



Investment Perspectives

Beyond Attractive Yields, Many Other Reasons to Consider Municipal Bonds

Municipal bonds offer ways to participate in some of today's most compelling investment themes.



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As investors weigh how to allocate their assets following a strong year for equities—and an extended period of high but now falling money market rates—one investment that may prove appealing is municipal bonds, especially with yields near their highest levels in a decade (see Figure 1). We think now may be a good time to consider how investments in municipal bonds can help people attain objectives beyond the traditional benefits of realizing attractive tax-equivalent yields via an asset class with strong overall credit quality.

Figure 1. Municipal Bond Yields Are Near Their Highest Levels in a Decade

Yield-to-worst on Bloomberg Municipal Bond Index, February 26, 2015–February 25, 2025



Source: Bloomberg. **Yield-to-worst** refers to the lesser of a bond's (a) yield-to-maturity or (b) the lowest yield-to-call calculated on each scheduled call date.

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Municipal Bond Market Composition

First, let's take a brief look at the municipal-bond landscape. People often think that the muni market is entirely composed of *general obligation bonds* ("GOs") issued by cities, states, and local governments. In fact, only around 30% of the outstanding bonds in the market are GOs; most municipal bonds are *revenue bonds* issued in a wide range of sectors covering a broad swath of the economy. Revenue bonds are often used to finance things many of us use every day—structures and services that are vital to the functioning of communities and businesses.

As a reminder, general obligation bonds are supported by the full faith and credit of a government to pay back its borrowings. This means that such issuers will use all available revenues to pay interest and principal on the bonds and will raise tax rates or fees if necessary to keep paying them back. Some of the largest issuers fit into this category, such as the State of California and the City of New York. These types of issuers are the ones in the headlines most frequently.

On the other side, revenue bonds are backed by specific revenues of an issuer. Some of the best-known issues of this kind are those backed by public utilities and water and sewer systems. Some of the less well-known issues might be issued for universities, not-for-profit hospitals, airports, toll roads, charter schools, housing, corporations in the industrial development space, and senior living facilities (see Figure 2).

Figure 2. Municipal Bond Issuance Climbed Across a Broad Array of Sectors in 2024

Long-term municipal bond sales volume and issuance counts by year

Sector	2024		2023		% Chg. 2024/2023
	Volume (Mil. US\$)	No. of Issues	Volume (Mil. US\$)	No. of Issues	
Industrial Development	11,533.4	458	12,254.3	361	-5.9
Education	113,415.9	3,054	95,023.1	2,884	19.4
Electric Power	26,732.1	119	18,650.8	97	43.3
Environmental Facilities	4,011.8	44	3,646.7	47	10.0
Health Care	36,032.4	290	16,953.7	213	112.5
Housing	47,298.2	874	41,094.4	886	15.1
Public Facilities	9,256.1	353	7,765.4	289	19.2
Transportation	75,364.3	528	45,456.7	405	65.8
Utilities	62,970.1	1,076	47,744.9	877	31.9
General Purpose	120,970.5	2,245	96,471.1	2,035	25.4
Total	507,584.7	9,041	385,061.1	8,094	31.8

Source: The Bond Buyer, December 31, 2024. For informational purposes only.



These bonds are an attractive opportunity set for active managers, often providing more yield than general obligation bonds because they require more research to understand, come from smaller issuers, and are less actively traded.

Municipal bonds are highly regarded by many investors for their resilient credit quality. Most municipal bonds carry investment-grade ratings, and the market historically has had low default rates (see Figure 3). However, there is a sizable amount in the below-investment-grade category as well; these bonds can provide even more yield and total return potential, along with lower historical default rates than comparably rated corporate bonds.

Figure 3. Municipal Bonds' Historical Default Rates Are Much Lower than Those of Similarly Rated Corporates

Credit Quality	Average 10-Year Cumulative Default Rates (1970-2022)	
Moody's Rating	Municipals	Corporates
Aaa	0.00%	0.34%
Aa	0.02%	0.75%
A	0.10%	1.90%
Baa	1.05%	3.64%
Investment Grade	0.09%	2.23%
Non-Investment Grade	6.84%	29.81%
All Rated*	0.15%	10.72%

*Ratings are not assigned to all entities.

Source: Moody's, "Moody's U.S. Municipal Bond Defaults and Recoveries, 1970–2022," July 2023 (latest available historical data). Data show the average 10-year cumulative default rates of Moody's rated corporate and municipal bonds for a study covering the period 1970-2022.

