

Research matters: The impact changing demographics has on the municipal bond market

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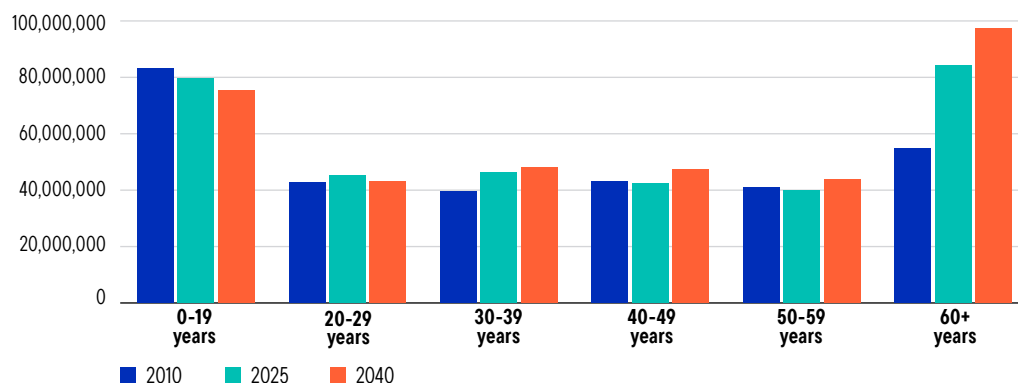


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Demographic trend: Falling birth rates

Birth rates peaked in the late 1950s following World War II, contributing to the rapid growth of today's 60 plus year-old population. Since the global-financial crisis birth rates have fallen below replacement levels. The US Census Bureau estimates the natural replacement rate is about 2.1¹ and measures the average number of children a woman must have during her lifetime to ensure the population remains stable over time without immigration. The fertility rate of the United States lies between the range of 1.6 to 1.8 children per woman.

Exhibit 1: United States Population 2010 vs. 2025 vs. 2040 (Estimate)



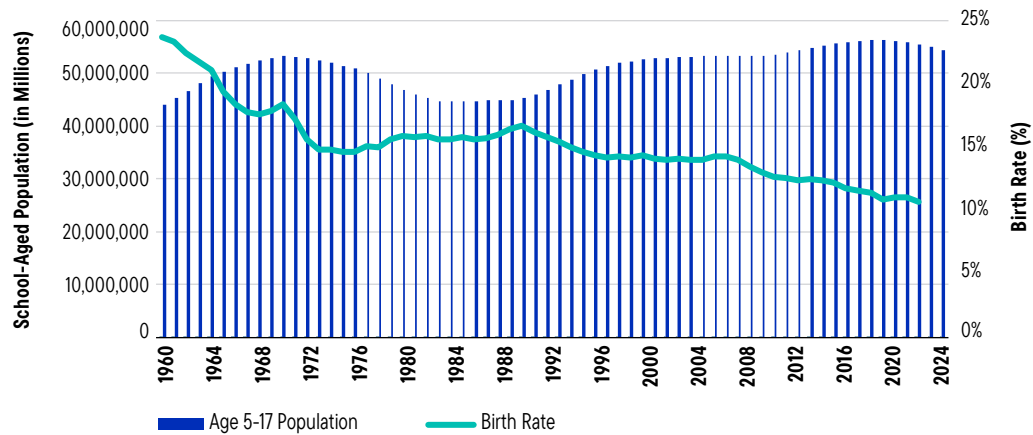
Source: US Census Bureau. Analysis by Franklin Templeton Fixed Income Research. There is no assurance that any estimate, forecast, or projection will be realized. As of December 31, 2025.

The next question as it relates to municipal bond credit is “so what?” What is the impact of older generations growing in population while younger generations shrink? From a portfolio perspective, these shifts matter because they create **increasing dispersion across issuers**, even within the same sector. Demographic trends do not affect municipalities uniformly, so understanding where these changes strengthen or weaken credit profiles is critical in our view to security selection and long term risk management.

