

Municipal Market Quarterly Review

Third Quarter 2026



Municipal market review

The S&P Municipal Index (Municipal Index) returned -5.57% in the third quarter and -3.62% year to date, as rising U.S. Treasury (UST) yields and record levels of issuance and supply were met with seasonally low reinvestment demand and negative fund flows (**Figure 1**). Performance was primarily driven by price returns amid the increase in interest rates, which more than offset income returns during the quarter.

During the quarter, the municipal yield curve flattened by 25 basis points (bps) to 1.59%, as measured by the spread between the 2- and 30-year rates. Short-term yields increased by 119 bps, while long-term yields increased 94 bps (**Figure 2**). The shift in municipal term structure indicates a decreased risk premium for interest rates as market participants priced in a higher-for-longer interest rate scenario. By comparison, the UST yield curve flattened to a lesser degree, falling 3 bps to 0.75%, as short-term rates increased more than long-term rates (**Figure 3, page 2**). Municipal bonds with maturities or call features under five years outperformed intermediate and long-term maturities, benefiting from their lower price sensitivity to increases in interest rates. Among quality cohorts, AA-rated and A-rated bonds outperformed BBB-rated bonds for the quarter, signaling a preference for higher-quality bonds.

In comparison with taxable fixed income sectors, the Municipal Index underperformed the Bloomberg U.S. Treasury Index by 253 bps in the third quarter as municipal yields increased more than similar-duration UST yields. Municipals also underperformed the Bloomberg U.S. Aggregate Index and Bloomberg U.S. Corporate Index by 206 and 163 bps, respectively. Relative performance for the quarter reflects a technical supply/demand dislocation, in our view, with strong municipal fundamentals largely intact.

From a technical perspective, third-quarter municipal bond issuance (supply) of \$182 billion brought year-to-date issuance to \$490 billion, a 12% increase

Figure 1. Fixed Income Returns and Statistics

S&P Municipal Bond Indices	Q3 2026 Return	YTD Return	Yield to Worst	Duration
Main	-5.57%	-3.62%	4.74%	7.2
Intermediate	-4.97%	-3.90%	4.47%	5.5
Short-Intermed.	-2.76%	-1.71%	4.09%	3.3
Short	-1.22%	0.03%	3.89%	1.8
General Obligation	-5.65%	-3.99%	4.51%	6.5
Revenue	-5.61%	-3.51%	4.90%	7.6
Taxable	-4.19%	-2.84%	5.85%	7.4

Bloomberg Indices

U.S. Treasury	-3.04%	-2.77%	5.13%	5.5
U.S. Aggregate	-3.51%	-2.91%	5.56%	5.7
U.S. Corporate	-3.94%	-3.11%	6.04%	6.3

As of 9/30/2026.

Sources: S&P Dow Jones Indices LLC, Bloomberg L.P., PNC

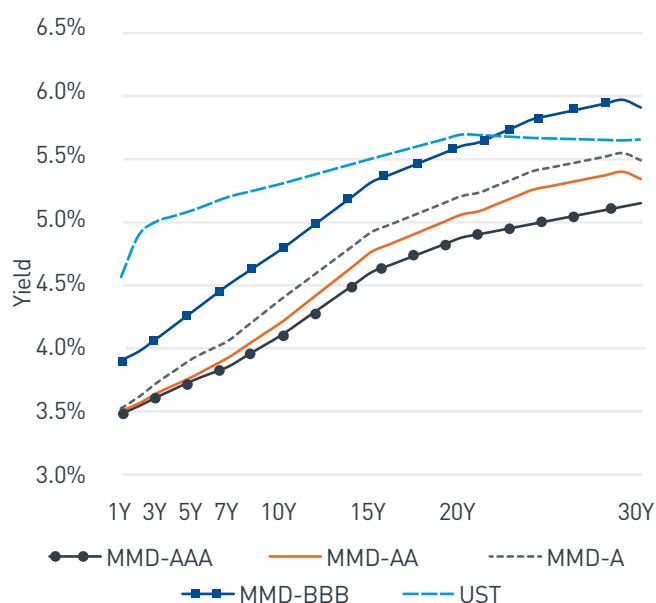
Figure 2. Quarterly Yield Curve Change (bps)

