U.S. Municipal Bond Market

The Secret's Out – Municipal Bonds Are Having a Moment

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- Municipal bonds remain one of the most attractive tax and risk-adjusted plays in fixed income and **yields just became more attractive**. We have not seen yields at this level since the beginning of September.
- As a result, municipal bonds are **gaining strong investor attention** as nearly $7 billion has flowed into municipal mutual funds since August 21, bringing net 2025 inflows to almost $17 billion.
- Primary market municipal issuance is on track to set another record in 2025, with October sales expected to exceed $50 billion, but investors could face tightening supply and increased competition for quality bonds in November and December.
- S&P Case-Shiller data shows home values rising, reinforcing property tax-revenue strength and supporting municipal credit stability.
- K-12 school district sector rating downgrades are rising, aligning with our January outlook which expected mounting structural challenges.
- The federal shutdown poses little risk to municipal credit, though delays in economic data could add to an already uncertain market.

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Yields are Higher & Investment Dollars are Flowing into Municipal Funds

Municipal bonds are no longer flying under the radar. Their value is gaining widespread recognition as investors respond to a rare combination of attractive yields, strong credit fundamentals, and tax-efficiency. The recent surge in demand reflects a growing

Summary of HTS 2025 Issuance Forecast (Updated Oct. 1, 2025)

Ten Year Average, 2015-2024	Month	2021 Actual	2022 Actual	2023 Actual	2024 Actual	2025 Actual	HTS 2025 Forecast, (BASE CASE)	Actual - Forecast, Difference	2025 Base Case / 2024 Actual, % Change
28	January	28	26	24	32	**37**	**40**	-3	26%
30	February	37	32	22	33	**41**	**40**	1	21%
36	March	48	46	34	39	**43**	**45**	-2	17%
35	April	37	40	33	45	**52**	**50**	2	12%
36	May	35	37	30	48	**53**	**50**	3	5%
43	June	50	38	40	49	**58**	**55**	3	13%
33	July	38	28	28	41	**55**	**45**	10	9%
41	August	45	42	39	51	**48**	**50**	-2	-1%
36	September	45	27	31	49	**45**	**45**	0	-8%
47	October	42	29	39	66	**-**	**50**	-	-24%
32	November	37	26	37	25	**-**	**30**	-	21%
33	December	41	20	24	32	**-**	**35**	-	11%
430	**Total**	**483**	**391**	**380**	**508**	**431**	**535**	11	**5%**
36	Avg/Mth	40	33	32	42	48	**45**	1	5%

Source: Refinitiv and HilltopSecurities.

awareness that U.S. municipal bonds are well-suited to meet a range of investment goals—particularly in today's environment of economic and political uncertainty.

The momentum is building, and knowledge of the value of municipal bonds is clearly spreading.

Since August 21, nearly $7 billion has flowed into municipal mutual funds, per Lipper data. That brings 2025's total to $17 billion, already ahead of the $14 billion seen during the same period last year. In all of 2024, municipal mutual funds attracted $22 billion. Back then, we called tax-exempt municipals the best-kept secret in the investing world. That's no longer the case. The momentum is building, and knowledge of the value of municipal bonds is clearly spreading.

What is Driving the Interest?

The Federal Reserve began raising interest rates in 2022 to address inflation that followed the COVID era. Questions about when the Fed would resume cutting its target rate have garnered attention for some time. Now, a weakening labor market, both structurally and cyclically, is shifting the economic outlook. In mid-September, the FOMC again lowered its target rate, and investors are moving quickly to secure yields before they decline further. That being said, tax-exempt yields actually traveled higher in that last week or so, after the 2nd quarter US GDP revision. The Bloomberg Municipal Bond Index is 13 basis points higher as of Sept 30th at a 3.66%, compared to about two weeks prior.

Municipal bonds continue to offer one of the most attractive combinations of tax advantages and risk-adjusted returns in the fixed income market. Yields have become even more compelling in recent weeks, and current levels have not been seen since early September. In a market searching for direction, municipal bonds are providing clarity and opportunity.

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We Still Expect Record Municipal Bond Issuance is Likely Again in 2025

The U.S. municipal bond market is again on track to reach a record issuance level this year. This surge is not unexpected. In November 2024, we projected a scenario of $535 billion in total issuance for 2025. After the signing of July's Big Beautiful Bill, which preserved the municipal bond tax-exemption, we made that projection our base case for the year.

Since mid-September, bonds have become harder to find. That was not an illusion, and many investors and financial advisors reported to us they were becoming more difficult to find. Some weeks in September were light, especially because demand was rising. September issuance closed at $45 billion, below the monthly average for the year. October is expected to exceed $50 billion. While November and December will likely see lighter issuance, investor flows are gaining momentum and institutional activity is increasing.

This tightening supply environment for the end of the year means investors will face more competition for quality bonds. Individual investors, in particular, may find it more challenging to access attractive offerings. October presents a key opportunity. With limited issuance expected to close out the year, investors should be ready to act quickly in October especially if issuance drops and demand remains strong.

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Housing Stability Continues to Support Municipal Credit

The latest S&P Case-Shiller data, reported this week, confirms that housing remains a pillar of economic resilience, as we highlighted in The Municipal Bond Market's Post-Golden Age Realignment (August 12, 2025). Even with higher mortgage rates and some regional price softening, national home values continue to rise. The S&P Case-Shiller Index increased year-over-year in July, although the pace of growth continues to slow. This steady performance reinforces the reliability of property tax revenue, which is essential for local government budgets. States and municipalities benefit directly from this stability, especially as federal pandemic aid phases out. Investors should take note: **strong housing fundamentals continue to support municipal credit quality across much of the country**.