Sector overview: Traditional public schools and charter schools

Declining birth rates and a shrinking school-aged population are already impacting public schools, both traditional district schools and charter schools. The National Center for Education Statistics (NCES), expects public school enrollment to drop 8% from 2019 to 2030.² But this rate isn't the same for every district or even every state. The NCES projects that some states, such as Utah, North Dakota and the District of Columbia could see *growth* of 5% or more, whereas states such as California, Georgia and New York could see *declines* of 5% or more.³

Exhibit 2: Birth Rates and School-Aged Population



Sources: United Nations Data Portal and US Census Bureau. Analysis by Franklin Templeton Fixed Income Research. As of December 31, 2025.

As we set the stage for the discussion of public schools, it is important to point out that the decline in US fertility since 2008 has generally coincided with explosive growth in the charter school segment. According to the National Alliance for Public Charter Schools, the amount of US charter schools in existence nearly doubled between the 2006–2007 school year and the 2023–2024 school year, increasing from 4,092 to 8,140, while the number of students attending charter schools more than tripled from 1.17 million to 3.87 million. During this time frame, the ratio of charter students to total public school students increased from approximately 2% to 8%. This means that in addition to challenges with declining birth rates, increased competition between traditional district schools and charter schools has heated up. The following table highlights key feature differences between traditional district schools and charter schools that shape how each type operates within this increasingly competitive environment.

Feature	Traditional District School	Charter School
Funding	State aid, local revenues, property taxes, federal revenues.	Primarily state and federal aid.
Governance Structure	School district and state.	Independent operator, nonprofit, charter management group, all with an authorizer.
Curriculum	District/state mandated.	Flexible, schools can also have a focus like science, technology, engineering and mathematics, classical education, etc.
Enrollment	All living in the district.	Open, school of choice and could require lottery if enrollment exceeds seats.
Staffing	State-certified teachers, often part of a union, and working under a contract.	Flexibility in hiring, with certification and union requirements varying by state and school.
Accountability	District and state.	Per charter contract, authorizer.

With fewer school-aged children and higher competition for those students, what is the landscape for these schools?

Since state funding is usually on a per-pupil basis, to the extent that there are fewer students, there will be less state aid. Fewer students doesn't necessarily mean lower expenses, however. To reduce staffing, you need to lose an entire class worth of students (or more depending on the type of school). Therefore, in many cases year-over-year revenue declines won't see matched expenditure declines, which can create budget deficits. Closing schools is very difficult politically, especially for traditional district schools. Families often want small, local public schools, particularly at the primary and elementary levels. When districts start discussing the need to close schools, there is often significant pushback from parents who don't want their schools to be further away. This can create pressure to operate schools that are too expensive and impair the ability to consolidate and achieve savings amid a declining revenue scenario. Declining enrollment that leads to an unprofitable charter school can lead to the closure of the school entirely. Both traditional district schools and charter schools will see challenges, but it doesn't mean that the sector as a whole is too risky to invest in. With a large and experienced research staff, Franklin Templeton Fixed Income can dig deep to really understand each credit, the extent to which it is experiencing these demographic changes and how it is addressing the challenges.

How do we find traditional public schools that we like?

Identifying resilient traditional public-school credits in a declining demographic environment requires a focus on factors that mitigate enrollment volatility and support long term financial stability:

Credit Factor	What We Assess
Enrollment Trends	Alignment with birth-rate trends and whether population growth/migration offsets declines.
Academic Draw	Ability of strong academics/facilities to retain students.
Revenue Diversity	Diversity and stability of revenue sources beyond per-pupil funding (e.g., property or other local taxes).
State Oversight	Strength of state oversight and intervention mechanisms to ensure academic and financial standards.
State Enhancement Programs	Presence of state credit-support structures that ensure debt service, boost ratings and lower borrowing costs.
Property Tax-Backed Bonds	Reliance on dedicated property taxes that insulate debt service from enrollment volatility.
Bond Insurance	Use of monoline insurance to guarantee debt service and lower borrowing costs.