Maturity	Market Spot Rates				UST
	AAA	AA	A	BBB	
1 Year	117	117	117	120	55
2 Year	119	119	119	122	72
3 Year	116	116	116	119	82
5 Year	115	115	115	115	87
7 Year	112	112	112	109	86
10 Year	115	115	115	108	83
15 Year	126	126	126	119	78
20 Year	108	108	108	101	72
30 Year	94	94	94	87	69

From 6/30/2026–9/30/2026.

Sources: Refinitiv, S&P Dow Jones Indices LLC, Bloomberg L.P., PNC



Figure 3. Municipal Market and UST Yield Curves

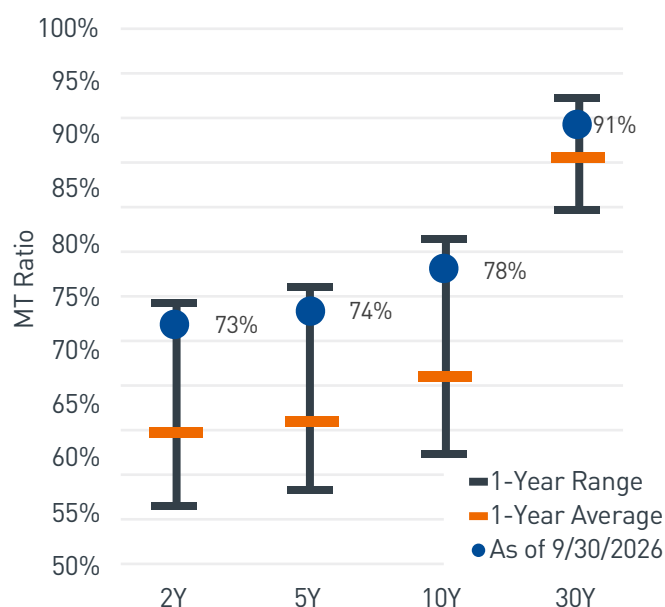
As of 9/30/2026.

Sources: Refinitiv, S&P Dow Jones Indices LLC, Bloomberg L.P., PNC

compared to the first nine months of 2025 and on pace for a record level of calendar-year issuance. The increased supply had been well digested by the market, but seasonally weak reinvestment demand and net outflows for municipal funds drove a supply/demand mismatch for the quarter, which pressured prices. Municipal bond mutual funds experienced net outflows of \$3.5 billion during the quarter, primarily due to an \$11 billion outflow in September, which marked the first month of net outflows since October 2025.

Tax-exempt municipal valuations improve

Municipal valuations relative to USTs were notably cheaper across the yield curve on a quarter-over-quarter (q/q) basis, an unsurprising development given the level of underperformance. The 2-, 5- and 10-year Municipal-to-Treasury (MT) ratios improved most, increasing by more than 11%, while the 30-year MT ratio increased least, increasing by 6%. Year to date, 5- and 10-year MT ratios have increased by more than 9%, reflecting the technical supply/demand-driven dislocation in September as fixed income markets repriced the expected path of Federal Reserve (Fed) monetary policy. The 2-, 5- and 10-year ratios are now trading nearly 10% above their respective one-year averages. (Figure 4).

