Boring but Durable: The Credit Characteristics that Set GO Bonds Apart

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Introduction

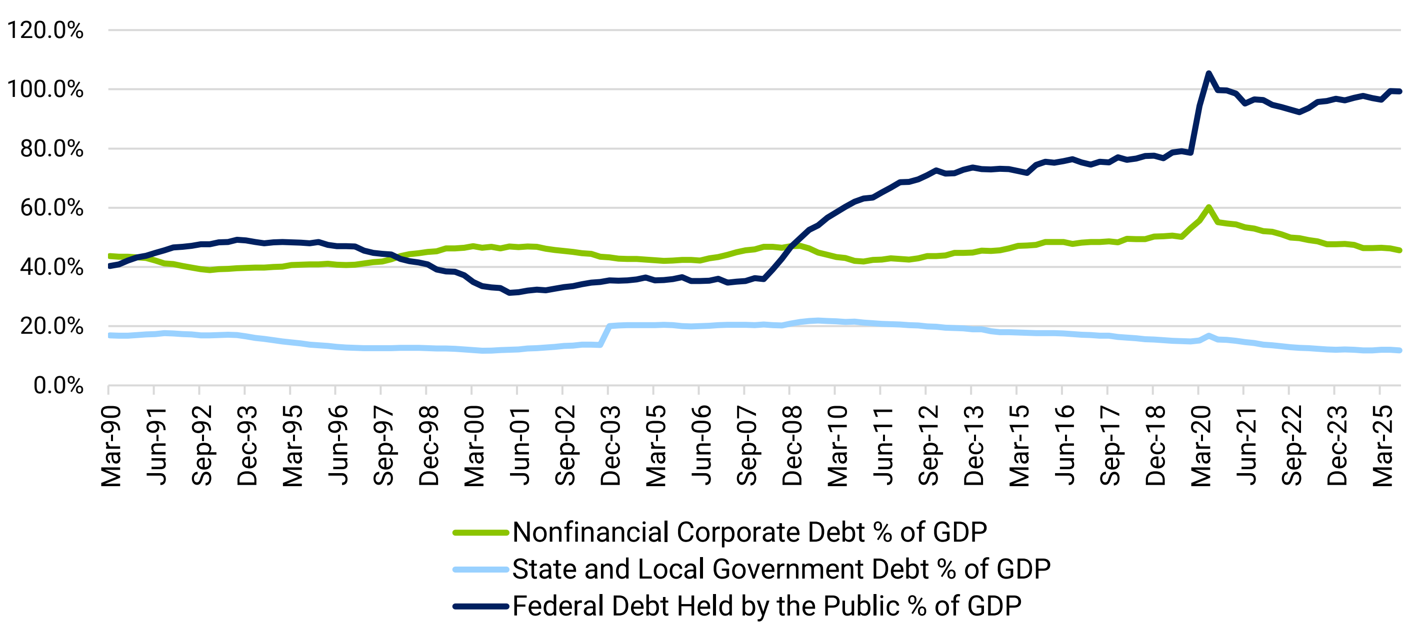
Perceptions of General Obligation (GO) bonds may have shifted over the past two decades following several high profile municipal and state bankruptcies including the City of Detroit (2013) and Puerto Rico Complex (2016-2017) credit events. However, default rates remain very low. The most recent available Moody's data indicates an improved median fiscal position for state and local governments.

State debt declined by 2.6% in 2024, while debt as a percentage of total revenue fell to 23.0%, a decrease of 0.7%.[1] For cities, long-term liabilities (including debt and pensions) declined to 182.2% of total revenue, down from 220.0% despite a rise in debt (counties: 124.9%, down from 160.7%).[2] Post COVID-19, fiscal stability among state and local governments has been partly supported by federal stimulus, as well as strong tax collections (property, sales, and income taxes).

Looking ahead, the economic cycle is likely to moderate, which could weaken tax revenue, but higher levels of borrowing are expected as states and local borrowers ramp up infrastructure investments after a period of deferred capital spending.[3] Simultaneously, borrowers find themselves in a period of federal retrenchment that may require states and local government to shoulder a larger share of spending on healthcare, infrastructure, and climate-related priorities.

This paper aims to demonstrate to investors why municipal GO credit is still considered among the most resilient segments of the fixed-income market in the context of additional borrowing.

