Credit Insights

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Belle Haven INVESTMENTS

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CREDIT INSIGHTS

The 2026 Midterm Elections: A Potential Tailwind for Municipal Bonds

Municipal bonds have rallied following the Democratic wave in the 2026 midterm elections, reflecting what we view as a largely favorable political development for the asset class. While broader financial markets have experienced considerable volatility following the results, municipal bonds have strengthened through Monday, November 9, as investors assess the implications of the election.

Historically, midterm elections have often favored the party outside the White House, and this election was no exception. However, the magnitude of Democratic gains, particularly in several traditionally Republican-controlled states, was notable.

Beyond the shift in political control, three themes emerged at the state and local levels that could matter for municipal credit and investor demand: property tax relief, growing opposition to AI data centers, and mixed voter support for higher taxes on wealthy households.

A Changing Political Landscape

Democrats made substantial gains in both Congress and state governments, potentially reshaping fiscal policy over the next two years.

According to the National Conference of State Legislatures (NCSL), Democrats flipped 12 state legislative chambers as of November 6, with some results still unofficial. Notable changes included Democratic gains in Arizona, Georgia, Pennsylvania, and Texas, where Republicans had maintained control of key legislative chambers for decades.

While the magnitude of these gains may appear extraordinary compared with recent election cycles, historical context is important. Over the past 125 years, an average of 11 to 12 state legislative chambers have changed party control during each two-year election cycle. The 2026 results therefore represent something closer to a return to historical norms than an unprecedented political realignment.

Democrats also expanded their control of governorships, adding to their ability to influence state-level fiscal priorities. This broader political shift could have important consequences for municipal issuers as policymakers pursue initiatives related to affordability, healthcare funding, taxation, and infrastructure development.

At the federal level, Democratic control of Congress alongside a Republican White House increases the likelihood of legislative gridlock. However, divided government does not necessarily mean an absence of policy changes. There may still be opportunities for bipartisan compromise on issues with meaningful implications for municipal credit quality.

A RETURN TO HISTORICAL NORMS

12 chambers flipped in 2026

11-12 average per cycle over the past 125 years

Source: National Conference of State Legislatures, as of 11/6/2026; some results unofficial

TWO FEDERAL DEVELOPMENTS TO WATCH

Federal healthcare funding

Democratic control of Congress could create an opportunity to revisit certain Medicaid funding reductions enacted under the One Big Beautiful Bill Act. Any restoration or moderation of these reductions would generally be favorable for state and local government budgets and healthcare providers, particularly hospitals with significant Medicaid exposure.

Preservation of the municipal tax exemption

While potential changes to the municipal tax exemption have periodically surfaced in tax policy discussions, we have consistently viewed sweeping reforms as unlikely, with much of the debate focused on specific sectors, particularly higher education. Divided government provides an additional measure of policy certainty. These discussions underscore the value of credit research, active security selection, and identifying relative value opportunities.

Although the federal policy outlook remains uncertain, we believe these developments represent a constructive backdrop for the municipal market.

THREE KEY THEMES FOR MUNICIPAL INVESTORS

1 Property Tax Relief: Affordability Comes at a Cost

Efforts to provide property tax relief continue to gain momentum as policymakers respond to rising housing costs and growing affordability concerns.

Florida offers one of the most recent examples, with voters approving Amendment 3, which provides a phased expansion of property tax exemptions for primary residences. According to Moody's, the changes could result in approximately $12 billion in lost revenue for cities and counties, creating potentially significant challenges for certain local governments.

The credit implications are unlikely to be uniform. Financially stronger municipalities with diversified revenue sources, healthy reserves, and greater budgetary flexibility should be better positioned to absorb the reductions. Weaker credits, particularly those with substantial reliance on property tax revenues, may face more difficult decisions involving spending reductions, alternative revenue sources, or changes in service delivery.

Florida is hardly alone. Policymakers in Colorado, Connecticut, Georgia, Indiana, Iowa, and New Jersey have considered or implemented changes to property tax structures or collection limits. Importantly, property tax relief is not exclusively a Democratic or Republican initiative, reflecting a broader response to affordability pressures across the country.

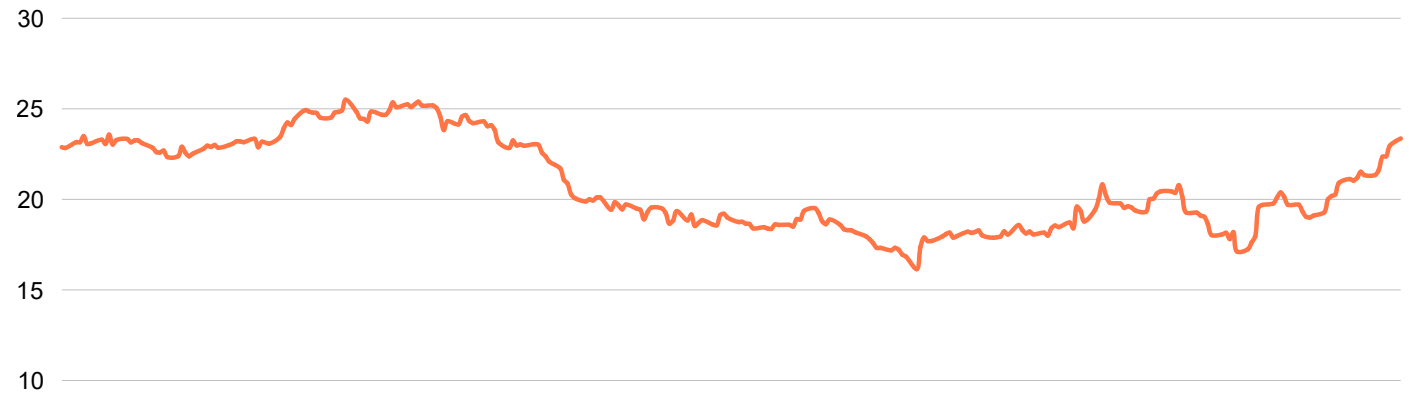
While these policies are intended to provide relief to homeowners, their effectiveness can vary. Property taxes remain among the most stable and predictable revenue sources for local governments, making changes to their collection particularly important from a credit perspective.

