

A Municipal Debt Boom Is Driving Public Projects and Tax Breaks for Investors

Municipal debt issuance surpassed \$500 billion last year, a record that's found a deep pool of buyers.



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Across America, state and local governments have been selling bonds at a record clip to finance projects like airports, roads and utilities.

They have found a deep pool of buyers keen on realizing the tax-exemption benefits from holding this municipal debt, which also provides relatively high returns.

Borrowing in the municipal bond market surpassed \$500 billion last year, breaking the \$498 billion record set in 2024. The “muni market” is now worth well over \$4 trillion, roughly equivalent to the market capitalization of Nvidia, the chip maker that has soared on the artificial intelligence boom, driving stocks to record highs.

“People really don’t understand how big this market is and how it impacts a lot of things that everybody does every day,” said Mike Bartolotta, an executive managing director and co-head of public finance at Hilltop Securities, a firm that specializes in municipal sales. “You drive to work, you go to school, you flush the toilet, you drink water? You’re likely going to use something that’s been touched by municipal securities.”

Mr. Bartolotta helped city leaders sell \$2 billion in bonds last year to expand Dallas Fort Worth International Airport. Four hours south of Dallas along Interstate 45, Houston is also making billion-dollar renovations to the George Bush Intercontinental Airport by issuing bonds, rather than earmarking taxpayer dollars for the project.

Spreading out the costs and funding schedule for long-term projects through long-term borrowing frees up room for competing priorities in annual budgets along the way, said Vernon Lewis, director of Houston’s treasury department.

“The reason we do it this way is because it gives us more of a cost-saving scenario,” Mr. Lewis said.

In the past two years, the issuance of municipal bonds is up 57 percent, according to Matt Fabian, the president of Municipal Market Analytics, an independent research and consulting firm.

Christopher Lanouette, a Boston-based investment manager at CIBC Private Wealth, said wealthier clients were attracted to these bonds for two reasons: Their returns are generally tax-exempt, and they can produce returns, or yields, comparable to stocks’ in a middling year — and often beat the returns on federal Treasury debt, the base line of the bond market.

JPMorgan Private Bank estimated at the start of 2025 that after tax advantages were factored in, yields for a typical municipal bond were over 7 percent. The yield for the benchmark 10-year Treasury note has been about 4 percent for the past few years.

President Trump himself is among the investors piling into municipal debt. According to his latest financial disclosures, Mr. Trump bought about \$100 million in municipal and corporate bonds from mid-November to late December, with a majority of the purchases from municipal bond issuers: a range of cities, school districts, utilities and hospitals.

It's one of those rare moments in finance when an asset class appears to be providing a low-risk, high-reward opportunity for investors as well as cities and states looking to build.

“The borrowing is coming out of strength,” said Susan Wachter, a professor of real estate and finance at the Wharton School of the University of Pennsylvania.

“State and local budgets are in good shape, and their rainy day funds are, generally, at highs,” she added — largely the downstream result of a strong economic recovery since 2020 and \$350 billion in federal aid designed to refill municipal coffers after the pandemic shock. By the end of 2023, state and local governments had billions in pandemic aid left to spend.

Still, such an accumulation of debt in such a short time has spurred some wariness among economists and money managers.

“It's a little too Pollyannish to say, ‘Oh, it's a win-win for everyone,’” said Jason Draho, the head of asset allocation for the Americas at UBS Wealth Management.

Analysts say the biggest risk is a bursting of a financial bubble in artificial intelligence. From 2023 to 2025, the A.I. build-out in communities around the country has pushed up corporate valuations and economic growth. The data centers needed to power A.I. have boosted construction activity and employment, contributing at times to tens of millions of dollars in local real estate taxes and other revenue.

But municipalities may face credit downgrades from bond rating agencies or even defaults if a bubble burst in A.I. is bad enough to prompt a downturn so severe that tax receipts from wages, commerce and property greatly decline.

Serious defaults are not without precedent: After the Great Recession, for instance, Detroit filed for bankruptcy in 2013, the largest municipal bankruptcy in U.S. history.

There are also more idiosyncratic risks that some investors think may get overlooked. Coastal areas, more at risk to devastating flooding, are home to almost 40 percent of the U.S. population. Last year, Standard & Poor's downgraded the outlook of California state utility issuer, Southern California Edison, from stable to negative based on prominent local threats like wildfire risk.

The same credit assessment from S&P named several Los Angeles-area issuers, with debt collectively worth tens of billions of dollars, that could also become riskier bets.

Still, even some of the riskiest municipal borrowers seem to have been getting their act together — with the help of federal aid earlier this decade.

Moody's in October upgraded Illinois's credit rating into A territory, the state's highest mark after over two decades of budget woes and unfunded pension liabilities. That was after the state passed seven consecutive balanced budgets and expanded its rainy day fund to almost \$2.4 billion.

Illinois plans to issue \$2.1 billion in bonds to fund capital projects during the 2026 fiscal year, up from \$1.3 billion the year prior.

“Not long ago, Illinois was facing repeated credit downgrades, mounting unpaid bills and some of the highest borrowing costs in the country,” a spokesman for JB Pritzker, the state's governor, said. “Today, after years of disciplined budgeting and responsible financial management, Illinois has earned 10 credit upgrades and

restored investor confidence in Illinois. The state has been able to accumulate meaningful saving on interest costs, allowing taxpayer dollars to better serve the public.”

Such optimism makes it likely that municipal debt may continue to sell to high-net-worth households in high-tax states from California to Texas to New York like ice cream on a hot summer day.

The muni boom is yet another aspect of the “K-shaped economy, where there’s been a divergence of wealth between the upper- and lower-income cohorts,” Mr. Lanouette of CIBC Private Wealth said.

Wealthier households, he added, aren’t the cohort most affected by cost-of-living concerns; they “are the ones that are looking to shield as much income from taxation as possible — so municipal bonds fit that bill.”

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