and continued economic growth.
- Municipal/Treasury (M/T) ratios are low on a longer-term look-back but within recent ranges.
- The 2- to 10-year curve steepened during the first half of 2026 but may have further to go.
- There may be more opportunities within credit and ratio trades in the second half given the incrementally weakening fundamental environment and the potential for Fed-related rate volatility.
- Tax-equivalent yields remain near multi-year highs.²



1. The Municipal/Treasury (M/T) ratio compares yields of municipals bonds with those of U.S. Treasury bonds of the same maturity. M/T ratios can show the relative value of municipal bonds compared with taxable bonds, by indicating when yields for municipal bonds exceed the after-tax yields on taxable bonds.

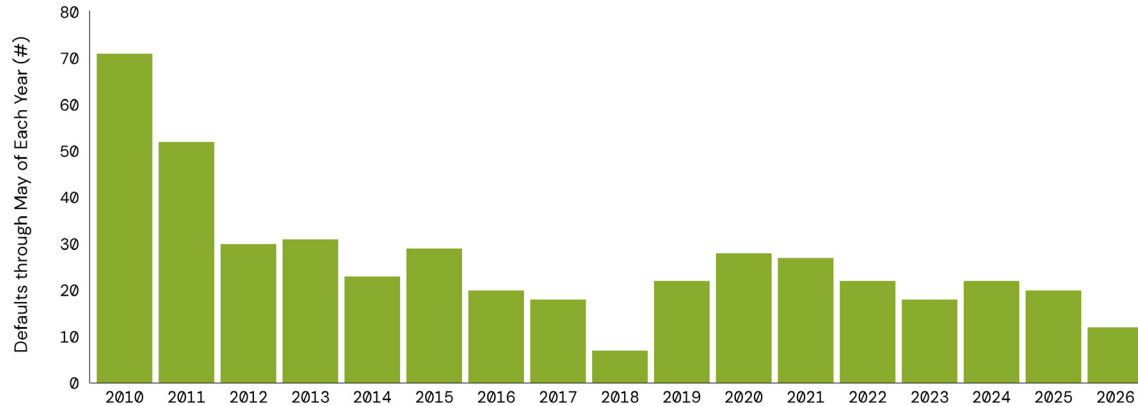
2. TEY assumes the highest federal tax rate of 37% plus an additional 3.8% net investment income tax for a combined rate of 40.8%. TEY for investors in lower tax brackets will be less than what is presented. Breckinridge is not a tax advisor and does not provide personal tax advice.



Fundamentals

Ratings & Defaults. Nearly 95 percent of the debt in the Bloomberg (BBG) Municipal Bond Index³ is now rated A-/A3 or better.⁴ That's a historically high figure and consistent with the market's stable impairment trend and low default rate (See Figure 1).⁵

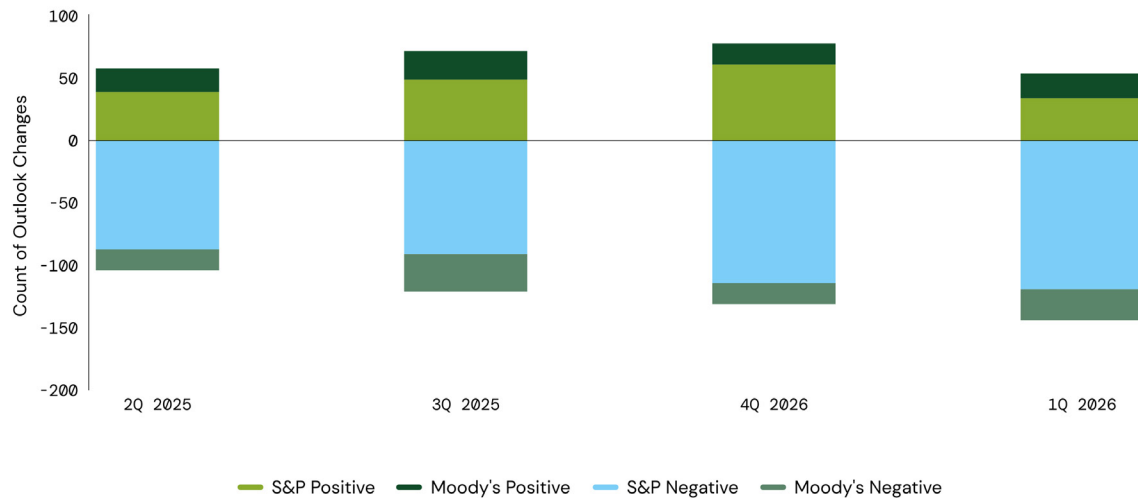
FIGURE 1: THE DEFAULT COUNT REMAINS LOW



Source: Municipal Market Advisors and Breckinridge Capital Advisors, Inc., as of May 2026.

However, the upward ratings bias that characterized the market after the COVID-19 pandemic shows some signs of reversing. Notably, downgrades outpaced upgrades at S&P *Global Ratings* (S&P) in five of the six months through April 2026.⁶ Negative outlooks are on the rise at both S&P and *Moody's Ratings* (Moody's) (See Figure 2).

FIGURE 2: NEGATIVE OUTLOOKS ARE BECOMING MORE COMMON



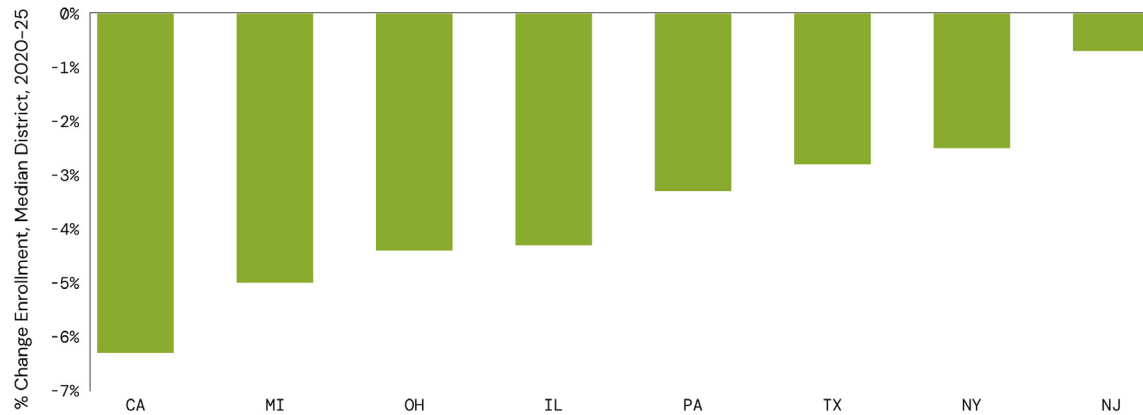
Source: Moody's, S&P, and Breckinridge Capital Advisors, Inc., as of May 2026.

3. The BBG Municipal Bond Index is an unmanaged index considered representative of the broad market for investment-grade municipal bonds. Bonds in the index have remaining maturities of at least one year. You cannot invest directly in an index.
4. Index data from Bloomberg/Barclays Broad Market Index, using lowest of S&P and Moody's ratings, as of May 21, 2026. Federal bankruptcy data per the U.S. federal court system.
5. Municipal Market Analytics, May 20, 2026 Default Trends report.
6. Breckinridge analysis of monthly S&P "Public Finance Rating Activity" data, May 2026.



Weaker education sectors. Downgrades have been concentrated in education-related sectors, including charter schools, private higher education, and even traditionally safe, tax-backed public K-12 school districts.⁷ In our 2026 Municipal Market Outlook, we noted that the operating environment for education providers is pressured by a mix of factors, including enrollment declines (See Figure 3), competition from voucher programs, decreased immigration, poor fiscal management of one-time COVID-19 aid, property tax fatigue, and federal regulatory pressure.

FIGURE 3: K-12 PUBLIC SCHOOL DISTRICT ENROLLMENT DECLINES ARE WIDESPREAD*



*Based on sample in each state of at least 246 districts with debt outstanding.

Source: Merritt Research Services and Breckinridge Capital Advisors, Inc., as of May 2026.

Local governments & property tax/cost-of-living backlash. There are also signs of weakening in the local government sector. Notably, the three largest U.S. cities by population each experienced a negative rating action in 1H2026. *Moody's* and *Fitch Ratings* (*Fitch*) placed New York City on negative outlook after the city forecasted larger-than-expected, spending-driven budget deficits. *Moody's* downgraded Los Angeles on “weaker finances” and ongoing litigation over the 2025 Palisades wildfire. *Fitch* downgraded Chicago for its persistent budget gaps and entrenched political gridlock.