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A Diversified Investment Opportunity

The sheer number of muni-bond sectors, and the fact that many of them provide essential services, offer investors the opportunity for effective diversification, in our opinion. For example, when the U.S. economy went through uncertainty following the onset of COVID-19 in early 2020, people still had to pay their water, sewer, and energy bills. They also still paid college tuition while students attended classes remotely. With shoppers pivoting to online stores, revenue from trucks on toll roads increased substantially. Hospital admissions increased during the pandemic, so although elective surgeries were reduced, patient volumes were very high. Even though airports saw reduced traffic, they still earned fees from airlines who didn't want to lose their gates; fortunately, airports had stockpiled a lot of cash on their balance sheets to help them ride out disruptions such as a global pandemic.

In addition to the attractive qualities listed above, municipal bonds can also be used to meet many investment strategies that are top-of-mind today, including those tied to strengthening infrastructure, shifting demographics, and responses to the imposition of tariffs by the United States and its trading partners.



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Strategy 1: Infrastructure Investment

Municipal bonds offer a way to invest in infrastructure, a sector where there are many funds being created for taxable or equity investments. The infrastructure category includes many more types of issues. For example, municipal bonds are issued to help:

- Create low-income or workforce housing
- Build toll roads
- Provide support to public corporations in building factories (via Industrial Development Bonds)
- Produce and distribute various sources of energy
- Support state disaster insurance efforts

In our view, municipal bonds may represent the largest opportunity set among the major asset classes to invest in building, maintaining, and repairing infrastructure in the United States.

Strategy 2: Demographic Shifts

For those focused on changing demographics, including how to make investments in the services that baby boomers (for our purposes, people from ages 60 to 80) will need as they grow older, there are many municipal bond options available. An obvious one is not-for-profit hospitals, where a large portion of the revenue comes from patients insured by Medicare. In the high yield municipal bond market, there is a whole sector for Continuing Care Retirement Communities (CCRCs) where occupancy is over 80% on average, and many parts of the country are facing shortages of available senior housing options. There are real estate communities that cater to older people (such as the Villages in Florida), which frequently issue bonds to support their growth.

A bigger-picture approach might be to invest in general obligation or revenue bonds in areas of the country that are attracting increasing numbers of retirees such as Arizona and Florida. More people are turning 65 this year than any year in history, so the revenues coming from this segment of the population should continue growing.

Strategy 3: The Potential Impact of Tariffs

Another hot topic lately is tariffs. Without suggesting an opinion about how they might affect the economy, one thing that is certain is that our government is not going to put tariffs on companies doing their production within the United States. As mentioned above, there are ways in the municipal bond market to invest in domestic production of goods and services through the industrial development bond sector. It may seem surprising that corporate issuers are able to bring municipal bonds to the market, but they can do so through private activity bond issuance. Each state has an allocation of municipal bond issuance to make available to public corporations to spur economic growth. Industrial development bonds can include issues covering a wide range of sectors such as steel, chemicals, airlines, investor-owned utilities, waste management, paper, and metals. Regardless of how the planned levies on non-U.S. producers are implemented in coming months, production within the United States will not face tariffs, so domestic industries could benefit.



Implementing These Strategies

Many of the strategic themes mentioned above may already be part of a municipal bond portfolio. Figure 2 pointed to the rising volume of issuance in key sectors; that growth is reflected in their weightings in the Bloomberg municipal bond indexes. In the investment-grade index, healthcare accounts for 9% of issuance, transportation 15%, housing 4%, and utilities 13%. In the high yield index, healthcare (combination of hospitals and CCRCs) represents 18%, industrial development bonds 20%, housing 10%, and special tax (which includes a lot of real estate-backed bonds) 19%. (Figures based on Bloomberg data as of February 14, 2025.) So, each of these strategies has a material size weighting in representative indexes.

Beyond the indexes, active managers of municipal-bond portfolios can harness their credit research and security-selection capabilities to make strategic allocations to capitalize on these trends. Also, those who hold separately managed accounts focused on municipal bonds may be able to customize weightings in these sectors or to certain parts of the country based on their individual preferences.

Summing Up

The municipal bond universe goes well beyond issues backed by general obligations of cities, states, and local governments; it encompasses a broad, differentiated set of revenue sectors as well. They provide not only diversification and attractive yields, but also the possibility of investing along many of the themes that strategists are currently highlighting for other markets. Additionally, revenue bonds have historically outperformed general obligations over the long term.