Exhibit 1: Debt Outstanding as % of GDP



Source: Federal Reserve Bank of St. Louis as of September 30th, 2025.

What is a General Obligation (GO) bond?

A general obligation bond or GO is debt issued by a governmental organization such as a State, City, County, or School District to fund its capital improvement projects essential to everyday use by Americans. Examples include school construction, road and expressway maintenance, public safety, parks and bridges. A GO is typically secured by the full faith, credit and general taxing power of the issuer.[4]

Local Government General Obligation Bonds

The strongest and most common form of a local GO is the unlimited taxable general obligation (ULTGO) bond which is backed by an uncapped property tax levy. What differentiates a local GO bond from other municipal bond types (such as revenue bonds), and corporate bonds, is the legally enforceable obligation to make principal and interest payments when due. A city, county, or school district will fulfill this obligation through its taxing authority. The taxing power given to the local government by the state, the enforceability of this power through legal frameworks (either statutes or constitution), together with the broad tax base that taxes are derived from, puts GOULTs among the stronger and more stable forms of fixed income credit.

Exhibit 2: Comparison of the Most Common Municipal Bond Types

Type	Security	Source of Bond Repayment	Demand Risk	Rate Making Flexibility	Legal Framework and Protections[5]	Debt Repayment Profile
General Obligation Bond – (city, county, school)	Unlimited ad valorem taxing authority	Economic base (property tax)	Low	High	Unlimited tax levy, voter-approved tax, constitutional or statutory protection (better recovery), priority of payment, state oversight/intercept mechanisms, debt limits	Annual level debt service payment
Revenue Bond – Essential Services (electric, water, airport, toll road)	System revenue	Rates and charges required to be set sufficient to pay debt service plus a cushion	Low to Medium	High (asset essentiality, natural monopoly)	Rate covenant (DSC), reserve fund, and priority repayment after O&M in cash flow waterfall	Annual level debt service payment (could vary for projects requiring ramp-up)
Revenue Bond – Competitive Enterprise and Project Finance (senior living, industrial development, hospital, higher education)	Project revenue and mortgage (varies)	Project cash flow	Medium to High (dependent on business cycle, nature of project)	Moderate to low (margin dependent, less essential asset, more competitive landscape)	Rate covenants (DSC & liquidity), reserve funds, capitalized interest, and step-in rights	Interest only period, level or rising debt service payment, principal redemption from excess flow
Corporate Bond	Unsecured obligation	Business cash flow	Medium to High (dependent on discretionary spending, competition, available substitutes, business cycles)	Low (less essential, dependent on competition and consumer price sensitivity)	Generally weaker than municipal deal covenants	Bullet maturities

Other types of GOs include GO unsecured bonds, backed by the borrower's general fund and General Obligation Limited Tax (GOLT) bonds backed by limited taxes. Credit quality among GOs can vary widely depending on factors including tax pledge, strength and breadth of tax base, taxing capacity, debt burden, health of fund balances, and management practices.