More broadly, local governments are having more difficulty increasing property taxes. At least 17 states considered property tax relief legislation in 2026. Relief measures lessen the tax impact of rapid home-price appreciation relative to incomes, since 2020 (See Figure 4). They are also a visible way for policymakers to address cost-of-living pressures. (Note that real wage growth has been flat since February 2025.⁹ The Michigan Consumer Confidence Index is at an all-time low, and the national savings rate reached a very low 2.6 percent in April 2026.¹⁰) However, property tax caps and limits tend to pressure budgets.¹¹ The property tax is the largest source of tax revenue for many local governments.¹²

7. For example, the charter school impairment count reached 31 in May 2026 per Municipal Market Analytics' database. This is the highest count on record, even though there are seven more months in 2026.

8. This includes states with many issuing local governments such as Florida, Georgia, Michigan, and Ohio. Estimated aided by AI-driven search.

9. Per the Bureau of Labor Statistics, real average hourly earnings for all employees was \$11.24 in February 2025 and \$11.25 in April 2026.

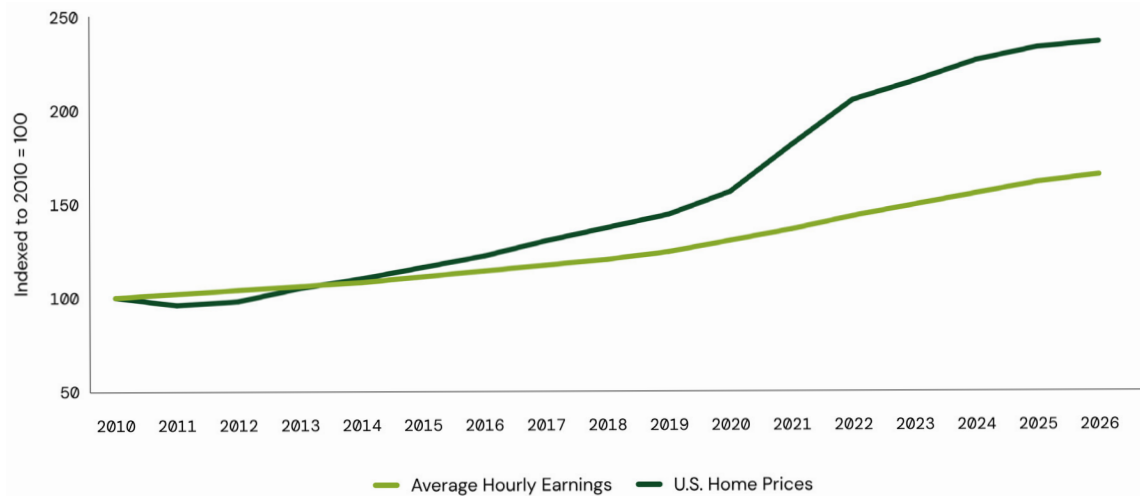
10. St. Louis Federal Reserve (FRED) data and Bureau of Economic Analysis. The personal savings rate in April 2026 was the 29th lowest on record, going back to January 1959, on a monthly basis (808 months).

11. “State Property Tax Reform Efforts Continue Amid Local Fiscal Strains,” Pew Charitable Trusts, February 24, 2026. Available at: <https://www.pew.org/en/research-and-analysis/articles/2026/02/24/state-property-tax-reform-efforts-continue-amid-local-fiscal-strains>.

12. Tax Foundation, Property Tax Relief & Reform, 2026. Available at: <https://taxfoundation.org/research/state-tax/property-tax-relief/>.



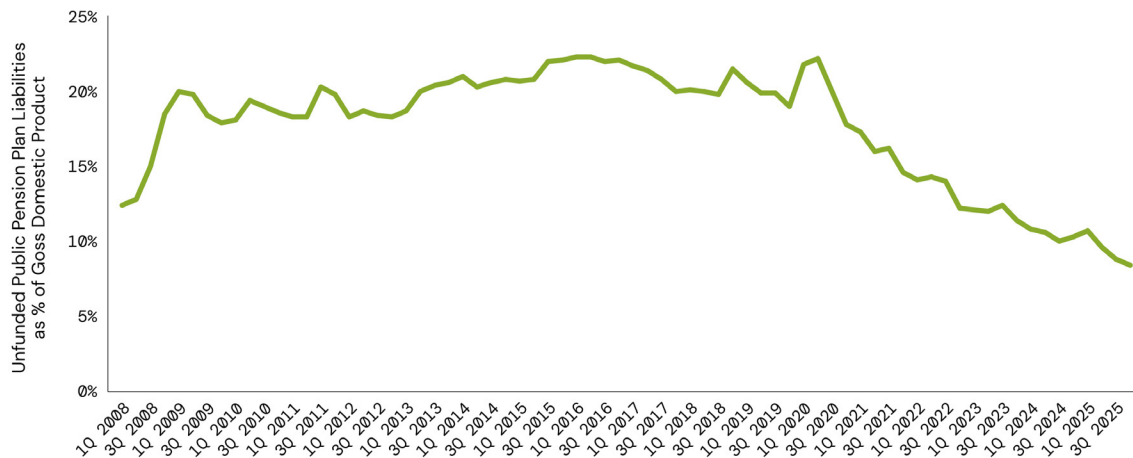
FIGURE 4: ERODING PUBLIC SUPPORT FOR PROPERTY TAX HIKES PARTLY REFLECTS FAST-RISING HOME PRICES RELATIVE TO INCOMES



Source: Bureau of Labor Statistics, Federal Housing Finance Agency, and Breckinridge Capital Advisors, Inc., as of May 2026.

Still solid pension health. Pension risk continues to subside in most places. The multi-year rise in equity market appreciation coupled with higher interest rates contributed to a reduction in unfunded liabilities for many issuers (See Figure 5). The funding ratio for the 100 largest public pension plans was 84 percent in April 2026.¹³ Going forward, pension risk is likely to be more issuer-specific and concentrated in cases where pension contributions comprise a large percentage of overall spending or where aggressive asset-allocation decisions lead to sharp asset repricing.

FIGURE 5: UNFUNDED PENSION LIABILITIES DECLINING



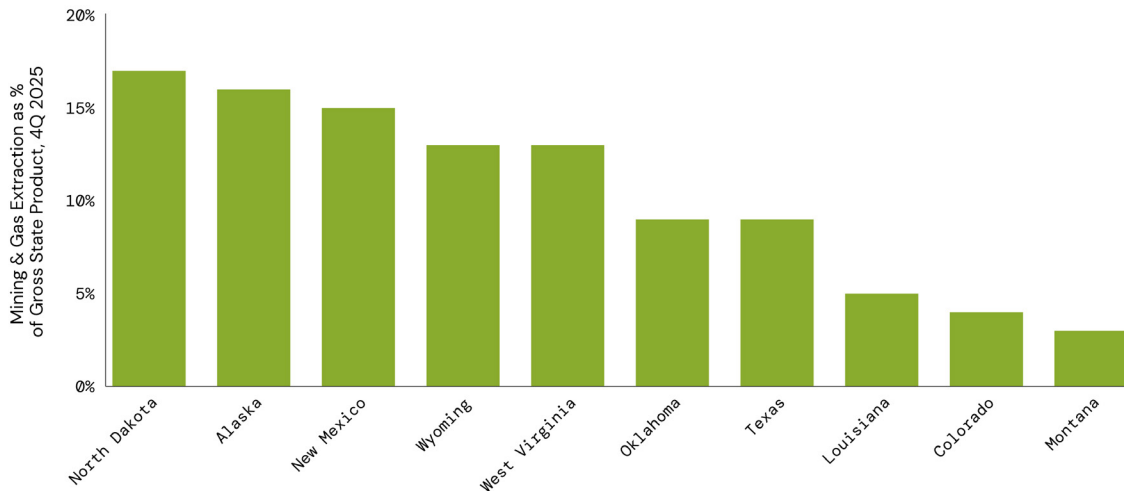
Source: Federal Reserve and Breckinridge Capital Advisors, Inc., as of May 2026.

13. Milliman Public Pension Funding Index (April 2026). Available at: <https://www.milliman.com/en/insight/public-pension-funding-index-april-2026>.



Manageable Iran war impact. Higher oil prices tend to benefit oil-reliant states via higher severance tax collections (See Figure 6). New Mexico may collect \$850 million more than expected for fiscal year (FY) 2026 (the current fiscal year).¹⁴ Alaska recently increased its revenue forecast.¹⁵

FIGURE 6: OIL-PRODUCING STATES MAY BENEFIT FROM SUSTAINED HIGHER OIL PRICES



Source: Bureau of Economic Analysis and Breckinridge Capital Advisors, Inc., as of May 2026.