The current yield environment puts these considerations into sharper focus. Tax-equivalent yields have historically been attractive versus other fixed-income sectors, and bond yields are now on the higher end of where they have been over the past decade. The credit quality of the overall muni market is strong, in our view, and studies of historical default rates show they are lower for municipals than other markets.

Municipal bonds give people the opportunity to invest in things that are important to them and regularly affect their daily lives. With all the uncertainty globally, we believe muni bonds are a good way to invest in domestic assets that might benefit from some of the investment themes we've detailed here, while potentially realizing attractive returns.



Glossary & Index Definitions

A **basis point** is one one-hundredth of a percentage point.

Municipal bond default rate refers to the percentage of municipal bonds that fail to make interest payments or repay principal on time.

Spread is the percentage difference in current yields of various classes of fixed-income securities versus Treasury bonds or another benchmark bond measure. A bond spread is often expressed as a difference in percentage points or basis points (which equal one-one hundredth of a percentage point).

The option-adjusted spread (OAS) is the measurement of the spread of a fixed-income security rate and the risk-free rate of return, which is adjusted to take into account an embedded option. Typically, an analyst uses the Treasury securities yield for the risk-free rate.

Yield is the income returned on an investment, such as the interest received from holding a security. The yield is usually expressed as an annual percentage rate based on the investment's cost, current market value, or face value. **Yield-to-maturity (YTM)** represents the expected return (expressed as an annualized rate) from the bond's future cash flows, including coupon payments over the life of the bond and the bond's principal value received at maturity. **Yield-to-worst** refers to the lesser of a bond's (a) yield-to-maturity or (b) the lowest yield-to-call calculated on each scheduled call date.

The **tax-equivalent yield** is the pretax yield that a taxable bond needs to possess for its yield to be equal to that of the tax-exempt yield on a municipal bond. This calculation can be used to fairly compare the yield of a tax-free bond to that of a taxable bond to see which bond has a higher applicable yield.

The Bloomberg Municipal Bond Index is a rules-based, market-value-weighted index engineered for the long-term, tax-exempt bond market. Bonds must be rated investment grade (Baa3/BBB- or higher) by at least two ratings agencies. They must have an outstanding par value of at least \$7 million and be issued as part of a transaction of at least \$75 million. The bonds must be fixed rate, have a dated-date after December 31, 1990, and must be at least one year from their maturity date.

The Bloomberg High Yield Municipal Bond Index is an unmanaged index consisting of non-investment-grade, unrated or below Ba1 bonds.

Bloomberg Index Information:

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The Municipal Market Data (MMD) AAA Curve is a proprietary yield curve that provides the offer-side of "AAA" rated state general obligation bonds, as determined by the MMD analyst team. The "AAA" scale (MMD Scale), is published by Municipal Market Data every day at 3:00 p.m. Eastern standard time, with earlier indications of market movement provided throughout the trading day. The MMD AAA curve represents the MMD analyst team's opinion of AAA valuation, based on institutional block size (\$2 million+) market activity in both the primary and secondary municipal bond market. In the interest of transparency, MMD publishes extensive yield-curve assumptions relating to various structural criteria, which are used in filtering market information for the purpose of benchmark yield-curve creation.

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Fixed-Income Investing Risks

The value of investments in fixed-income securities will change as interest rates fluctuate and in response to market movements. Generally, when interest rates rise, the prices of debt securities fall, and when interest rates fall, prices generally rise. High yield securities, sometimes called junk bonds, carry increased risks of price volatility, illiquidity, and the possibility of default in the timely payment of interest and principal. Bonds may also be subject to other types of risk, such as call, credit, liquidity, and general market risks. Longer-term debt securities are usually more sensitive to interest-rate changes; the longer the maturity of a security, the greater the effect a change in interest rates is likely to have on its price. There is a risk that a bond issued as tax-exempt may be reclassified by the IRS as taxable, creating taxable rather than tax-exempt income. Municipal bonds may be affected by local, state, and regional factors. These may include, for example, economic or political developments, erosion of the tax base, and the possibility of credit problems.

The credit quality of fixed-income securities in a portfolio is assigned by a nationally recognized statistical rating organization (NRSRO), such as Standard & Poor's, Moody's, or Fitch, as an indication of an issuer's creditworthiness. Ratings range from 'AAA' (highest) to 'D' (lowest). Bonds rated 'BBB' or above are considered investment grade. Credit ratings 'BB' and below are lower-rated securities (junk bonds). High-yielding, non-investment-grade bonds (junk bonds) involve higher risks than investment-grade bonds. Adverse conditions may affect the issuer's ability to pay interest and principal on these securities.

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