

FROM THE OFFICE OF THE CIO

# Fixed Income Insights: Interpreting shifting municipal governance and budget dynamics

Toby Tolino, Senior Vice President, Fixed Income Portfolio Manager

---

## Overview

Amid changing political initiatives emanating from Washington, a closer assessment of how state and local governments recalibrate budgetary frameworks is warranted. As fiscal pressures mount, shifting priorities, especially in urban centers with increasing demand for expansive public services, are adding complexities. Understanding the challenges associated with these changing dynamics is essential to evaluating credit risks and identifying municipal investment opportunities.

## State of the states

The Trump administration's second term has ushered in a clear and deliberate policy shift as it pertains to federal support for core social programs, infrastructure and public services. This has implications for municipal issuers, particularly in high-cost, high-service regions. The change in governance and fiscal support from Washington is signaling that municipalities must become more self-reliant, even as inflationary pressures and demographic shifts increase demand for public services.

To date, federal funding grants that have been curbed or eliminated include drug addiction intervention, BRIC (Building Resilient Infrastructure and Communities) subsidies, affordable housing initiatives, health and disease prevention programs, as well as select education and research allotments. Housing vouchers and SNAP (Supplemental Nutrition Assistance Program) benefits have been scaled back. Additionally, state and local governments face nearly \$900 billion in Medicaid reductions over the next decade, beginning in 2027. Defunding of planned and ongoing critical infrastructure and capital improvement projects, including the high-profile

New York Hudson River "Gateway Program," have made headlines and sparked concern.

However, there are significant legal and constitutional constraints that limit how far fiscal changes from the Trump administration can go. The president does not have full authority to act unilaterally and withhold or redirect funds once Congress has legally appropriated them. Furthermore, the Impoundment Control Act of 1974 requires, by law, that the president must notify Congress of any intention to delay or cancel spending, the latter of which must be granted by congressional authorization. A recent example of this premise is the federal ruling in the case of the City of San Francisco v. Trump, which barred the administration from withholding funds from a "sanctuary city." While state and local governments are afforded legal protections and backstops, political uncertainty and administrative delays can still create fiscal strain.

## For every action there is a reaction

Several state and local governments have taken aggressive steps against the current administration's policy shift through legal, emergency measures and budgetary reallocations to continue to provide services to their constituents. These actions are short-term, stop-gap measures and municipalities will be forced to pivot and thoughtfully plan for temporary or, in some cases, permanent funding lapses over the long term.

Implementation of practical mechanisms in response to reduced funding levels and increasing demand will be paramount. We anticipate that municipalities will begin

to adjust revenue collections where politically feasible, through increased taxes, fees and enforcement. Additional offsetting measures include more conservative budgetary assumptions, operational efficiencies, contract renegotiation and procurement reform. State and local governments will be forced to examine program design and shift from an entitlement-like structure to a means-tested or phased benefit to manage recurring costs. Additional borrowing and tapping into rainy-day funds will be utilized as mechanisms to smooth timing mismatches of revenue receipts and assist in the facilitation of capital improvement projects.

Amidst increasing fiscal burdens on state and local governments, a rising swell of socialist priorities have taken hold, shifting the landscape of governance in major urban centers. So how will municipalities balance increasing needs and demands from their constituents during an era of financial challenge? We take a closer look at NYC to try and understand the complexities around implementation.

### **New York City's transformative moment**

Setting aside political tensions, the outcome of the NYC mayoral election presents an interesting case study. Zohran Mamdani, the mayor-elect, campaigned on an expansive progressive platform including fare-free public transportation, free childcare services, a universal healthcare program, rent freezes, expanded public housing and city-owned grocery stores. While these proposals reflect a growing sentiment among urban voters in search of more equitable and expansive public services, enactment raises critical questions about fiscal feasibility.

Campaign promises should always be viewed cautiously, especially when they diverge from the realities of governance given a municipality's structural framework. This is especially true given strong legislative guardrails that exist within NYC's framework. Lofty political initiatives typically don't evolve into fiscal stress because, as in the case of NYC, a balanced budget (both during annual construction and in the event of a mid-cycle shortfall) is required by both state law and local city charter.

Modifications to income taxes, both corporate and personal, would require state approval. As one of the highest taxed regions in the country, decision makers in Albany have been somewhat reluctant to authorize large-scale hikes. Proposed additional borrowing to fund programs could potentially run into challenges with the state's constitutional debt limit. While this cap can always be challenged, it would be a stark divergence from only four modest approved increases over the past two decades. Other proposals, such as eliminating bus fares, would require buy-in from state-appointed administrators making implementation challenging. Leaders at the Metropolitan Transportation Authority (MTA), a state-controlled agency, have indicated their hesitancy to authorize any fare modifications unless a replacement revenue stream is identified. Mamdani's campaign promise to make the biggest public bus system in the U.S. free for riders has investors of the MTA's \$17 billion of farebox bonds closely watching developments.

