U.S. Municipal Bond Market

Top Municipal Bond Opportunity Closing Fast as Market Heals

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- **Yields are Dropping as the Top Municipal Investment Opportunity Since 2023 Closes Fast:** Economic weakness and potential falling interest rates present a fleeting window of opportunity for investors. Increasing exposure to fixed-income securities, particularly tax-free municipal bonds, can reduce investment risk and protect portfolios from potential private sector and equity market weakness.
- **Potential Legislative Delays and the Reduced Threat to the Municipal Bond Tax-Exemption:** The "Big, Beautiful Bill," could be delayed until September or even December due to ongoing negotiation issues. As a reminder, the threat to the municipal bond tax-exemption has decreased to around 10% for state and local governments but remains higher for private activity bonds at 50% or greater.
- **Harvard's Tax-Exempt Status:** The IRS is considering rescinding Harvard University's tax-exempt status, an outcome which could impact other 501c3 organizations and the municipal bond tax-exemption for private activity bonds. The influence could be significant due to the vital role higher-education and medical institutions play in regional, state, and local economies.

The Top Municipal Investing Opportunity Since 2023 is Closing Fast

Many are divided over what the first 100 days of the second Trump administration have meant. Some argue the first 100 days have marked a Return to American Greatness, as Roger Marshall a Republican Senator from Kansas wrote in Newsweek. Others argue that economic weakness is building, for example Trump's First Economic Scorecard Gets Marked With GDP Contraction. Additionally, Hilltop's Scott McIntyre and Greg Warner wrote this week, "The U.S. economy contracted for the first time since June 2022 as businesses and consumers braced for the impact of global tariffs," in Q1 GDP is Negative as Imports Surge.

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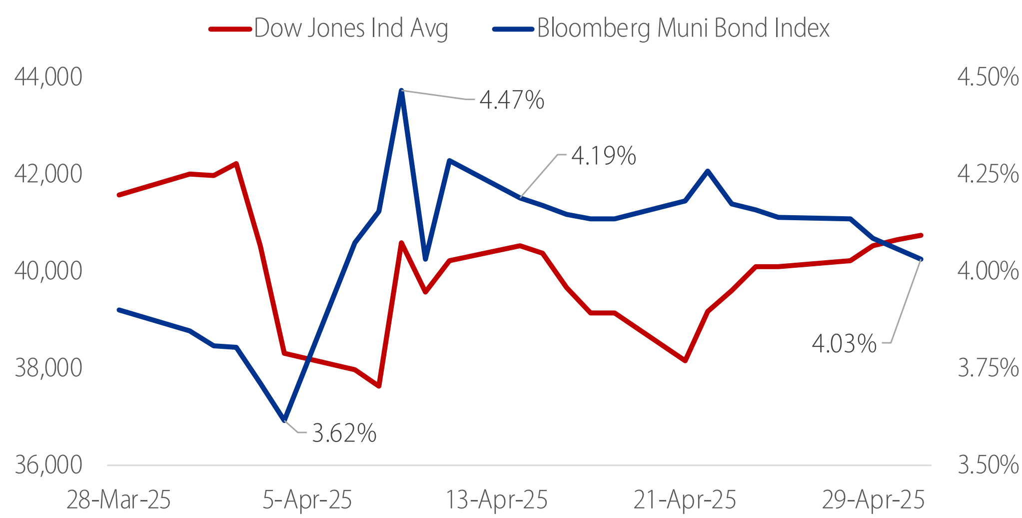
Municipal Yields are Dropping, but Still Attractive



Source: HilltopSecurities and Bloomberg.

Please see disclosure starting on page 4.

We are watching the window of opportunity for municipal investors quickly close. To review, just after April 2, the day referred to as Liberation Day, we indicated we saw the Top Municipal Opportunity Since 2023 Amid Macro, Tariff Uncertainty. The day after, the Bloomberg Municipal Bond Index rose to 4.47%.

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Shortly after municipal yields peaked for the year (so far at least), we reminded investors to seize the opportunity being offered up by policy and macro uncertainty again in Rising Yields, Falling Confidence: Seizing the Next Municipal Bond Opportunity. The Bloomberg Municipal Bond Index was still at a healthy 4.19%.

Municipal yields have dropped ever since. Now, the top opportunity for municipal investors remains, but it is closing and closing fast. The Bloomberg Municipal Bond Index closed yesterday, Thursday May 1 at a 4.03%. This is still about 40 basis points above April 4's 3.62%, but almost 45 basis points lower than April 9's peak.

With economic weakness potentially on its way. Apollo's Chief Economist published a chartbook of mostly softening economic indicators which illustrates How Are U.S. Consumers and Firms Responding to Tariffs? Now, economists put the possibility of a recession at a toss-up, up from only a one in four chance in February.

The potential for falling interest rates due to economic weakness presents a compelling argument for investors to seize this fleeting window of opportunity. Additionally, investors can reduce their investment risk by increasing exposure to fixed-income securities, particularly tax-free municipal bonds now, and especially if they benefit from the tax benefit. This strategy can help protect investor portfolios from potential private sector and/or equity market weakening.

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Potential Timing for Tax Policy

Some in D.C. believe Speaker Mike Johnson and President Trump's Big, Beautiful Bill, which could include 2025 tax policy elements, may be signed into law as early as the beginning of July. This week is the first Congress is back in session after a two-week recess. Budget reconciliation negotiations have so far not been going smoothly. We are seeing The megabill has mega issues, and details of The House's reconciliation problems. We would not be surprised to see the timing of the GOP's Big, Beautiful Bill to be pushed back to September, potentially at the earliest- or even December.

As a reminder, we see a reduced threat to the municipal bond tax-exemption, at least for now. Please see Last Week's Big Beautiful Budget Framework: A Potential Lifeline for the Tax-Exemption for more on this, and where we wrote: 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.

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Eds and Meds, Caught in the 2025 Political Debate

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Currently, the IRS is considering whether to rescind Harvard University's tax-exempt status. The executive branch of the U.S. government does not have the legal authority for such a move, but the Internal Revenue Service does, under certain circumstances. Harvard is defending itself.

This is an ongoing debate that we will be sure to continue to continue to monitor not just because of the potential consequences to Harvard, but also because there could be economic fallout to other 501c3 organizations throughout the country, and even to different regions, state and local economies.

The importance of eds and meds, or higher-education and medical institutions to the economic engines and credit quality of state and local government cannot be over-stated. They are extremely important to cities and states of all sizes.

A 2024 report titled, "Engines of Opportunity: How eds and meds institutions can become more powerful drivers of prosperity in America's cities," by the Director for Economic Growth at the George W. Bush Institute at Southern Methodist University highlights this relationship.

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"Eds and meds play a more central role in cities today than ever before. First of all, they are far larger than in the past. America's roughly 3,500 colleges and universities employ approximately 3 million people, amounting to 2% of the nation's working population." The report also highlights the individual contribution that certain institutions can have on even large cities and states. The report indicates, "The University of Pennsylvania and its affiliated medical center constitute by far the largest employer in Philadelphia, employing five times more people than the second largest employer. Mass General Brigham hospital system is the largest employer in the state of Massachusetts."

Recent HilltopSecurities Municipal Commentary

- Last Week's Big Beautiful Budget Framework: A Potential Lifeline for the Tax-Exemption, April 16, 2025
- 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

Readers may view all of the HilltopSecurities Municipal Commentary here.