

An Introduction to Municipal Bonds

The income from municipal bonds is tax free (unless otherwise indicated), and that is what initially attracts investors. And one step further---most states exempt their bonds from state income tax for residents of their state. Of equal importance is the fact that general obligations and essential service revenue municipal bonds in particular have also had an excellent record for safety.

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The following table will help you determine the yield required from a taxable investment to equal a tax-free yield.

Taxable Equivalent Yields

SINGLE Return	\$25,351-\$61,400	\$61,401-\$128,100	\$128,101-\$278,450
JOINT Return	\$42,351-\$102,300	\$102,301-\$155,950	\$155,951-\$278,450
FEDERAL TAX BRACKET	28.00%	33%	39.60%
TAX-EXEMPT YIELDS (%)	TAXABLE EQUIVALENT YIELDS		
1.00%	1.38%	1.49%	1.65%
1.50%	2.08%	2.23%	2.48%
2.00%	2.77%	2.98%	3.31%
2.50%	3.47%	3.73%	4.14%
3.00%	4.16%	4.47%	4.96%
3.50%	4.86%	5.22%	5.79%
4.00%	5.55%	5.97%	6.62%

These figures only take into account the exemption from Federal income taxes. A state's municipal bonds are usually exempt from state taxes for its residents, which can be a significant additional benefit if you live in a high tax state, so be sure to add the exemption from state income tax when calculating your taxable equivalent yield. Be sure to consult your tax advisor to see how much your state tax exemption increases your taxable-equivalent yield.

Most municipals have ratings which are provided by Moody's and Standard & Poor's, but the type of municipal you buy can be even more important than the rating. We usually prefer general obligations and established essential service bonds. General obligations are payable from real estate taxes which must be paid prior to the first mortgage so owning a general obligation bond is better than having part of a first mortgage on every piece of taxable property in the community. Essential service revenue bonds are payable from water, sewer and electric services which are discontinued if the bills are not paid.

Ratings from Baa3 or BBB- and higher are generally considered "investment grade."

MUNICIPAL BOND RATINGS

MOODY'S	STANDARD & POOR'S	DEFINATIONS
Aaa	AAA	Highest Quality
Aa1	AA+	High Quality
Aa2	AA	High Quality
Aa3	A-	High Quality
A1	A+	Best of Upper Medium Grade
A2	A	Upper Medium Grade
A3	A-	Upper medium Grade
Baa1	BBB+	Medium Quality
Baa2	BBB	Medium Quality
Baa3	BBB-	Medium Quality

Note: As you can see each rating category is further refined into three sub-divisions. (Example) AA highest, Aa2 next and Aa3 next.

Maturities range from six months to over 30 years. Shorter term bonds pay less, but they offer better protection of principal. Longer term bonds have higher yields but they fluctuate more in the market which could hurt you if you have to sell when the market is off.

Marketability – Municipals are highly marketable although they fluctuate up or down in price according to market conditions.

Municipal Bond Funds – Investors who are new to the market often mistakenly huddle to bond funds as the apparent safest alternative for beginners. Possibly they do so because of their experience with equity funds which tells them that a good fund, comprised of professionally selected stocks is safer than stocks they may select by themselves. Not so with muni bond funds. Remember when you buy bonds or bond funds you're buying a yield. If you buy a Unit Trust Fund there is a "Front End Load" and that's on top of the normal bond spreads not in place of. If you buy the so called "No Load" Open End Funds, they may be even more expensive than the Front End Load funds because they take a portion of your yield each and every year you own the fund, so the longer you own it the more expensive it becomes.

Too often beginners are quoted only the current yield which is very misleading. So whenever you consider buying a bond fund be sure to ask for the SEC yield which is your estimated true yield. You may be shocked to see the difference between the yield you may have been quoted and the SEC yield.

That is not to say the one size fits all bond funds do not fit anybody. They do fit certain people and we can help you decide if they are right for you or not.

HELPFUL BOND LINGO – GLOSSARY OF TERMS

Accrued Interest – Interest earned on a bond since the last interest payment.

Maturity – The date upon which the principal becomes due.

Callable Bond – A bond which is subject to redemption prior to maturity at the option of the issuer.

Current Yield – The percent of interest in relation to the market price of a bond.

Yield to Maturity – The annualized percentage of income from a bond---your actual true yield.

General Obligation – A bond secured by a pledge of the issuer's full faith, credit and taxing power.

Revenue Bond – A bond payable from the revenues collected from the users of a specified project.