

# Business

Berry Jensen editor/591-2300



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O&E Thursday, March 1, 1984

## Tax-exempt securities — are they for you?

Second of two parts

Last week, we discussed some pluses and minuses of investing in tax-exempt securities. This week, we will discuss the attendant risks of these securities.

How safe are municipal bonds? In general, they are considered second in safety only to U.S. Government obligations. According to Standard Poor's, a service that rates the safety of bonds, there have been only 362 bankruptcies since 1936 among 80,000 potential issuers of municipal bonds.

What protection does an investor have against future municipal defaults? An investor can buy bonds that are protected by private insurance

companies against such an event. These bonds carry a A rating, the highest rating given by a credit rating service. The issuer pays for the insurance. Yields on such bonds are relatively low because they are considered safer.

What are bond ratings? Two major services rate the safety of municipal bonds: Standard Poor's and Moody's Investors Service. Rates usually consider four key factors.

First, the rating services look at the community's economic base. Is it dependent on one industry or company? If so, how is that industry or firm doing?

Second, they look at the financial position of the issuer. Is the community's income meeting its expenditures? Third, they look at the issuer's histo-



finances and you

Sid Mittra

ry of meeting debt payments and examine the financial backing of the debt. The rating agencies ask how much additional money the city or state will have to borrow. Will that impair the ability to pay off present debt?

Fourth, they examine the political factors surrounding the issuer. How well is the municipality governed? In the case of publicly owned utilities, rating agencies also consider whether

state regulatory commissions are willing to allow rate hikes to cover increased costs.

Do political factors cause a city's bond rating to fall? Yes, they do. For example, in 1983 Standard Poor's reduced Chicago's rating because of major differences between Mayor Harold Washington and the city council in closing a \$100 million deficit.

How can I buy and sell tax-exempt bonds? In most cases, your broker can buy or sell bonds on the open market, as if they were stocks or corporate bonds. In some instances, it may take longer to find a buyer or a seller, especially if the issue is not well known. Bonds are usually sold in units of \$1,000.

Brokers also sell unit trusts — portfolios of municipal bonds that are usually held until maturity. The main benefit of these trusts is that they are diversified and usually pay monthly dividends. Investors can also buy municipal-bonds funds, which are managed portfolios of bonds.

Municipal bonds can be the top choice of many investors. But before you jump in, make sure that these bonds are for you. If possible, consult

your financial adviser, who can make a professional determination of your needs for investing in tax-exempt securities.

**FINANCIAL PLANNING SEMINAR:** The Observer & Eccentric Newspapers and Coordinated Financial Planning staff will conduct a financial planning seminar on Tuesday, March 6, at the Michigan State University Management Center in Troy. This session features comprehensive financial planning, retirement planning, investment planning and tax shelters. Admission is free, and no registration is necessary. For more details, call 643-8888.

Sid Mittra is a professor of economics and management at Oakland University in Rochester and president of Coordinated Financial Planning Inc. in Troy.

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