Credit Quality Distribution and Default Rates

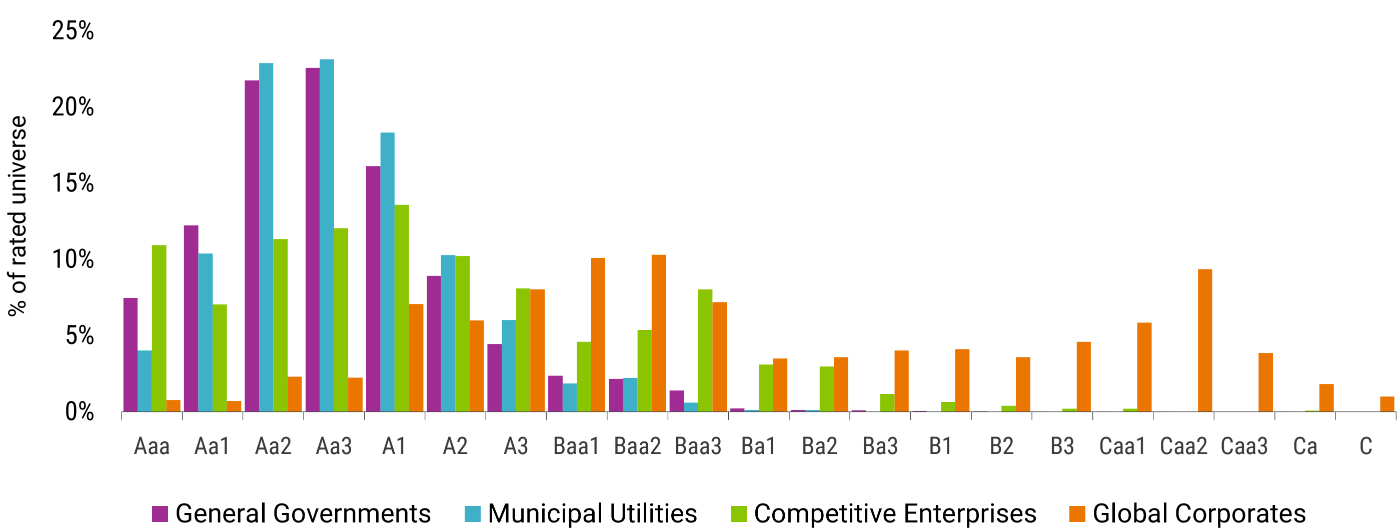
- Municipal bond rating quality tends to be skewed towards the higher end of the rating spectrum with a median rating of Aa3 (all rated municipals) which includes general government (Aa3), municipal utilities (Aa3), and competitive enterprises (A1) in contrast to the corporate bond median rating of Baa 3.[6]
- About 41.4% (or 3,728) of GO issuers are rated Aa2 or higher, compared to 37.3% (or 621) for municipal utilities, and 29.3% (or 453) competitive enterprises. Across the same rating categories, corporates account for only 3.76% of total rated issuers.[7]
- Average recovery on rated municipal bonds is 65.0% compared to 47.0% for a senior unsecured global corporate bond. Recovery rates vary within the municipal universe and may be unpredictable and are dependent on strength of claim, liquidation, and whether they compete with pensions.[8]
- As of the end of 2024, the number of municipal defaults since 1970 totaled 117 ($72.2 billion) of which $59.0 bn was related to the Puerto Rico defaults between 2015 and 2017.[9] To put default volume into perspective, the size of the municipal bond market (debt outstanding) as of Q4 2025 was $4.4 trillion.[10] Municipal cumulative default rates since 2015 (after a five-year period) are still low at 0.05% compared to 8.3% for corporates.

Exhibit 3: Default Rates over the Period 1970-2024: Municipal Issuers and Global Corporates

All rated issuers	Cohort	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
General Government	9,667	0.01%	0.01%	0.02%	0.02%	0.03%	0.04%	0.04%	0.05%	0.05%	0.06%
Municipal Utilities	1,826	0.01%	0.01%	0.02%	0.03%	0.03%	0.04%	0.05%	0.06%	0.07%	0.08%
Competitive Enterprises	2,100	0.07%	0.15%	0.22%	0.29%	0.35%	0.42%	0.48%	0.54%	0.60%	0.65%
Global Corporates	3,899	1.62%	3.22%	4.69%	5.96%	7.06%	8.01%	8.81%	9.52%	10.20%	10.82%

Source: Moody's Rating as of August 4th, 2025.

Exhibit 4: Rating Distribution: Municipal Issuers and Global Corporates



Source: Moody's Ratings as of August 4th, 2025.

State General Obligation Bonds[11]

Historically, state GOs, at the median, are considered relatively more stable than other municipal sectors because of the structural underpinnings which include budgetary practices, constitutional and statutory protections, and political discipline. Altogether, these factors can lead to better financial flexibility through enhanced liquidity to manage economic uncertainty and fiscal stress. It is important to note that the economy is a very important factor, but insufficient on its own to draw a reliable conclusion on state GO credit quality and its sustainability. A good proxy for how a state government runs its business is the condition of its rainy-day fund (RDF). We view the RDF, while a lagging indicator, as a supplemental "policy optionality" available to state lawmakers. Without a rigorous budgetary process, strong state laws and constitutional framework, rainy day funds would not be replenished in anticipation of the next shock, and without strict transfer requirements, funds could be easily draw down for any purpose at time when they should not be accessed.

