U.S. Municipal Bond Market

Last Week's Big Beautiful Budget Framework: A Potential Lifeline for the Tax-Exemption

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- **Continued Advocacy Needed:** There is no time to relax. To maintain improvements to U.S. infrastructure, advocacy and educational efforts in support of the tax-exemption must persist without slowing down. Although the threat has dropped, it will continue until Dec. 31, 2025. Additionally, future deficit reduction talks could pose an even stronger threat to the municipal bond tax-exemption after 2025.
- **Reduced Threat to the Tax-Exemption:** The risk of eliminating the municipal bond tax-exemption has significantly decreased to around 10% for state and local governments if lawmakers target only $1.5 trillion in spending cuts, though the threat to private activity bonds remains high at 50% or greater.

Importance of the Recent Public Entity and Public Finance Advocacy Effort

America's infrastructure earned a "C" grade by the American Society of Civil Engineers in its 2025 infrastructure report card unveiled in March 2025. This was a noticeable improvement especially since the ASCE scored U.S. infrastructure at a "D+" in 2017.

We wrote last month that the Improvement in America's Infrastructure [is] Endangered by the Threat to the Tax-Exemption. 2025 tax policy still could be a threat to the tax-exemption, unless advocates keep up the tempo of advocacy and education about the importance of the tax-exemption in financing America's infrastructure.

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Supporters should not consider their work for this year completed until Dec. 31, 2025. It is crucial for public entities and those in public finance to continue advocating and educating about the tax-exemption. Additionally, even after Dec. 31, 2025, ongoing support will be necessary. Advocacy and educational efforts must be intensified, as we anticipate that deficit reduction talks in 2026 and 2027 could pose an even stronger threat to the municipal bond tax-exemption.

Recent advocacy efforts have resulted in bipartisan support from Congressional leadership and members. This is important progress, but it needs to continue and be strengthened by the public entity and public finance community, despite the good news mentioned below. The recent significant progress includes:

- The bi-partisan Dear Colleague letter written by Representative Don Bacon (R-NE) in support of the municipal bond tax-exemption which included 25 House Representatives who also signed the letter in support of municipal bonds.
- House Financial Services Committee (HFSC) Chairman French Hill (R-AR) who, last week along with all Republican HFSC Subcommittee Chairs, sent a letter of support for the tax-exemption to House Ways and Means Chairman Jason Smith (R-MO).

Please see disclosure starting on page 3.

- The Public Finance Network, which includes the Government Finance Officers Association and over two dozen other organizations that represent public entity groups and private industry groups has been very active in communicating with lawmakers and their staffs. Notable was a projected 10-year analysis Protecting Bonds to Build Infrastructure and Create Jobs they published. Other organizations such as the ASCE also shared their support for the tax-exemption.
- Important analysis came from the academic world to help inform policymakers. An April 2025 report released by UT Austin's LBJ School, and U. Chicago's Harris School titled, Municipal Bond Tax Exemption: History, Justifications, Criticisms and Consideration of Reforms has been and will continue to be a very important tool. Additionally, the U. Chicago's Harris School also created a Municipal Bonds in Congressional Districts database that creates tear sheets showing municipal bonds by congressional district.

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Some Positive News

For now, some good news in a year so far that has been very turbulent. The threat level toward to the municipal bond tax-exemption has improved.

A very important takeaway, before we get to the details of why the landscape has improved, is that the advocacy and educational efforts should not stop, or even slow down. Relaxing is not an option now. Even if the municipal bond tax-exemption survives 2025 tax policy discussions, an even stronger threat looms in the future if or when deficit reduction talks commence. We expect a threat in the form of the proposal published by the Bowles Simpson Commission in 2010 or something similar to materialize after 2025.

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House Budget Framework Passed Last Week is a Potential Lifeline

Last week, the U.S. House of Representatives passed a budget framework using the Senate-adopted outline. This was achieved by convincing last-minute holdouts after House Speaker Mike Johnson and Senate Majority Leader John Thune promised at least $1.5 trillion in spending cuts in the final big, beautiful bill.

The inclusion of new and extended tax cuts and spending without offsets at this level would be unprecedented, according to the Committee for a Responsible Federal Budget. This approach could potentially lead to a debt spiral by 2035 or even sooner, the CRFB also noted. However, there is good news regarding the threat to the municipal bond tax exemption, thanks to the progress made during last week's legislative process.

If D.C. lawmakers are only going to be targeting about $1.5 trillion of spending cuts, that reduces the threat to the municipal bond tax-exemption, at least in the near term.

The amount lawmakers are targeting for spending reductions could change. For this reason, it is important the advocacy and education efforts continue.

Just after the 2024 elections I wrote I was expecting: ***Significant Risk of Elimination*** **-** Without substantial and unified outreach and advocacy from public entities and market participants, there is a 50% or much greater chance that the tax-exemption will be eliminated or significantly curtailed by the end of 2025 during tax policy negotiations.

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Now I think: If lawmakers only target $1.5 trillion of spending cuts the odds the municipal bond tax-exemption for state and local governments being targeted as a pay-for has dropped significantly. Odds of its elimination, only if this spending target remains- and only in 2025, is closer to only 10%. The threat to tax-exemption for private activity bonds remains elevated, still at 50% or greater.

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What Has Changed? Why Has the Threat Declined?

One of the key reasons the threat to the tax-exemption was as severe as we thought, was because we expected lawmakers could be targeting anywhere from $4 to $10 trillion of spending that would have required corresponding budget cuts. Before the election the CRFB published that their central estimate for President Trump's fiscal plan was $7.75 trillion. If lawmakers are only targeting $1.5 trillion in spending cuts it is unlikely state and local government bonds would be targeted as pay-fors. It is more likely under the current scenario that only changes around the periphery of the municipal bond tax-exemption, if any, are made.

Recent HilltopSecurities Municipal Commentary

- Rising Yields, Falling Confidence: Seizing the Next Municipal Bond Opportunity, April 14, 2025
- "… Outreach is Needed and Fast", April 10, 2025
- Liberation Day Impact: Top Municipal Opportunity Since 2023 Amid Macro, Tariff Uncertainty, April 8, 2025
- The Greatest Tax-Exemption Threat Remains Imminent, Timing Uncertain, April 1, 2025
- Improvement in America's Infrastructure Endangered by the Threat to the Tax-Exemption, March 25, 2025

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