Figure 4. MT Yield Ratios

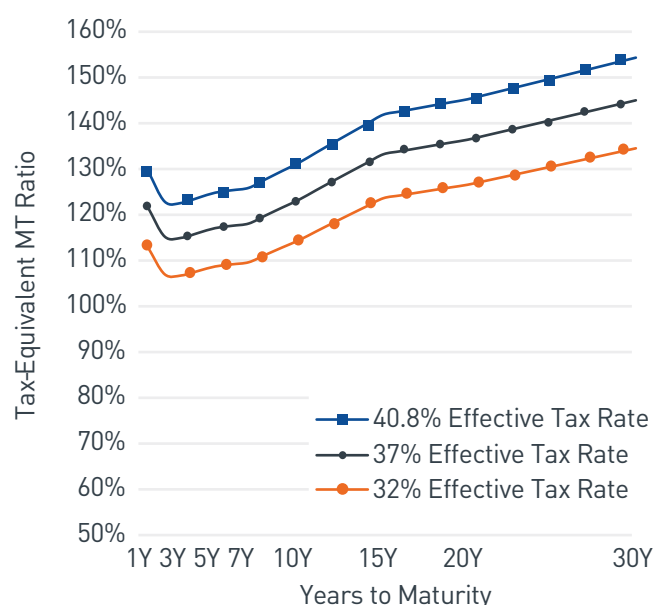
As of 9/30/2026.

Sources: Refinitiv, S&P Dow Jones Indices LLC, Bloomberg L.P., PNC

Tax-exempt municipal bonds remain attractive on a tax-equivalent basis compared to taxable alternatives, particularly for longer maturities. Assuming an estimated federal tax rate of 40.8% (37% maximum federal income tax level plus 3.8% Medicare tax that may apply to some taxpayers), the tax-equivalent yield of a 10-year AAA-rated municipal bond now offers 131% of the 5.28% yield offered by a 10-year UST, up from 122% at the end of the second quarter. For investors with a federal tax rate of 32% to 37% (based on federal tax brackets, not including the 3.8% Medicare tax), tax-equivalent MT ratios are more than 100% across the yield curve, with greater advantage in long-term bonds. (Figure 5, page 3).

Taxable municipals outperform tax-exempt counterparts

The S&P Taxable Municipal Bond Index (Taxable Municipals) returned -4.19% in the third quarter and outperformed tax-exempt municipals by 1.38%. However, taxable municipals underperformed the Bloomberg U.S. Corporate Index by 26 bps for the quarter and reflected greater spread widening in taxable municipal bonds vs. corporate bonds with similar ratings and maturities. The shift in relative spreads has made A-rated taxable municipal bond

Figure 5. Tax-equivalent MT Yield Ratios

As of 9/30/2026.

Sources: Refinitiv, S&P Dow Jones Indices LLC, Bloomberg L.P., PNC

yields more attractive on a relative basis, but remain 5-10 bps lower, on average, compared to similar-duration corporates for maturities between three and 10 years. We believe supply/demand technicals remain supportive of valuations given the competitive yield landscape and our expectation for stable taxable issuance in 2026.

Municipal credit review

Despite the jarring movement in rates that occurred during the third quarter, credit spreads displayed relative stability. Credit spreads widened slightly from otherwise historically tight levels. Both AA- and A- cohorts experienced slight widening in the period, while the BBB cohort was effectively flat. Municipals underperformed Treasuries and corporates during the period, on a combination of rate and spread movement. In our view, the limited and largely retail investor base for municipal bonds served to exacerbate the impacts of reduced liquidity as rates rose.

Credit quality within the municipal market remains steady, exemplified by a relatively quiet budget season for states with a June 30 fiscal year end. Three states were delayed in passing budgets: Pennsylvania, Massachusetts and South Carolina. Otherwise, budget

processes dodged much consternation, owing to positive outcomes in the prior fiscal year and benign outlooks for the current one. However, pockets of weakness cannot be overlooked, particularly in the high yield portion of the market. For example, the bankruptcy filing of Brightline Trains Florida LLC was concerning to many investors.

Brightline entered Chapter 11 bankruptcy protection in September. Brightline was a prolific issuer of debt, with a complex capital structure, including \$2.2 billion of tax-exempt bonds. At that level of issuance, the bankruptcy was meaningful to the overall tax-exempt market. The tax-exempt bonds were issued in mid-2024 with investment grade ratings, but by March 2026, S&P downgraded their rating to CCC- and withdrew. The \$2.2 billion of tax-exempt bonds, while not currently included in the bankruptcy estate, are currently priced to near-default levels and weigh heavily on the credit side of the municipal market.