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As housing values remain strong and assessed valuations stay elevated, the outlook for many local governments and especially property tax-backed municipal bonds is increasingly favorable. We are expecting most local governments are likely to enter 2026 with a solid revenue base, which supports credit strength and reduces investment risk. For investors, this creates a timely opportunity to target high-quality municipal credits tied to strong housing markets. It is important to keep in mind the credit normalization process that state and local governments are currently undergoing and will continue to navigate in upcoming budget cycles.

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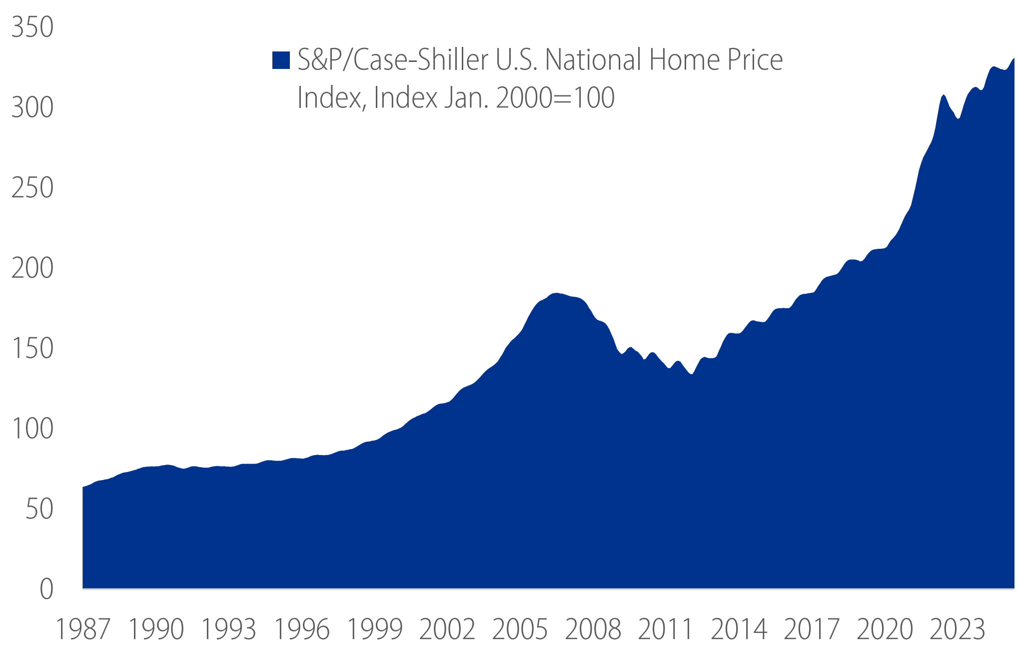
Housing Market Valuations Remain Healthy



Source: FRED and HilltopSecurities.

Negative Rating Actions Toward K-12 Schools Align with Our January Outlook

In January 2025, we lowered our municipal sector credit outlook for the U.S. K-12 School District sector to "Cautious" from "Stable," anticipating a shift from the Golden Age of Public Finance to a phase of credit normalization and structural headwinds. Declining enrollment, driven by demographic trends, is creating long-term revenue challenges

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for districts that rely on per-pupil state funding. Rising personnel costs and tighter state budgets are forcing difficult decisions, including campus closures, even in some fast-growing states. These are among the challenges we anticipated at the beginning of this year.

The financial health of some public schools is deteriorating.

S&P's latest report on this topic confirms this trajectory. Negative rating actions for school districts rose 40% between June 2024 and June 2025. **One-third of districts ran operating deficits in 2024, up from 17% in 2021**. The end of federal stimulus, inflationary wage pressures, and enrollment declines are driving expenses above revenues. Districts are tapping into reserves, but those cushions may erode quickly if fiscal pressures persist. The financial health of some public schools is deteriorating. "In a weakening economy we do start to see more structural imbalances," said Jane Ridley, of S&P who was quoted in Bloomberg.

Federal Government Shutdown Uncertainty and Credit Implications

D.C. lawmakers did not come close to compromising on a continuing resolution by the Sept. 30 (end of day) deadline, and the federal government shutdown began last night. We believe the risk to municipal credit is minimal. For more please see Brooking's, "What is a government shutdown?"

Historically, most shutdowns have been short-lived and politically unpopular, with 14 since 1980 and the majority lasting only a few days. Even the longest, during the previous Trump administration, lasted 35 days (and was a only a partial shutdown) and had little if any meaningful impact on municipal credit quality. What could make this situation different is the deeper divide between parties and a reduced willingness to compromise, which could lead to a longer disruption. However, rather than triggering widespread credit deterioration, a prolonged shutdown is more likely to shift spending patterns and delay data collection.

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Municipal credits in regions with a high concentration of federal workers may face short-term spending pressures, but we do not expect lasting damage. The more immediate concern is the disruption to key economic data releases, which could increase market uncertainty and complicate monetary policy decisions. With the Fed relying heavily on employment and inflation data, a shutdown that halts agency reporting could **cloud the economic outlook**. Still, the underlying fundamentals of most municipal issuers remain strong, and we expect them to weather this period without significant credit stress.

Recent HilltopSecurities Municipal Commentary

- Intro to the New Era of AI, Infrastructure & Growth, September 18, 2025
- From Budget Issues to Labor Challenges: Insights from the HilltopSecurities 2025 Public Finance Leaders Survey, September 15, 2025
- Labor Pains, Rate Gains, and Why Muni Investors Can't Wait, September 8, 2025
- Fed Signals September Shift and Tax Threat Resurfaces, August 25, 2025
- The Municipal Bond Market's Post-Golden Age Realignment, August 12, 2025

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Readers may view all of the HilltopSecurities Municipal Commentary here.