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Demand for insured municipal bonds is booming. Here's why

More insured municipal bonds were sold in the first half of 2025 than in any year since the 2008 Global Financial Crisis, as states and local governments ramp up their infrastructure spending and investors seek to lock in attractive yields while managing increasing volatility from potential economic and policy changes.

Wealthy US individual investors remain the bedrock of the US municipal bond market, because they can capture the most economic benefit from munis that deliver tax-exempt income (which represented 89% of all new-issue volume in the first half). In a survey sponsored by BAM Mutual earlier this year, 85% of responding financial advisors said that they or their clients invest in municipal bonds, and 95% said that the tax-free income offered by municipal bonds was the top reason their clients participate in the market.

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"Tax-exempt income is back in focus," says Grant Dewey, BAM's head of municipal capital markets. "We haven't seen sustained muni yields like this in a decade—it's a prime opportunity to lock in tax-advantaged income."

Given market conditions, however, both retail and institutional investors are increasingly turning to insured municipal bonds as a tool to deliver credit quality and liquidity while boosting diversity and adding a layer of protection to their portfolios.

Bond insurance guarantees timely repayment of principal and interest in the event of issuer default. Insured municipal bonds, which now account for about one in every five new-issue transactions, are gaining traction as investors respond to growing uncertainty around the economic impact of policy changes, such as tariffs, and increasing risks from natural disasters like wildfires.

BAM's insurance is increasingly being used on larger deals, and its first half activity included guaranteeing a diverse slate of larger issues with strong underlying credit ratings, including $455 million for the Los Angeles Department of Water and Power (rated Aa2 by Moody's ratings), and $221 million for the school district in Fayette County, Kentucky (rated AA-minus by S&P Global Ratings). The firm's average transaction size in the first half reached a record $19.7 million.

An expanding market

Demand for municipal bonds, generally, is broadening, thanks to historically high yields creating an attractive entry point, especially for high-net-worth investors who have more to gain from tax-free growth. Retail investors are also turning, specifically, to insured municipal bonds, especially in transactions that rely on consistent cash flows from an issuer's ongoing operations or annual appropriations from elected officials.

Through June 17th, the Investment Company Institute reported more than $3.5 billion of net inflows to municipal bond mutual funds, mostly from retail investors. Direct retail investing is also increasing, boosted in part by the growth in Separately Managed Accounts, which can efficiently deploy professional portfolio management on portfolios that are tailored to individual investors' specific risk appetites and cash-flow needs (for college, retirement, or other events).

"Over the last two years, the average transaction size has come down fairly significantly, which is an indication that direct retail buying is relatively high," says Don Farrell, BAM's head of investor relations. Data from the Municipal Securities Rulemaking Board shows that average deal size fell from a high of about $357,000 in 2020 to $229,000 in 2024.

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Another factor potentially driving interest in insured bonds from this group: they may appreciate the dedicated surveillance team of bond insurance companies, which monitor their investments and can help identify and mitigate risks before they pose a threat to bond payments.

"The retail investor doesn't have the research staff to help them make a decision on whether or not they should buy, and whether they should hold their assets," Farrell says.

BAM publishes three-page summaries of every transaction that the firm insures, so that both individual and institutional investors can easily find information on their insured bond and see which sectors the firm is leaning into. Municipal bond insurance also helps ease some investors' concerns in sectors like healthcare and higher education, which are vulnerable to Federal aid cuts.

"That's one of the things that's considered when a municipal advisor is advising their issuer on whether or not to submit a package to the bond insurance industry," Farrell says.

In addition to more individual investors, the insured bond market is increasingly providing smaller issuers, with more efficient access to the markets, particularly during times of elevated volatility. Rural school districts or small transit systems, for example, can go to market with insured bonds and attract more investors — and achieve lower borrowing costs — even though they don't have the brand awareness of larger states or cities.

"There's an illiquidity premium on smaller- to mid-size issuers," Dewey says. "Insurance really helps mitigate that for credits that are less recognizable than the larger, widely held credits. Mitigating the illiquidity premium for smaller insurers is a big driver of insurance."

Boosting returns

Meanwhile, institutional investors are increasingly buying insured municipal bonds tactically to improve the liquidity and returns of their portfolio.

"They're recognizing that the cost of insurance is less than the increased value of the bond," Dewey says. "So, they're paying $10 per bond for the insurance and having a bond that they think is worth $20 more."

Expectations for lower rates could also be driving investors to seek lower-risk ways to add bonds to their portfolio now to lock in higher rates on municipal bonds, creating a more valuable tax exemption.

There are also non-economic factors at play: The recent wildfires in California served as a wakeup call for some municipal bond investors about the risks that municipal bonds can face in the wake of a natural disaster. That awareness is starting to show up in credit spreads, increasing the value of insurance. For example, the recent Los Angeles Department of Water and Power deal traded about 60 basis points wider than pre-wildfire levels, which prompted the issuer to seek bond insurance for the first time.

"Prior to January of 2025, there would have been little-to-no value provided by a wrapper for a transaction like that," Farrell says. "Those spreads just weren't as wide."

That deal, which took place in April, also reflected another trend impacting larger transactions this year: side-by-side issues of insured and uninsured bonds. In that case, BAM insured $455 million of the $990 million overall issue.

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'An inflection point'

As bond insurers and issuers take more creative approaches to expanding the appeal of deals, demand for municipal bonds appears poised to persist. In the recent survey, 96% of financial advisers said they expect their clients to maintain or increase their exposure to municipal bonds in the next few years. Continued market instability means the accelerating demand for insured municipal bonds will likely also continue.

"At this point, people view the fixed income markets as at an inflection point," Dewey says. "There's lots of demand, and there's lots of investor flows coming in, at a time where you can really lock in a very attractive yield."

Learn more about BAM Mutual-insured muni bonds

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