

Business

Barry Jensen editor/591-2300



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O&E Thursday, February 23, 1984

Municipals have a place in your portfolio

First of two parts

The default in 1983 of the \$2.25 billion of municipal bonds issued by the Washington Public Power Supply System — or "Whoops" — sent shock waves through the tax-exempt securities market. Nevertheless, the municipal bonds market is still safe and sound. In a two-part article, we will critically evaluate this market.

What are municipal bonds? They are the debt obligations of towns, cities and states or authorities established by them. Many people call them "tax-exempts." By whatever name, the obligations are paid off by taxes or by revenues from projects built by the communities.

Why do people buy them? Primarily

because the interest is free from federal income tax. The bonds are usually exempt, too, from state and local taxes in the area in which they are issued. For instance, if you are a resident of Michigan and buy a municipal bond issued in this state, you pay no taxes on the interest. But if you buy a California bond, you will owe state of Michigan taxes and probably local taxes as well. In either case, you would have to pay a capital-gains tax on the profit if you sold the bond for more than you paid for it.

How do yields for municipals compare with those for other types of bonds? As a result of the tax break on interest, municipals carry lower yields than do comparable corporate bonds or even U.S. Treasury issues, which are subject to federal tax. In recent times,

long-term tax-exempts have returned approximately 7.5 percent on average. By comparison, long-term corporate issues have yielded about 11.8 percent on average, and a treasury bond 11.6 percent.

Does that make tax-exempts attractive for all investors? Not necessarily. Some investment advisers suggest that people consider municipal bonds only if they have income taxed at more than 30 percent. If you are in the 30 percent tax bracket, buying a long-term municipal bond yielding 9.79 percent is the equivalent of receiving taxable interest of 14 percent. If you are in the top 50 percent bracket, 9.79 percent tax-free is the same as a taxable yield of 29.6 percent.

Is there more than one type of mu-

nicipal bond? Generally, there are two major types of securities: General-obligation bonds and revenue bonds. Today, nearly 70 percent of all bonds issued are revenue bonds. These are bonds on which the interest and principal are paid from the receipts of the facility built from the bonds, such as toll roads, electric-generating facilities, bridges and airports. On general-obligation bonds, the interest and principal are paid from tax revenues.

Does that mean that one is better than the other? It all depends. Traditionally, general-obligation bonds had been considered safer because they had the state or local government's taxing power behind them. But in recent years, shaky city finances have caused some experts to favor revenue issues



finances and you

Sid Mittra

that are backed by earnings of specific projects.

Next week: ABC's of Tax-Exempt Securities, Part II.

Financial Planning Seminar: The Observer & Eccentric Newspapers and Coordinated Financial Planning staff will conduct a financial planning seminar on March 7 at the MSU Management Center in Troy. This session fea-

tures comprehensive financial planning, retirement planning, and investment and tax shelters. Admission is free and no registration is required. For more details call 644-8888.

Sid Mittra is president of Coordinated Financial Planning in Troy and a professor of Economics and Management at Oakland University in Rochester.

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