Against a backdrop of increasing need for supplemental support and the shifting federal landscape, policy enactment faces additional hurdles beyond just monetary. The newly elected mayor cannot act unilaterally and, as such, budgetary proposals require approval by the city council, which maintains a mayoral veto override with a two-thirds majority. Lastly, the New York State Fiscal Control Board, a state oversight agency that regularly reviews the city budget, is empowered to take stewardship of NYC's finances if certain budgetary standards are not met.

To date, despite polls that forecasted a Mamdani victory, New York City General Obligation bonds have not experienced widespread credit or price deterioration. Until insight is gained from the adoption of a new budget for NYC, a process that begins in earnest in January, market reaction will be more rooted in headline risk. During the discovery process, modest spread widening is a possibility. This potentially provides an opportunistic entry point as policy implementation will face challenges, as outlined above.

## Credit implications

Beyond NYC, the federal shift in governance has the potential to have far reaching impact across the broader public finance spectrum. From a credit viewpoint, it is important to note that the aforementioned challenges are not indicative of a systemic breakdown of municipal fundamentals. Entering 2025, state and local governments continued to maintain near record levels of reserve funds. While Covid-era aid has sunsetted and revenue collections have slowed from recent years, substantial draw-downs from rainy-day funds have not yet materialized.

If legal challenges to federal cuts are defeated, operating margins, reserve levels, debt service coverage ratios and continued uptrend in new debt issuance could result in downward rating pressures. We believe that an active approach emphasizing thoughtful portfolio construction, including broad geographic diversification, issuer selection, and sector concentration can potentially mitigate risk. Our

bias continues to focus on sectors and credits that maintain high levels of prudent fiscal management and governance, as well as issuers with diverse and resilient revenue streams. Essential service revenue bonds and state general obligations continue to be preferred. Conversely, issuers heavily reliant on federal pass-through payments from the federal government, such as Medicaid-dependent hospitals and federally subsidized transit systems, or those issuers subject to legal or regulatory risk, are viewed less favorably.

## Conclusion

The intersection of federal austerity and local progressive ambition presents both challenges and opportunities. For municipal bond investors, the key lies in understanding the evolving policy landscape, its implications for credit quality, and fiscal resilience. As always, our role is to navigate these complexities with discipline, foresight and a commitment to protecting client capital.

## ABOUT THE AUTHOR

*Toby Tolino joined Citizens Private Wealth in 2019, via merger with Richter Bober Asset Management as a Portfolio Manager. He has more than 20 years' experience working with ultra-high-net worth, high-net-worth and institutional clients.*

*Toby is responsible for working with clients to develop and implement tailored investment solutions that align with their overall wealth objectives while providing ongoing oversight and the highest level of client service.*

## DISCLOSURES

The investment products and financial strategies suggested herein are subject to investment risk, including possible loss of principal amount invested. There can be no guarantee the suggested strategies or investments will lead to successful outcomes. PAST PERFORMANCE IS NOT A GUARANTEE OF FUTURE RESULTS.

The primary risks associated with fixed income investments are interest rate risk and credit risk. Generally, when interest rates rise, the market value of bonds declines. Credit risk refers to the possibility that a bond issuer may be unable to meet its obligations to pay principal and interest.

Municipal securities may carry additional risks. Information about the financial condition of municipal issuers may be less readily available than for publicly traded corporations. The market for municipal bonds can also be less liquid than that for taxable bonds. Portions of the income generated may be subject to federal, state, or local taxes, and some investors may be subject to the Alternative Minimum Tax (AMT). Any capital gains distributions are taxable. This material is intended for informational purposes only and does not constitute personalized financial advice. It should not be relied upon solely when making investment decisions.

Please be aware that securities, insurance products, and investment advisory services offered by Citizens Securities, Inc. and Clarfeld Financial Advisors, LLC (both affiliates of Citizens Bank, N.A.) are different from those offered by the bank and are subject to investment risk, including possible loss of principal.

The information contained herein is for informational purposes only as a service to the public and is not legal or investment advice or a substitute for legal counsel. You should do your own research and/or contact your own legal or tax advisor for assistance with questions you may have on the information contained herein. Citizens Wealth Management (in certain instances DBA Citizens Private Wealth) is a division of Citizens Bank, N.A. ("Citizens"). Securities, insurance, brokerage services, and investment advisory services offered by Citizens Securities, Inc. ("CSI"), a registered broker-dealer and SEC registered investment adviser - Member FINRA / SIPC. Investment advisory services may also be offered by Clarfeld Financial Advisors, LLC ("CFA"), an SEC registered investment adviser, or by unaffiliated members of FINRA and SIPC providing brokerage and custody services to CFA clients (see Form ADV for details). Insurance products may also be offered by Estate Preservation Services, LLC ("EPS") or an unaffiliated party. CSI, CFA and EPS are affiliates of Citizens. Banking products and trust services offered by Citizens.

**SECURITIES, INVESTMENTS AND INSURANCE PRODUCTS ARE SUBJECT TO RISK, INCLUDING PRINCIPAL AMOUNT INVESTED, AND ARE:  
· NOT FDIC INSURED · NOT BANK GUARANTEED · NOT A DEPOSIT · NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY · MAY LOSE VALUE**