What about charter schools?

Similar to traditional schools, the shrinking US school-age population is impactful to charter schools because of their reliance on per-student aid distributed by state and local governments, which accounts for the primary source of charter school operating revenue. A decline in charter school enrollment typically leads to a proportional drop in revenues, while many costs, such as debt service, operating leases, insurance premiums and faculty expenses, remain largely fixed and difficult to reduce without disrupting educational programs. In an increasingly competitive environment, this dynamic makes charter school credit quality highly sensitive to enrollment trends, amplifying the importance of underwriting discipline and ongoing credit surveillance.

As the number of charter schools continues to grow while the available pool of school-aged children continues to stagnate or decline, we expect that competition for enrollment between charter schools (as well as district and private schools) could increase. Consequently, underperforming charter schools may struggle to remain viable, while stronger operators with demonstrated demand, scale and financial flexibility can continue to access capital markets, underscoring the need for selective exposure rather than broad allocation.

For this reason, we highlight several credit factors to look for when investing in bonds backed by charter school revenues:

Credit factor	What we assess
High Waitlists & Retention	Strength of demand indicated by large waitlists (less than or equal to 50% of enrollment) and high retention rates (less than or equal to 90%).
Strong Academics & Mission	Academic performance compared to district peers and any distinctive curriculum that enhances appeal.
Local Population Growth	Whether the school is in a growing community that supports stable or rising enrollment.
Ample liquidity	Cash on hand (typically 50–200 days) to manage enrollment or revenue fluctuations.
Multi Site Scale & Diversification	Networks operating campuses across regions could reduce localized demographic risk as well as leverage economies of scale.
Budget Flexibility	Prudent fiscal management that makes budget adjustments in response to changes in enrollment and funding.

Traditional public schools and charter schools are both public schools facing the same demographic headwinds but digging below the surface reveals that each type of school has its own strengths, weaknesses and tools to manage this trend. One size does not fit all when it comes to fundamental analysis.

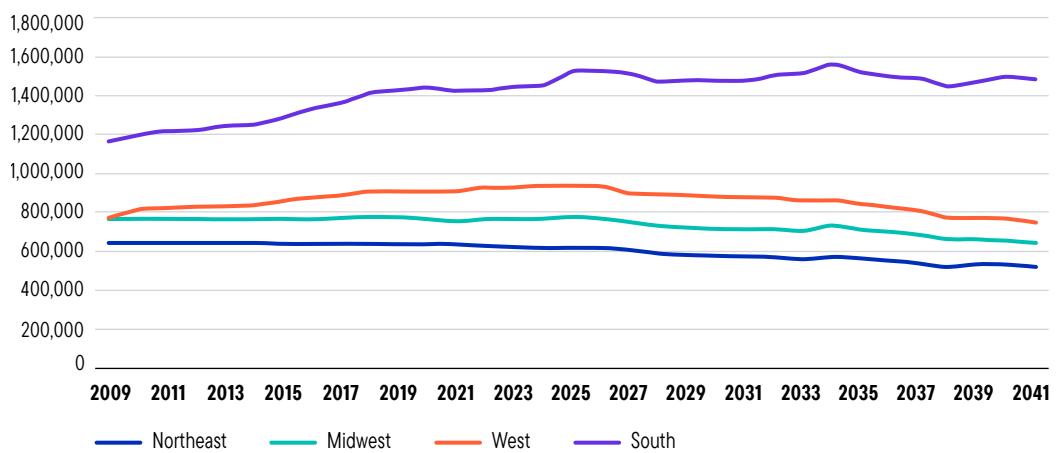
Sector overview: Higher education

Shrinking birth rates also impact higher education in the United States. After several decades of demographic tailwinds, the US higher education industry faces a shrinking pool of traditional-age students over the next decade, introducing longer-term structural pressure on many institutions' credit fundamentals. From an investor standpoint, these trends increase the divergence between institutions with the scale and adaptability to withstand declining demand and those facing mounting structural pressure, elevating the importance of credit research.