A federal gas tax holiday represents the war's most immediate credit risk for munis. A gas tax suspension would negatively impact GARVEE (grant anticipation revenue vehicle) bonds, which are directly backed by gas taxes in the federal Highway Trust Fund (HTF).¹⁶ Fortunately, all legislation proposed to date would replenish any HTF shortfalls.

Three thematic issues that arose in conversations with clients year-to-date have mixed implications for investors:

(a) Interstate tax competition and migration risk

Tax policy diverged meaningfully this year across states. In Washington, lawmakers enacted the state's first income tax, a 9.9 percent levy on incomes over \$1 million.¹⁷ In New York, lawmakers passed a property tax on New York City's high-end nonprimary homes.¹⁸ In California, in November, voters may enact the nation's first state-based wealth tax.¹⁹ In Minnesota, lawmakers are considering a wealth tax, though legislation has been tabled.²⁰

By contrast, eight states lowered their individual income tax rates in 2026. This is consistent with a multi-year pattern in which more states lowered income tax rates than raised them.²¹

Growing tax policy divergence may weaken fundamentals in some higher-tax states, over time. Consider the following visuals.

14. Per the legislature's budget and accountability office as cited by the AP. <https://apnews.com/article/new-mexico-strait-hormuz-oil-haaland-bregman-79d4fe226494eb79aca6b4bb92e5c6a0>.

15. Alaska Department of Revenue Spring 2026 Forecast, March 2026.

16. For example, like the bill proposed by Senators Kelly and Blumenthal in Spring 2026. <https://www.congress.gov/bill/119th-congress/senate-bill/4032/text>.

17. Washington's millionaire's tax law remains subject to litigation. Notably, the Washington constitution has been interpreted to bar progressive income taxes. The millionaire's tax was structured to work around this prohibition by characterizing "income" as something that is "received" as opposed to a "form of property". In 2023, the Washington State Supreme Court permitted an "excise" tax on the receipt of capital gains income on the grounds that such income was not a form of property. The court may rule in the same fashion after hearing arguments on the new, progressive income tax rate. See: "Historic millionaire's tax and other important changes enacted in Washington," Baker Tilly, April 7, 2026 (<https://www.bakertilly.com/insights/washington-millionaires-tax-and-tax-updates>) and <https://nslawgrp.com/washingtons-proposed-millionaires-tax-2026-update-and-legal-analysis/>.

18. Passed as part of New York's state budget, on May 28, 2026. The tax would eventually be imposed on properties worth \$5 million or more with tax rates beginning at 0.8 percent and rising to 0.3 percent as the value of property rises.

19. See: "California One-Time Wealth Tax for State-funded Healthcare, Education, and Food Assistance Programs Initiative."

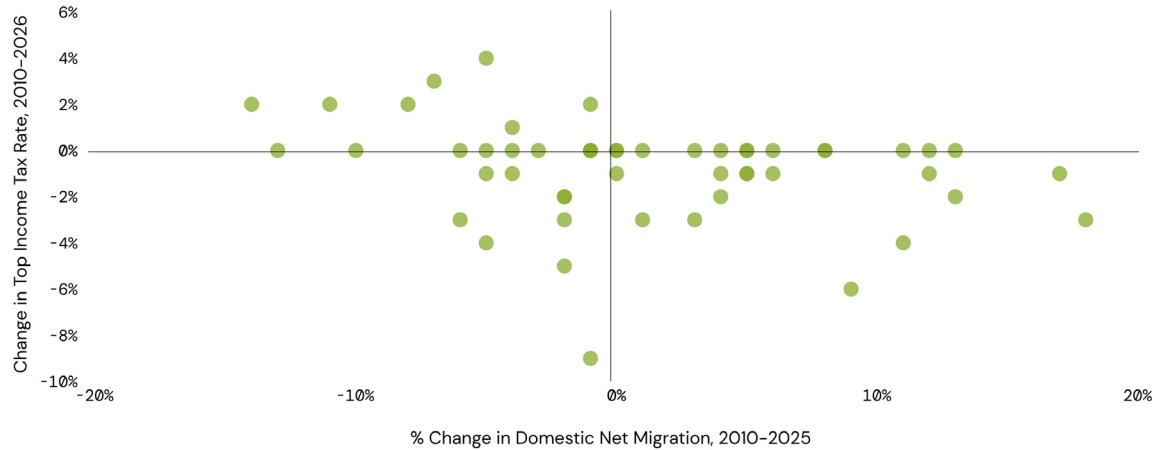
20. "Minnesota Wealth Tax Proposal Stalls in 2026 Session but Expected to Reemerge in 2027," Lathrop GPM. <https://www.lathropgpm.com/insights/minnesota-wealth-tax-proposal-stalls-in-2026-session-but-expected-to-reemerge-in-2027>.

21. See various Tax Foundation analyses at: <https://taxfoundation.org/research/all/state/2026-state-tax-changes/> and <https://taxfoundation.org/blog/state-income-tax-trends/>.



States with higher tax rates have experienced an outmigration of residents over the past 15 years (See Figure 7).

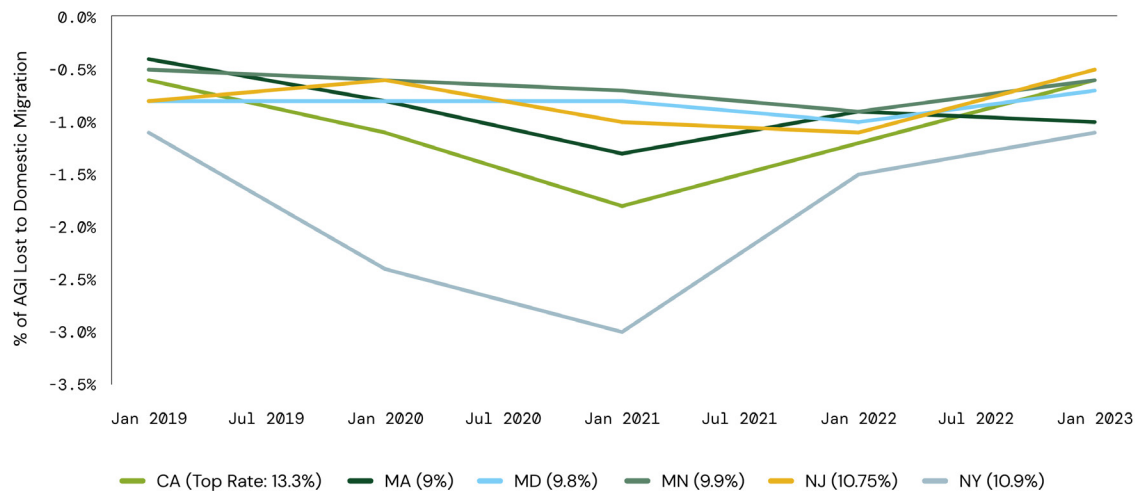
FIGURE 7: LOWER-TAX STATES ATTRACTED MORE U.S. RESIDENTS SINCE 2010



Source: U.S. Census, Tax Foundation, and Breckinridge Capital Advisors, Inc., as of May 2026.

Movers tend to be more affluent, which resulted in a net outflow of taxable income from higher- to lower-tax states (See Figure 8).

FIGURE 8: HIGHER-TAX STATES LOST ADJUSTED GROSS INCOME (AGI) TO MOVERS

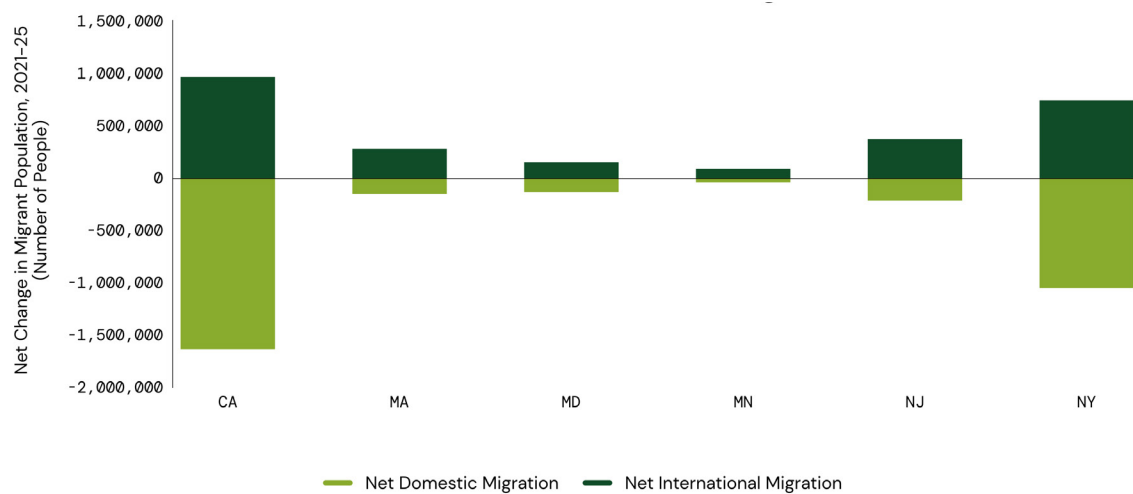


Source: Internal Revenue Service, Tax Foundation, and Breckinridge Capital Advisors, Inc., as of May 2026.