At the end of the quarter, Moody's downgraded \$2.4 billion worth of federal lease-backed bonds, on a swath of unique financings, to below-investment grade. The downgrades revolved around Moody's re-evaluating its overassessment of the essentiality of the leases to the federal government and its underappreciation of the structural shortfalls built into the financings.

Looking ahead

After a difficult quarter that included interest-rate volatility and technical-driven liquidity dislocation, the reset in relative municipal valuations amid stable fundamentals strengthens our view that municipal yields offer a compelling option for tax-sensitive investors.

While recession risk has risen, the PNC Economics team lifted their forecast for real GDP growth in 2026 from 2.1% to 2.4%, and expects economic growth to continue through 2028, albeit at a slower pace than 2026. Stronger-than-anticipated growth and still-



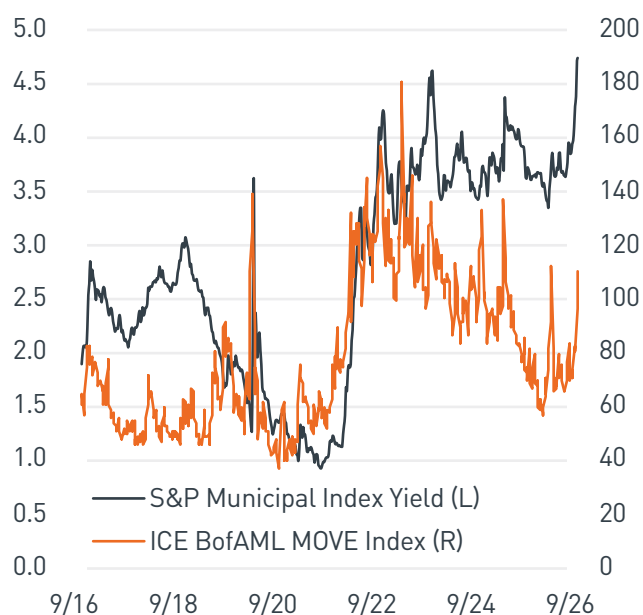
Third quarter weakness has led to more attractive valuations within the municipal universe.

elevated inflation have also led the Economics team's to raise their forecast for policy rates through 2027, with two additional rate hikes now expected by the end of next year.

The recent price volatility reinforces our view that taking a more measured approach to credit risk is prudent given our expectation for flat to potentially wider credit spreads over the course of the next 12 months. We also believe that credit pricing is reflective of the currently strong underlying fundamentals and high levels of financial reserves. As such, we expect income to be the primary driver of returns during the next 12 months, following the sharp repricing that took place in September.

Overall, third-quarter volatility has led to an improvement in relative valuations and absolute yields within the municipal universe. The Municipal Index yield is now in the 100th percentile of its 10-year range (**Figure 6**), which we believe illustrates the tactical and strategic value municipal bonds can offer tax-sensitive investors.

Figure 6. S&P Municipal Bond Index Yield & Rate Volatility



As of 9/30/2026.

Sources: Bloomberg L.P., PNC

Key theme recap

- ▼ The Municipal Index returned -5.57% in the third quarter and underperformed comparable taxable indices on a quarterly and year-to-date basis.
- ▶ The municipal yield curve flattened as short-term yields increased more than long-term yields, which indicated a decreased risk premium for interest rates.
- ▲ Municipal valuations cheapened relative to USTs on a maturity-matched basis for the quarter.
- ▶ While municipal fundamentals remain strong, we believe taking a more measured approach to credit risk is prudent given our expectation for flat to potentially wider credit spreads over the next 12 months.
- ▲ We believe municipal yields offer a compelling option for tax-sensitive investors relative to taxable alternatives, particularly for maturities between four and 12 years.

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