The number of US high school graduates is projected to have peaked in 2025 at **approximately 3.8 million students and is expected to decline to roughly 3.4 million students by the early 2040s.**⁴ Regional trends diverge, while graduate levels in the south are expected to stagnate, the northeast, midwest and west face severe declines.

Exhibit 3: Actual/ Projected High School Graduates by Region (Forecast)

December 31, 2025



Source: Western Interstate Commission for Higher Education. As of December 31, 2025. There is no assurance that any estimate, forecast or projection will be realized.

Adding to the decline in the high school graduate pipeline is growing uncertainty about the economic value of higher education and its influence on college-going behavior. The Bureau of Labor Statistics estimates that approximately **62% of recent high school graduates** (ages 16–24) were enrolled in college in October 2024, down from its peak of 70% in 2016.⁵ The emergence of artificial intelligence has contributed to a more uncertain career outlook for recent college graduates.⁶ A December 2025 study by the New York Federal Reserve found that following decades of historical outperformance, the unemployment rate for recent college graduates exceeded the national median in 2022, with the gap widening through the third quarter of 2025.⁷ A sustained period of labor-market weakness for recent graduates could further reduce college-going rates and intensify demographic pressures.

Traditional undergraduate students do not represent the entire higher education market. Approximately 25% of students at US postsecondary institutions are aged 25 or older, including roughly 75% of the approximately 3.2 million graduate students.⁸ International students also remain a potential source of demand to offset declining US demographics, although geopolitical tensions, visa policy uncertainty and global competition may limit growth.

Large flagship public universities and highly selective private universities are often the first choices of prospective students, leaving them relatively insulated from a shrinking target market. In contrast, regional public universities and less-selective private universities are likely to face intensifying competition for students, leading to increased tuition discounting and pressure on operating margins. Proactive management will be critical in navigating these trends, including the development of workforce-aligned programs, strengthened transfer pathways, employer partnerships and brand expansion beyond the local commuting radius. Governance considerations for public universities include maintaining affordability within a labor-intensive, politically sensitive cost structure, while private universities face management challenges such as mergers, program teach-outs (arrangements that allow enrolled students to complete their studies when an institution closes or discontinues a program) and asset monetization.

We expect mounting structural pressures from declining demographics, shifting student preferences and financial strain to drive increased institutional stress and closures over time. Against this backdrop, our research analysts are focused on identifying universities with the scale, selectivity, financial flexibility and strategic execution to adapt to this changing macroeconomic environment.

Conclusion

Demographic change is slow and uneven, but its impact on municipal credit is significant. Falling birth rates are already reshaping demand for public services and altering long-term credit trajectories across education-related sectors.

For investors, this environment raises the cost of being indiscriminate. Issuer-level research is critical to distinguishing between credits that can adapt and those facing structural pressure, underscoring the value of professional municipal management in building resilient, long-term portfolios.

1. Source: US Census Bureau. Global population estimates vary, but trends are clear: Population growth is slowing. As of November 9, 2023.

2. Source: National Center for Education Statistics. Projections of Education Statistics to 2030. As of February 2024.

3. Ibid.

4. Source: Western Interstate Commission for Higher Education, "Knocking at the College Door" As of December 2024.3. Ibid.

5. Source: Bureau of Labor Statistics, College enrollment and work activity of recent high school and college graduates— 2024." As of April 22, 2025.

6. Source: Stanford Digital Economy Lab, "Canaries, Interest Rates, and Timing: More on the Recent Drivers of Employment Changes for Young Workers." As of February 9, 2026.

7. Source: Federal Reserve Bank of New York, "The Labor Market for Recent College Graduates." As of February 4, 2026.

8. Source: National Center for Education Statistics. As of 2022. This is the most current data available.

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