Foreign immigration has offset the loss of tax revenue and economic activity from departing residents (See Figure 9). But current policy calls for less immigration, not more. The outflow of taxable income may grow as a result.

FIGURE 9: IMMIGRATION OFFSET POPULATION & AGI OUTFLOW, BUT THIS PATTERN COULD CHANGE



Source: U.S. Census and Breckinridge Capital Advisors, Inc., as of May 2026.

The tax savings from moving has grown larger in some places. Take California and New York, which comprise a combined 32 percent of the intermediate-duration muni market.²² Since 2010, the combined effective local, state, and federal top income tax rate rose by 12.2 percent in California and 14.8 percent in New York City (See Figure 10).²³

FIGURE 10: TOP EFFECTIVE PERSONAL INCOME TAX RATES HAVE RISEN IN THE LARGEST SPECIALTY STATES

	2010 CA	2026 CA	2010 NY	2026 NY
Top Personal Income Tax Rate	35.0%	37.0%	35.0%	37.0%
Net Investment Income Tax	0.0%	3.8%	0.0%	3.8%
State Personal Income Tax Rate	10.6%	13.3%	9.0%	10.9%
NYC Personal Income Tax Rate	N/A	N/A	3.9%	3.9%
Deductability of State Income Tax	YES	NO	YES	NO
Effective Federal Tax Rate + State Tax Rate + Local Tax Rate	41.9%	54.1%	40.8%	55.6%
Change Since 2010		12.2%		14.8%

Source: Tax Foundation and Breckinridge Capital Advisors, Inc., as of March 2026.

Notwithstanding the backdrop, Breckinridge cautions against anchoring investment decisions around tax competitiveness, alone.

22. Per the BBG Municipal Bond 1-10 Year Blend (1-12 Year) Index, as of June 12, 2026. The BBG Municipal Bond 1-10 Year Blend (1-12 Year) Index measures the performance of short and intermediate components of the Municipal Bond Index. It is an unmanaged, market value-weighted index which covers the U.S. investment grade, tax-exempt bond market. You cannot invest directly in an index.

23. The increase in effective tax rates results both from higher state personal income tax rates imposed in both states as well as the cap on the federal deduction for state and local income taxes for high-income taxpayers, which was enacted as part of the 2017 Tax Cuts and Jobs Act. The cap on was recently made permanent, with certain changes, in the One Big Beautiful Bill Act (OBBBA) in 2025.

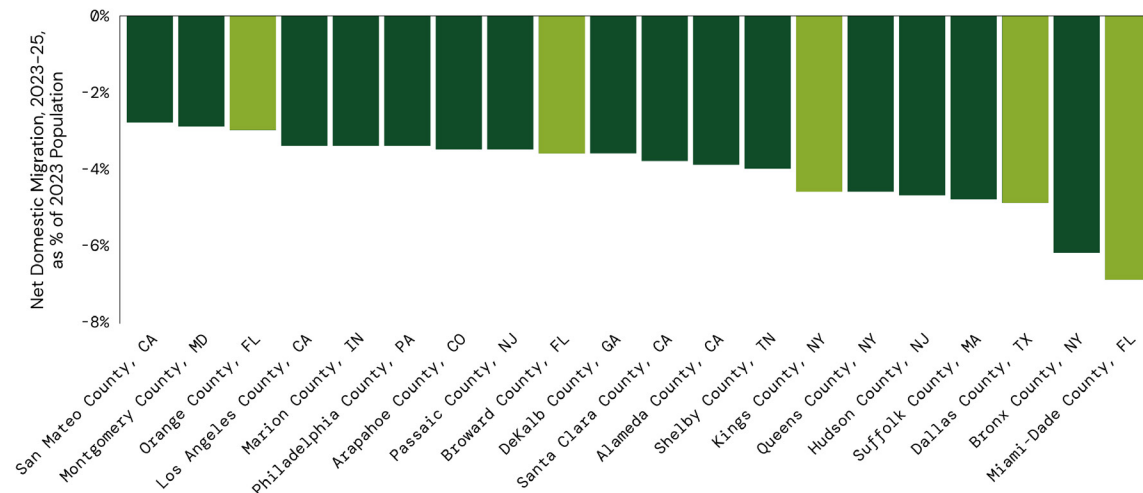


First, recent migration trends reflect more than interstate tax differentials. They also reflect cost-of-living concerns, especially high housing costs. Many high-tax states are reorienting policy to address this problem, which may eventually blunt the pace of outmigration.²⁴

Second, housing costs are not just a high-tax-state problem. Among the 20 counties with at least 500,000 residents and the most net domestic outmigration between 2023 and 2025, five were in states with no income tax (See Figure 11). Miami-Dade County, FL, lost nearly 7 percent of its domestic population since 2023. Its rental market is among the least affordable in the U.S.²⁵

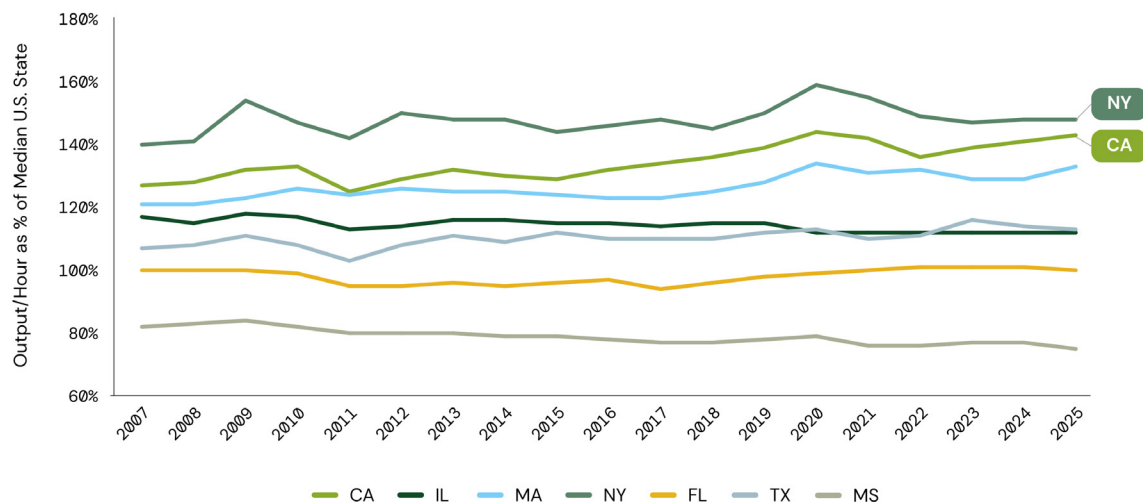
Third, high-tax states exhibit remarkably durable and high productivity relative to peers (See Figure 12). This reflects a mix of factors, including generally high educational attainment, a “hustle” culture in certain locations, and the “agglomeration” effects associated with population density in large urban areas.²⁶ The capital and labor networks in Silicon Valley and New York City have generally powered their regional and state economies *despite* the loss of residents.

FIGURE 11: HOUSING AFFORDABILITY CHALLENGES DROVE OUTMIGRATION FROM COUNTIES IN LOW-TAX STATES



Source: U.S. Census and Breckinridge Capital Advisors, Inc., as of June 2026.

FIGURE 12: PRODUCTIVE STATES TEND TO STAY RELATIVELY PRODUCTIVE DESPITE OUTFLOW OF RESIDENTS



Source: Bureau of Economic Analysis, Bureau of Labor Statistics, and Breckinridge Capital Advisors, Inc., as of June 2026.

24. Plerhoples Stacy, Mehrotra, and Hendy, “States are Stepping in to Address the Housing Affordability Crisis. Is Your State Doing Enough?”, Urban Institute, October 14, 2025. Available at: <https://www.urban.org/urban-wire/states-are-stepping-address-housing-affordability-crisis-your-state-doing-enough>.

25. See April 2026 WalletHub study, available at: <https://wallethub.com/edu/cities-with-the-most-affordable-rent/147756>.