Thus far, the market reaction in Florida has been relatively modest. As illustrated in the chart, Florida municipal bond spreads have generally held within a one-year range of roughly 18–25 basis points over the broader municipal market.

However, the more meaningful effects may emerge over time as local governments determine how to replace lost revenue or adjust expenditures. **This could lead to greater credit differentiation among Florida issuers, reinforcing the importance of fundamental credit research and active management.**

Florida spreads vs. the broader muni market

Spread differential, Florida index to Municipal Bond Index (bps)



Source: Bloomberg, 11/6/2025–11/9/2026

2 Data Centers: Growing Resistance to a Powerful Economic Driver

Voters across the political spectrum expressed growing concerns about the rapid expansion of AI data centers, particularly their impact on electricity demand, water consumption, and local infrastructure. Several communities supported restrictions or moratoriums on new development, while candidates campaigned on stronger oversight and measures to limit the impact on household utility costs.

Data center investment has been an important source of economic development, construction activity, infrastructure investment, and tax revenue growth for many state and local governments. States such as Virginia and Texas have benefited from policies designed to attract these facilities. A slowdown could moderate future tax revenue growth, particularly for municipalities increasingly dependent on this activity, and reduced construction spending could weigh on certain local economies. Meanwhile, nearby states are reportedly actively recruiting data center development, potentially benefiting from increased investment, job creation, and tax revenues. These projects have supported strong tax collections in recent years, and continued development could create new opportunities for states successful in attracting investment. Active credit research will be essential to identifying potential beneficiaries while monitoring the implications for states that may miss out on future development.

For municipal investors, the key will be distinguishing between issuers with diversified economic and revenue bases and those more dependent on continued data center investment. Utilities facing substantial capital expenditure requirements tied to projected demand growth may also warrant closer scrutiny.

56% of voters named AI and data centers a crucial or major factor in their congressional vote

Source: NBC News exit poll

40+ data center measures tracked; the overwhelming majority reportedly added restrictions

Source: Moody's

3 Taxing the Wealthy: Mixed Results, but Potential Support for Municipal Demand

What voters decided

Colorado	Approved Amendment 87: 4.4% flat income tax replaced by a graduated system with six new tax brackets for earners over $500K ranging from 7.4% to 8.4%.
Washington	Retained an added tax on incomes above $1 million.
California	Rejected Prop. 40, a one-time wealth tax on billionaires. Approved Prop. 3, which made income taxes on higher earners permanent.
North Carolina	Reduced the limit on the top income tax rate from 7.0% to 3.5% with the upcoming rate at 3.49%.

Voters delivered mixed messages on proposals to increase taxes on higher-income households. Support appears highly dependent on the state, the structure of the proposal, and the intended use of the revenue.

This matters given that the value of tax-exempt income generally increases as an investor's marginal tax rate rises. Higher income taxes could also generate added revenue for states pursuing expanded public services. **Overall, rising income taxes could provide a tailwind for municipal bonds in the years ahead by increasing the relative attractiveness of tax-exempt income, particularly in states like Colorado, where top earners will now on average pay almost 2% more in taxes annually.**

However, greater reliance on high-income taxpayers may increase revenue volatility, particularly during periods of market weakness. The ultimate impact will depend on both investor demand and the resulting changes in state fiscal flexibility.

Conclusion: A Constructive Backdrop, with Credit Selection Increasingly Important

The Democratic wave in the 2026 midterm elections was not without historical precedent, but its implications could provide an additional tailwind for the municipal bond market. At the federal level, divided government appears to reduce the risk of changes to the municipal tax exemption while creating potential opportunities for compromise on healthcare funding and other fiscal priorities.

At the state and local levels, however, voters have endorsed a range of policies that could produce increasingly divergent outcomes for municipal issuers. Property tax reductions may pressure local government revenues, restrictions on data center development could alter economic growth expectations, and higher income taxes in select states may enhance the relative attractiveness of tax-exempt income.

Together, these developments reinforce our view that the municipal market remains attractive, but that credit selection will be increasingly important as policy changes unfold. Without a clear national trend, our mantra remains that all politics is local and we need to remain vigilant for investors in picking good credits with healthy fundamentals that can stand the test of time.

The election through a credit lens

Theme	What happened	What it could mean for munis
Federal	Divided government	Greater certainty around the municipal tax exemption; possible compromise on healthcare funding
Property tax relief	Expanded exemptions and limits	Pressure on local government revenues; weaker credits most exposed but risks are mixed
Data centers	Bans, moratoriums, tighter rules	May temper growth expectations for issuers reliant on development while creating new opportunities for states attracting investment
Taxing the wealthy	Mixed results by state	Higher rates in select states may lift the appeal of tax-exempt income

Looking Ahead

With municipal yields remaining elevated relative to much of the past decade, even after the recent rally, investors continue to have opportunities to lock in attractive tax-exempt income.

In our view, the election results add another constructive element to the market's outlook, while highlighting the value of active management in navigating an increasingly differentiated municipal credit landscape.

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