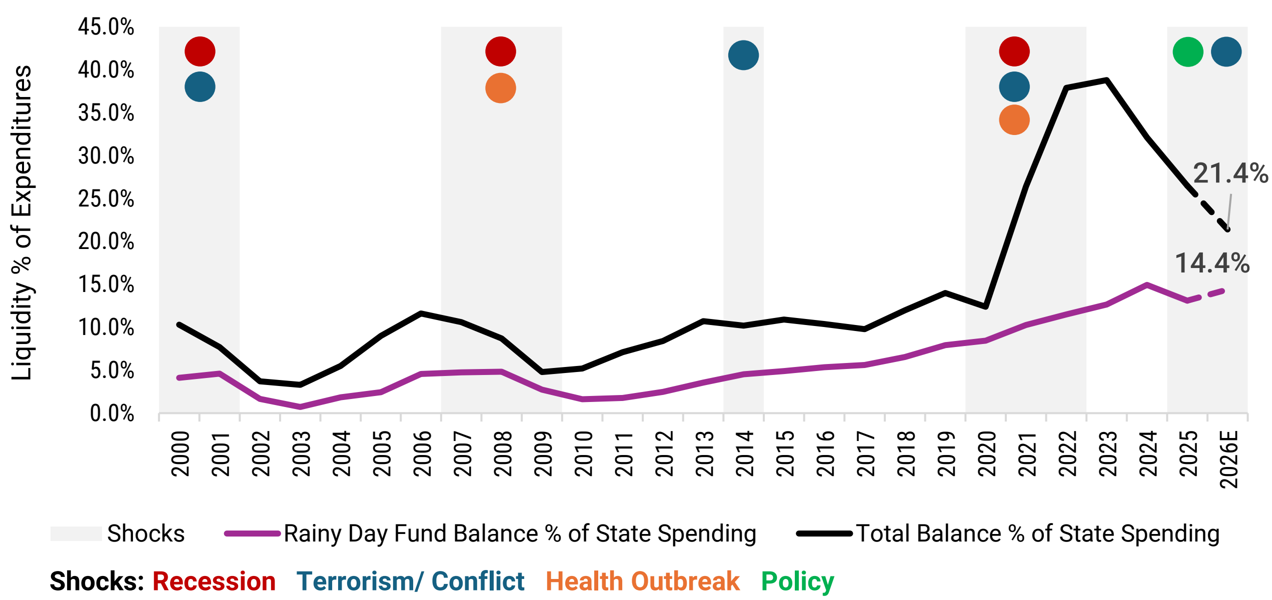
Exhibit 5: State GO Bond Ratings

Rating tier	States
AA+ or better — all agencies Highest consensus quality	23
AA– or better — all agencies Includes the 23 AA+ states above	36
Split rating — A / AA across agencies Pennsylvania, New Jersey	2
Single A category — consensus Illinois	1

Universe: 39 states with GO ratings. Source: Bloomberg.

Exhibit 6 illustrates the intent behind a state's RDF during and following the Great Financial Crisis. States drew down their balances to mitigate fiscal stress in that period, and structural mechanisms forced the replenishment of the funds. The median RDF as a percentage of state expenditures at its lowest in 2010 was 1.6% (down from 4.8% in 2008) and reached an all-time high of 14.9% in 2024.[12]