26. Productivity growth is generally understood to drive real gross domestic product (GDP) growth. Factors that are associated with productivity growth include educational attainment (<https://ourworldindata.org/grapher/productivity-vs-educational-attainment>) and network effects (Edward Glaeser, “Agglomeration Economics,” The University of Chicago Press, February 2010. Available at: <https://www.nber.org/system/files/chapters/c7977/c7977.pdf>). For the proposition that “hustle” culture is back, see: <https://www.wsj.com/tech/ai/ai-race-tech-workers-schedule-1ea9a116>.



The people and companies that remain generally have high incomes and capital to deploy. Aggregate state income in high tax states has typically grown faster than the net amounts lost to movers.²⁷

Fourth, AI-related investment may supercharge productivity and tax receipts. Notably, job growth in the San Jose, CA, metropolitan area exceeded all but one of 25 metro areas in Texas in the 12 months through April 2026.²⁸ Revenues outperformed budget projections in California, Massachusetts, and New York in the current fiscal year, and initial public offerings for OpenAI, Anthropic, and SpaceX may further increase near-term revenue in each state.²⁹ Anthropic's Claude app is utilized most in high-productivity states.³⁰

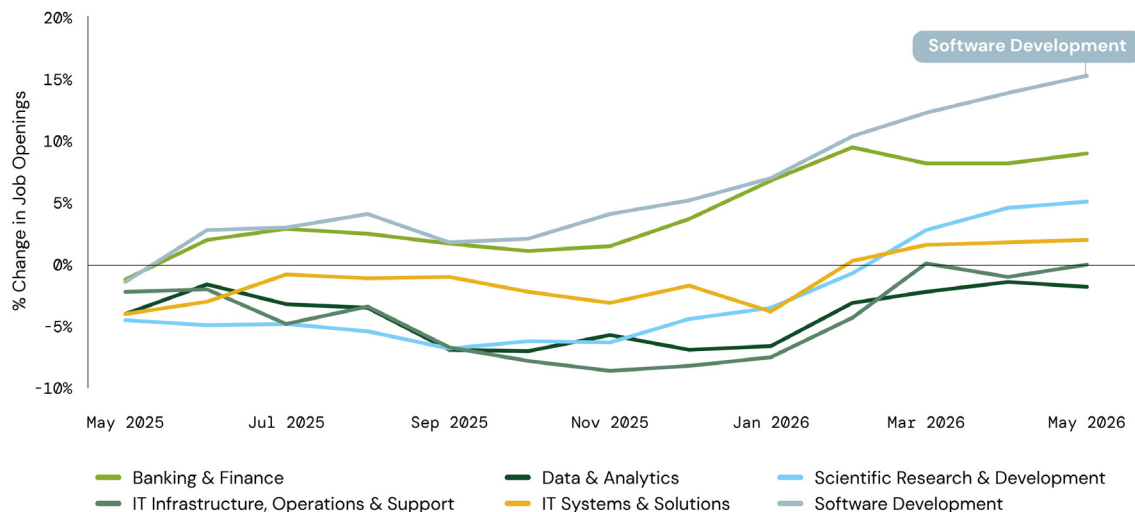
Lastly, as we outlined in the *2026 Outlook*, the credit backdrop for most states and local governments remains reasonably strong. State reserves are near all-time highs. Municipal debt is lower as a percentage of most state economies relative to pre-COVID levels. We think there are plenty of high-quality names to buy across states in the current environment, and this is likely to remain the case for quite some time.

(b) The AI build-out

In our November 2025 perspective *California Credit and the Risk of an AI Bubble*, we highlighted several potential impacts to California and other municipal issuers from the AI transition. These included: (a) the risk of a stock market correction and the impact on public pension plans and tax collections, (b) the possibility that utilities procure power for underutilized data centers, and (c) the potential for professional-class job displacement.

To date, none of these risks has materialized. The S&P 500 Index³¹ has risen by 9 percent since November.³² Demand for data centers remains quite strong.³³ Job openings increased in AI-exposed sectors (See Figure 13).

FIGURE 13: AI IS NOT YET REPLACING JOBS..



Source: Indeed.com Hiring Lab, and Breckinridge Capital Advisors, Inc., as of June 2026.

27. Per the Bureau of Economic Analysis, quarterly personal income growth in high tax states tends to grow regardless of the lost adjusted gross income (AGI). IRS wage and salary data show similar trends. The exceptions are years in which recognized capital gains are very high or very low or when tax laws have changed, year-over-year. For example, per IRS data, AGI fell between 2021 and 2022 in California, entirely because of recognition of capital gains, but wage incomes grew over the same period.

28. Bureau of Labor Statistics data and Breckinridge analysis.

29. Per Breckinridge analysis of New York State Comptroller's Monthly Report on Cash Basis of Accounting, for the 12 months through March 2026, Massachusetts' Department of Revenue May Revenue Collections Report, and California's

30. <https://www.anthropic.com/economic-index#us-usage>.

31. The S&P 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market-value-weighted index with each stock's weight in the index proportionate to its market value. You cannot invest directly in an index.

32. As of June 22, 2026

33. Note that real private fixed investment in information processing equipment and software reached 44% of all non-residential private fixed investment in Q1-26, per the Bureau of Economic Analysis.



We are now focused slightly more on three additional AI-related issues:

- **Ratepayer fatigue.** Public support for higher utility fees may wane, weakening revenue bond coverage or liquidity. Seven in 10 Americans oppose the construction of data centers in their area.³⁴ Larger majorities believe that data center owners and technology companies should finance their construction and energy needs.³⁵
- **Tax base risks and opportunities.** Local government credit quality may deteriorate in places where data center assets depreciate faster than anticipated and officials improperly forecast revenues.³⁶ The risk grows where a large data center comprises an outsized share of a small town's tax base.

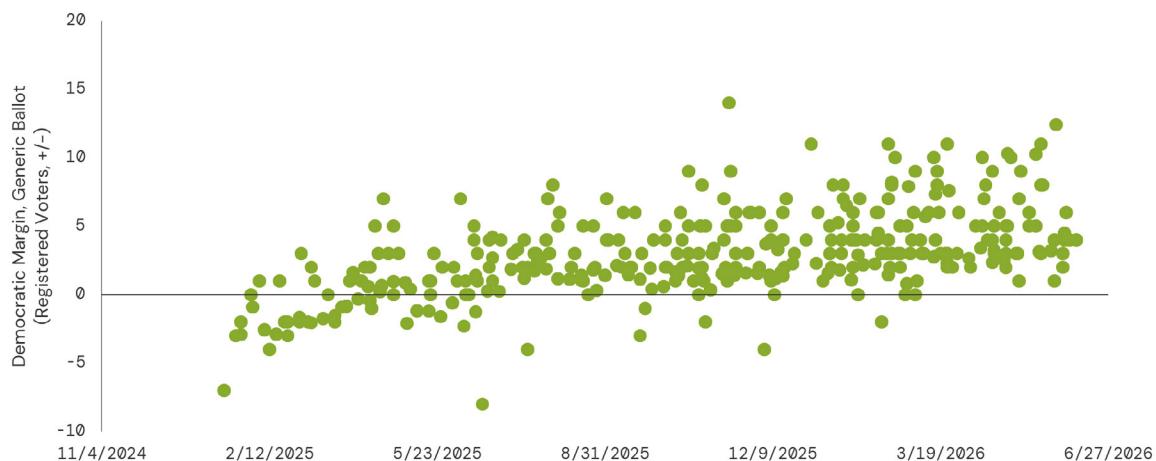
By contrast, where tax breaks are not renewed, local government credit quality may improve.³⁷ Many data centers benefit from tax exemptions that are likely to be removed, eventually.

- **Cyber risk.** The release of Anthropic's "Mythos," a general-purpose, frontier AI model that has located security vulnerabilities in "every major operating system and web browser, suggests new vulnerabilities for municipal issuers may be at hand.³⁸ Several issuers have suffered material attacks in recent years, including Suffolk County, NY (2022), Baltimore, MD (2019), and Atlanta, GA (2018). The attacks cost the issuers \$25 million, \$18 million, and \$17 million, respectively.³⁹

(c) Midterm Elections

A range of indicators seem to suggest that Democrats are likely to retake the House of Representatives in the November midterm elections. The president's net approval rating is low at about 19 percent, a level that typically foreshadows significant midterm House of Representative losses for his party.⁴⁰ Democrats retain a lead on the generic ballot, which is also correlated with midterm election wins, even after adjusting for recent gerrymandering (See Figure 14).⁴¹ The share of voters identifying as Democrats (or Democrat-leaning) is on the rise.⁴² Democratic candidates outperformed expectations in most special elections over the past 18 months.⁴³ Republicans retain a slim five-vote majority in the chamber.

FIGURE 14: DEMOCRATS ARE FAVORED WHEN VOTERS ARE ASKED WHICH PARTY THEY PREFER TO WIN HOUSE ELECTIONS



Source: New York Times 2026 Polling Database and Breckinridge Capital Advisors, Inc., as of June 2026.

34. May 13, 2026, Gallup poll. Available at: <https://news.gallup.com/poll/709772/americans-oppose-data-centers-area.aspx>.

35. University of Houston, Hobby School of Public Affairs survey, May 2026.

36. For a useful note on the vagaries of data center depreciation rates and valuation, see: <https://www.goldmansachs.com/insights/articles/tracking-trillions-the-assumptions-shaping-scale-of-the-ai-build-out>.

37. <https://goodjobsfirst.org/cloudy-with-a-loss-of-spending-control-how-data-centers-are-endangering-state-budgets/>.

38. Quote from Anthropic's website: <https://www.anthropic.com/glasswing>.

39. See: <https://thecyberexpress.com/ransomware-cost-suffolk-county-25-7-million/>, <https://conduitstreet.mdcounties.org/2019/05/30/baltimore-city-estimates-cost-of-ransomware-attack/>, <https://the-atlas.com/projects/atlanta-cyberattack>.

40. <https://www.presidency.ucsb.edu/statistics/data/seats-congress-gainedlost-the-presidents-party-mid-term-elections>.

41. <https://centerforpolitics.org/crystalball/a-simple-model-for-forecasting-the-impact-of-mid-cycle-redistricting-on-the-2026-house-elections/>.

42. <https://news.gallup.com/poll/700499/new-high-identify-political-independents.aspx>.

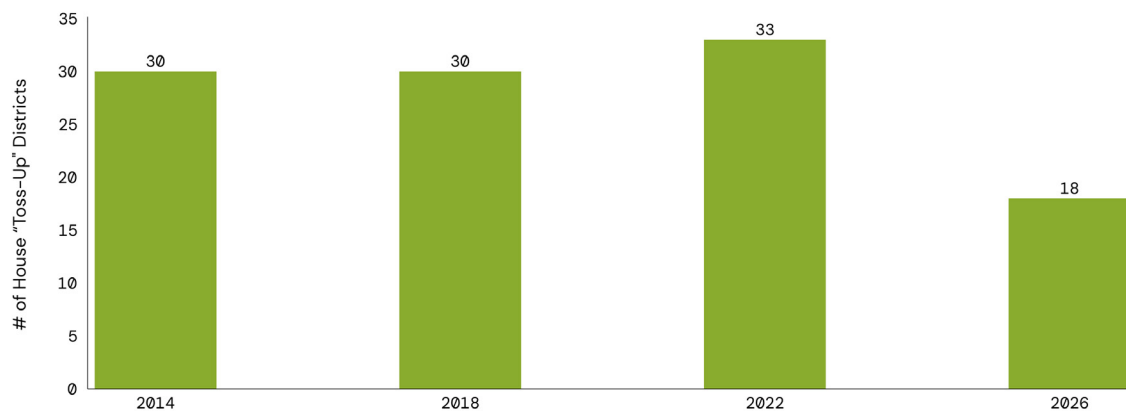
43. Across 107 special election races in 2025 and 2026, Democratic candidates' margin of victory was, on average, 12.8% greater than the margin in the 2024 presidential election for the same jurisdiction in which the election was held. See publicly available data from The Downballot.com: <https://www.the-downballot.com/p/data>.



However, the Democrats' polling advantages may be insufficient to retake the Senate. Republicans currently hold 53 seats, 51 of which are widely acknowledged to lean Republican.⁴⁴

There are also reasons to expect some races to tighten over the next few months. Republicans are well funded.⁴⁵ There are nascent signs of economic improvement. Gerrymandering may be more meaningful than anticipated (See Figure 15). As a party, Democrats are less popular than the president.⁴⁶

FIGURE 15: GERRYMANDERING MAY HAVE FURTHER REDUCED THE NUMBER OF COMPETITIVE HOUSE DISTRICTS



Note: the 2026 figure may rise as election date approaches and more polling data becomes available.
Source: Cook Political Report and Breckinridge Capital Advisors, Inc., as of June 2026.

Figure 16 highlights select investment implications from the most probable midterm election outcomes.

FIGURE 16: MIDTERM IMPLICATIONS FOR SELECT MUNI ISSUES

	House / Senate Party Control		
	D / R	D / D	R / R
Subjective Odds	50%	15%	35%
Election "Story"	Mean Reversion	Large Democratic "Sweep"	Policy Validation
Issue Area			
Deficit Expansion	Stable/Lower	Stable/Lower	Potentially Higher
Government Shutdown Risk	Medium	High	Low
Industrial Policy	No Change	More Oversight	Less Oversight
Medicaid, SNAP Cuts	Delayed	Delayed or Restored	Take Hold; Negative for Hospitals, States
Private Higher Ed	R&D Funding Partially Restored	R&D Funding Partially Restored	Continued Austerity
Tax Policy	No Change	Low Potential for Higher Tax Rates	No Change
Trump-Proposed Budget Cuts	Avoided	Avoided	Partially Enacted

Source: Breckinridge Capital Advisors, Inc., as of June 2026.

44. <https://centerforpolitics.org/crystalball/2026-senate/>.

45. <https://thehill.com/homenews/campaign/5863917-nrcc-rnc-fec-2026-midterm-elections/>.

46. <https://www.pewresearch.org/politics/2026/05/01/americans-continue-to-view-both-the-republican-and-democratic-parties-negatively/>.



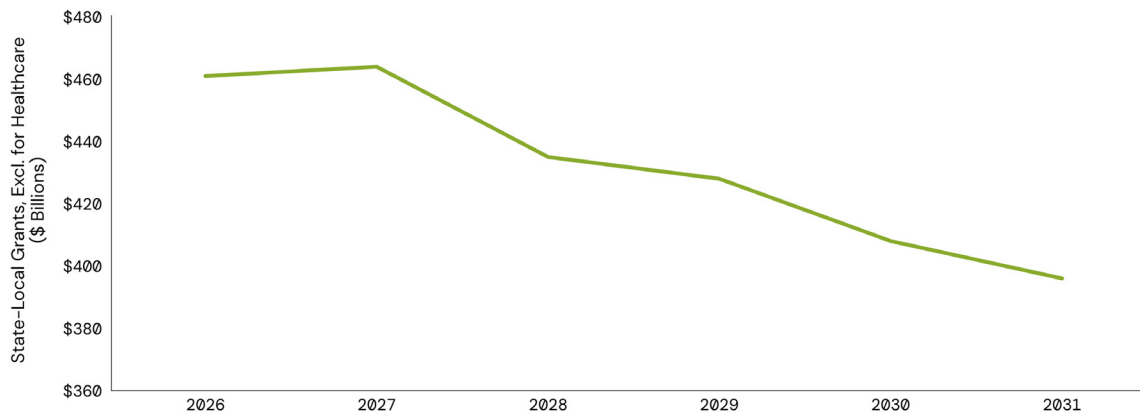
In scenarios where Democrats take the House, Senate, or both, we anticipate a marginally improved credit runway for hospitals, states, and private higher education issuers. Some Medicaid cuts, which would reduce hospital revenue and could pressure state budgets, are likely to be delayed or restored. Similarly, research universities are likely to benefit from a more reliable funding environment.

A wave election in favor of Democrats creates potential for a broader range of outcomes. One likely scenario: budget negotiations become contentious and a government shutdown ensues, slowing the economy.

However, we are open to surprises. For example, a wave election might create conditions for higher marginal tax rates. President Trump previously supported higher rates on the wealthy.⁴⁷ Last year, 18 Republican senators supported higher marginal tax rates to fund rural hospitals.⁴⁸ A filibuster-proof majority for higher marginal rates might be achievable, in connection with certain spending priorities and a perceived voter mandate. Tax-free municipal interest could become more valuable.

In scenarios where Republicans retain control of both houses of Congress, the administration's existing policy prerogatives are likely to become more entrenched. For municipal issuers, this outcome could herald a more austere federal funding environment. Some of the proposed cuts in the president's budget are likely to materialize (See Figure 17).

FIGURE 17: A STATUS QUO OUTCOME SUGGESTS A MORE AUSTERE FEDERAL FUNDING ENVIRONMENT FOR MUNI ISSUERS



Source: Office of Management and Budget and Breckinridge Capital Advisors, Inc., as of June 2026.