Exhibit 6: State Liquidity Through Time

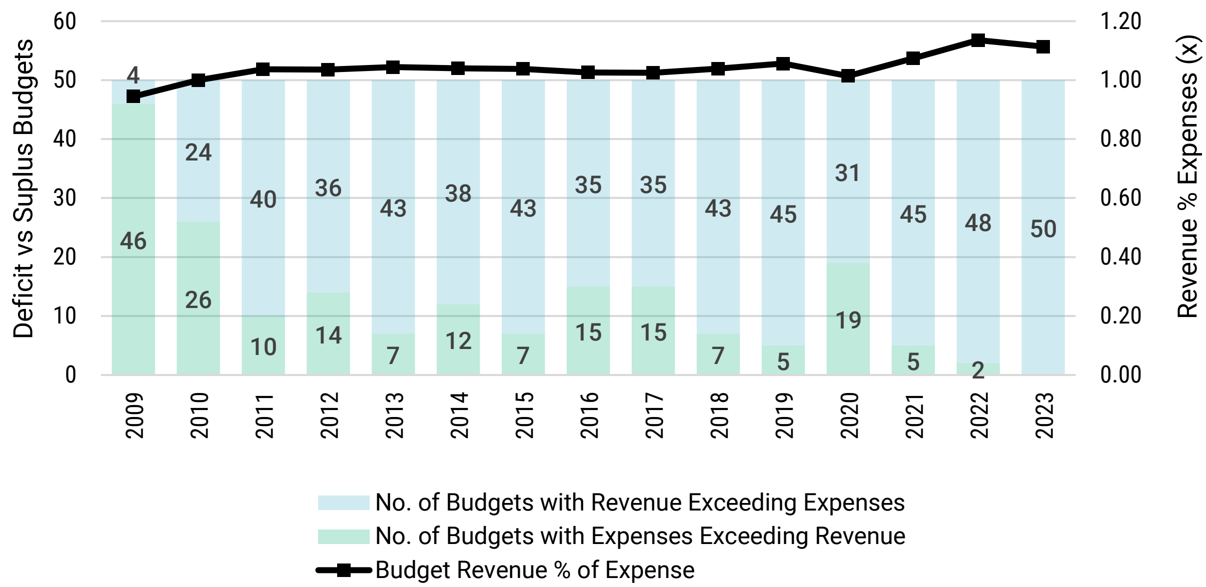


Source: Pew Research as of December 31st, 2025.

Cash is "king", and while even the healthiest of RDF balances may not solve credit challenges, it gives state governments the flexibility to get through a downturn, rethink policy (raise revenue, cut spending) and implement an action plan without dysfunction.

A good example is the recent passage of One Big Beautiful Bill Act (OBBBA, H.R.1) in 2025 that introduced $911 billion in federal spending cuts to Medicaid over the next 10 years.[13] Most significant changes won't take effect until 2027 or later,[14] and states with good liquidity positions are more likely to smooth out the impact of such cuts without the need for drastic revenue or spending measures. Balanced budgets and the underlying mechanisms to reinforce them indicate the level of state fiscal health as shown in Exhibit 7 below, where the median budget revenue as a percentage of expenses exceeds 1.0x since 2011.[15]

Exhibit 7: State Budgets (2009-2023)



Source: Pew Research

Overcoming Complacency – Key Takeaways

The municipal landscape continues to evolve as new uncertainties are introduced, and existing stresses are magnified. Our research team maintains that through a rigorous analytical approach and credit selection, we are able to uncover nuances unique to certain credits and identify those that may be best suited to manage through economic, political, and social volatility. **The following reasons suggest why GO bonds, both state and local, present durable credit characteristics today:**

- State and local governments have constitutional and statutory frameworks that anchor the likelihood of debt repayment, a quality unique to GOs.
- Underlying revenue source is in an economic base rather than project/asset cash flow.
- Historical default data suggests that GO bonds are among the most resilient sectors.
- Proceeds from debt issuance pay for critical infrastructure and social programs, creating an incentive to repay debt and maintain market access.
- GOs are not created equal and come in different forms defining the quality of the pledge, making credit analysis integral.

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Sources

[1] State Pension Liabilities Continue to Decline, Improving Leverage Metrics, Moody's Ratings, September 19, 2025.
[2] Medians – Financial Positions Continue to Improve Post-Pandemic, Moody's Ratings, May 28, 2025.
[3] State and Local Governments Face Higher Debt, Less Free Cash Flow Amid Capex Catchup, Moody's Ratings, May 1, 2025.
[4] Credit Quality will vary depending on the underlying factors specific to each issuer.
[5] Legal framework varies across states.
[6] US Municipal Bond Default and Recovery Rates (1970-2024), Moody's Ratings, August 4, 2025.
[7] Ibid.
[8] Ibid.
[9] Ibid.
[10] US Municipal Bond Issuance, Trading Volume, Outstanding, Holders, SIFMA, April 1, 2026.
[11] State Ratings data from Bloomberg.
[12] Pew Research Center, www.pew.org.
[13] State "Medicaid: What to Watch in 2026," January 23, 2026, www.kff.org.
[14] Ibid.
[15] Pew Research Center, www.pew.org.

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