Restrictive immigration and trade policy are likely to remain largely unchanged. The executive branch retains broad authority over both policy domains. Congress recently codified some administration priorities in a multi-year immigration-funding bill.⁴⁹ The Supreme Court limited the most aggressive tariff policies in its February 2026 decision, *Learning Resources v. Trump*, but some executive levers over tariffs remain.⁵⁰ The current policy stance is likely to maintain pressure on input prices and wages, though the outcome of the Iran conflict and gas prices are likely to have a greater impact on the Fed's interest rate policy.

47. <https://www.reuters.com/world/us/trump-says-he-is-ok-with-republicans-raising-taxes-rich-2025-05-09/>.

48. <https://thehill.com/homenews/senate/5378256-gop-senators-taxes-hospital-fund/>.

49. S2. Secure America Act. <https://www.congress.gov/bills/119th/congress/senate-bill/2/text#toc-ide01d67f831914e48a71fc909653206c8>.

50. https://www.supremecourt.gov/opinions/25pdf/24-1287_4gcj.pdf.



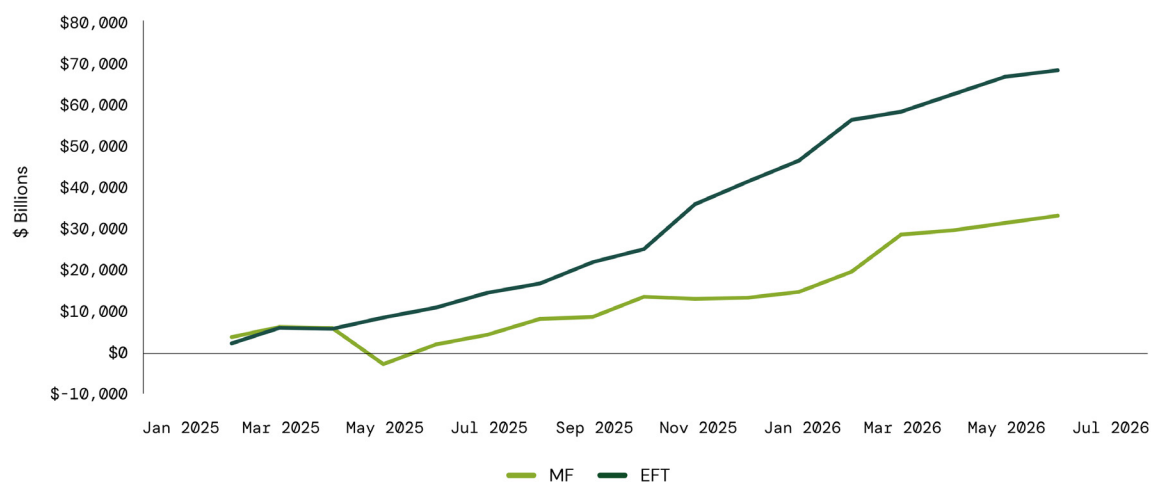
At least two state ballot initiatives are worth monitoring:

- 1. California's wealth tax.** Current polling suggests there is slight majority support for enacting a one-time, 5 percent state wealth tax on individuals and trusts worth \$1 billion or more.⁵¹ If the measure passes, an outflow of some very high-income taxpayers and a slower rate of capital formation is possible, over the medium term. However, we believe support for the measure is likely to wane over the ensuing months. Contentious ballot measures tend to lose public support in the months leading up to the November vote, and Governor Newsom is rallying an unusual coalition against this one.⁵²
Even if the proposition passes, there are legal and practical hurdles associated with implementation. Proposition supporters require 50 percent approval to enact the measure (for more, see *Wealth Taxes, Public Benefit Fraud, and What Matters for Muni Bonds*).
- 2. Florida's property tax relief initiative.** The "Save our Homes from Excessive Property Taxes" ballot measure amends the Florida constitution to exempt from property tax the first \$250,000 of each home's assessed value (excluding school taxes).⁵³ It also narrows permissible uses for property taxes and limits future assessments. The measure requires 60 percent approval to pass, which we believe is unlikely. However, if voters approve the amendments, local government credit fundamentals may weaken across the state.

Technicals

Demand for tax-exempt municipal bonds remained strong during the first half of 2026. Inflows into both mutual funds and ETFs were positive for every month of the year through May and are close to a record (See Figure 18). As we outlined in our 2026 Outlook, munis benefit from several technical supports: (a) the baby boom generation is retiring at an accelerating pace and needs a safe, tax-advantaged, fixed income solution, (b) the household sector is generally underweight bonds, and (c) technology improved the steadiness of demand for small trade lots, which are often purchased into separately managed accounts (SMAs).⁵⁴

FIGURE 18: MUTUAL FUND & ETF INFLOWS REMAINED STRONG IN 1H2026



Source: Investment Company Institute (ICI) and Breckinridge Capital Advisors, Inc., as of June 2026.

51. <https://www.ppic.org/publication/ppic-statewide-survey-californians-and-their-government-may-2026/>.

52. Jeremy White, "Gavin Newsom's race to block a billionaire tax," Politico.com, June 11, 2026. Available at: <https://www.politico.com/news/2026/06/11/gavin-newsom-billionaire-tax-00959379?nid=00000150-384f-da43-aff2-bf7fd35a0000&nname=california-playbook&nrid=00000154-c35f-da38-a556-f7df87340001>.

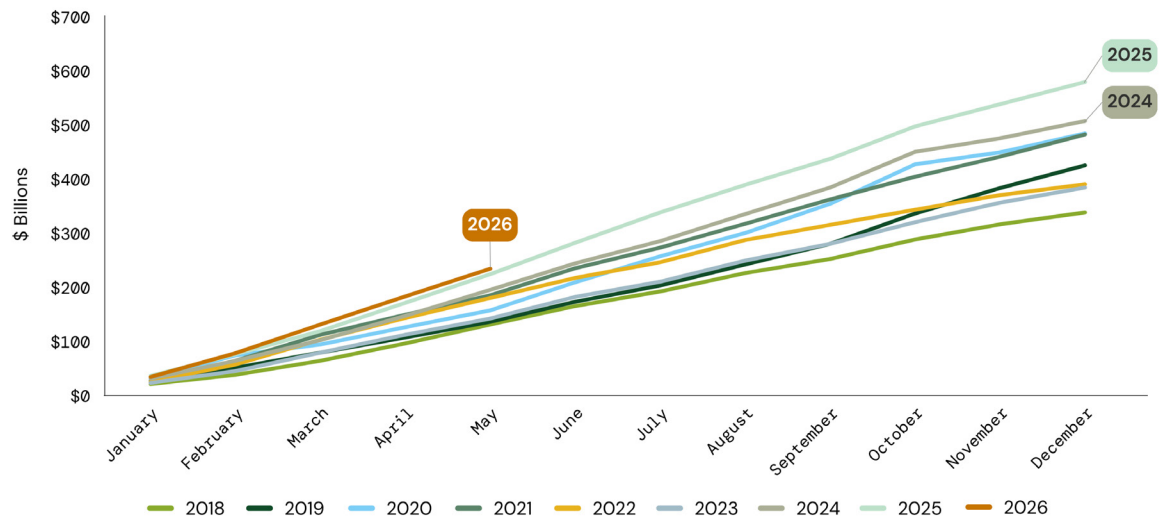
53. <https://www.flsenate.gov/Session/Bill/2026F/1F/BillText/er/PDF>.

54. <https://www.breckinridge.com/insights/2026-municipal-market-outlook>.



Supply is strong and currently on pace for another record year (See Figure 19). Hospital issuance is up 36 percent year-to-date through May 2026.⁵⁵ Electric power is up 26 percent. Both sectors exhibit stable credit characteristics this year and a meaningful backlog of infrastructure needs. Combined, these sectors are 11 percent of the intermediate market.⁵⁶

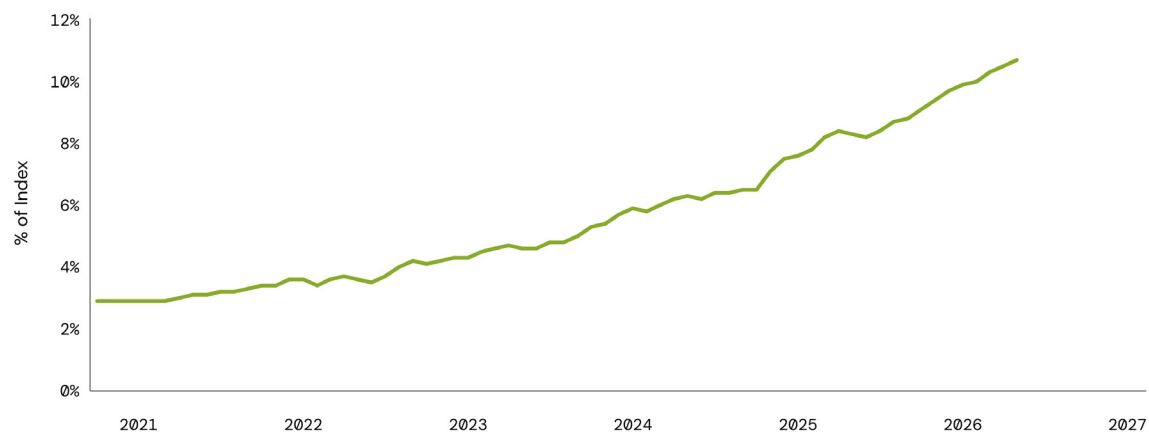
FIGURE 19: NEW ISSUE SUPPLY IS ON PACE FOR ANOTHER RECORD YEAR



Source: Bond Buyer and Breckinridge Capital Advisors, Inc., as of June 2026.

Another driver of supply is the ongoing increase in energy prepay issuance (See Figure 20). Energy prepay bonds help finance the purchase of long-term gas or electricity supply for public utilities. Prepays are structured product-like securities that involve a mix of underlying contracts and multiple parties. But at bottom, prepay credit quality is guaranteed by a corporate obligor, typically an investment bank or insurance company.

FIGURE 20: ENERGY PREPAY BONDS NOW COMPRISE OVER 10% OF THE INTERMEDIATE-DURATION MARKET



Source: Bloomberg 1-10 Blend Index and Breckinridge Capital Advisors, Inc., as of June 2026.

55. Bond Buyer data, through May 2026.

56. Per the BBG Municipal Bond 1-10 Year Blend (1-12 Year) Index, June 12, 2026.



Prepays offer higher tax-free yields than traditional municipal debt owing to the bonds' weaker liquidity, complicated structures, mandatory puts, and corporate security pledges. Prepay securities with more complex structures and less liquidity may be poorly aligned with the needs of high-quality, safety-oriented SMA investors. However, in a diversified vehicle where liquidity is less of a concern, these securities can provide value due to their higher tax-exempt yields.

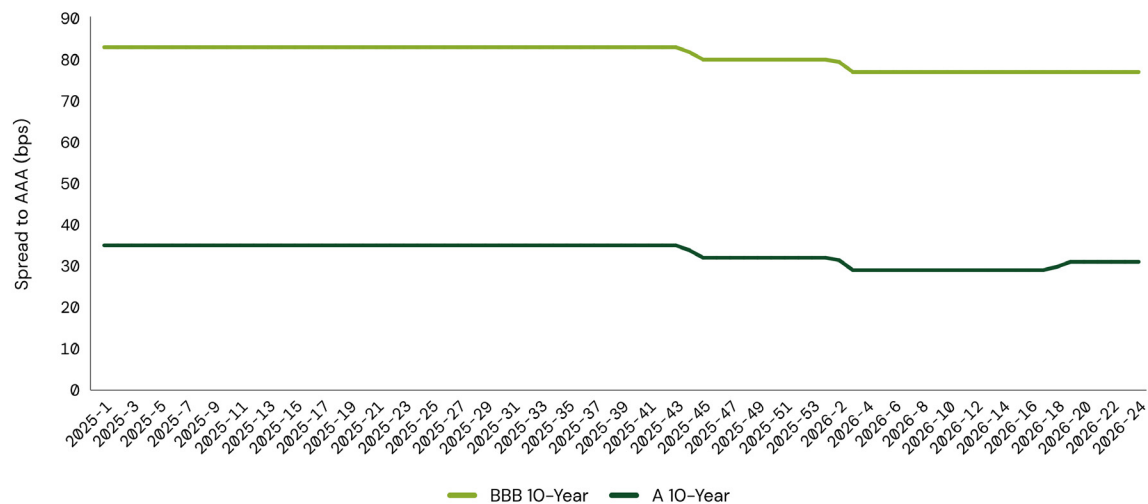
We anticipate a slower pace of supply over the next few months. The recent uptick in interest rates and a more hawkish Fed may slow the rate of issuance while hospital and education providers may wait until after the midterm elections to issue, given Medicaid and education-related regulatory policy could change.

Valuations

Opportunities in the second half of the year may stem more from credit picking and ratio trades than from duration-related strategies. The slope of the curve from 2 to 10 years steepened slightly but the yield curve from 10 to 15 years flattened year-to-date, suggesting little value in moving beyond 10 years. We believe the 30-year range offers the most compelling part of the curve for less duration-sensitive investors. Tax-equivalent yields remain near multi-year highs.

Credit. As outlined above, the credit outlook is stable, but weakening incrementally. Spread widening is possible on a name-specific basis, as the year progresses. Spreads moved little in the first half of the year based on rating category (See Figure 21).

FIGURE 21: A & BBB SPREADS MOVED LITTLE IN 2026

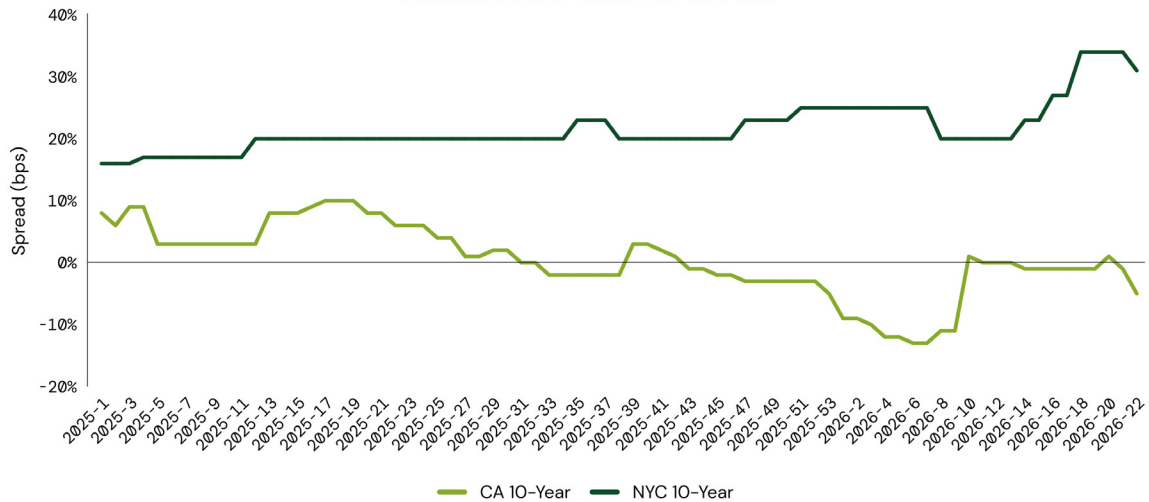


Source: MMD, Bloomberg, and Breckinridge Capital Advisors, Inc., as of June 2026.



Where we saw spread movement, technical factors played a larger role than credit concerns. For example, strong demand for California paper caused the state to trade through the AAA scale, despite its long-term structural deficit (See Figure 22). New York City yields rose in March 2026, mostly because most New York-biased accounts already held enough city paper.

FIGURE 22: SELECT STATE SPREADS HIGHLIGHT TECHNICAL FACTORS AS MUCH AS CREDIT



Source: Refinitiv and Breckinridge Capital Advisors, Inc., as of June 2026.

Ratios. M/T ratios seem likely to remain in the current range or go lower in the second half of the year. Ratios are lower than in late 2025 and early 2026, but higher than in early 2024 (See Figure 23). If supply slows, which we believe is possible, they could tick down further.

FIGURE 23: RATIOS COULD GO LOWER IF SUPPLY TAPERS OFF IN 2H2026



Source: Refinitiv and Breckinridge Capital Advisors, Inc., as of June 2026.



Duration. The municipal AAA curve steepened in 1H2026, as investors became more concerned about entrenched inflation and the potential for higher interest rates (See Figure 24). Heightened uncertainty stemming from the Iran conflict, the path for inflation, and new Fed Chair Kevin Warsh suggests there is potential for more curve steepening. We remain cautious about extending duration and note the average 2-year/10-year weekly spread has been 93 basis points since 2011, above the current 50 to 60 basis point range.⁵⁷

FIGURE 24: THE MUNI CURVE STEEPENED ALONGSIDE AN UPTICK IN INFLATION EXPECTATIONS



Source: MMD and Breckinridge Capital Advisors, Inc., as of June 2026.

For yield-oriented buyers, absolute tax-free interest rates remain at decade-plus highs (See Figure 25).

FIGURE 25: ABSOLUTE YIELDS REMAIN ABOVE LEVELS IN RECENT YEARS



Source: Refinitiv and Breckinridge Capital Advisors, Inc., as of June 2026.

57. Per Refinitiv data, through June 16, 2026.



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