

Municipal Bonds

A municipal bond, also known as muni bonds, is issued by a local government or an allied agency in order to finance public projects such as roads, airports, schools etc.

In India, guidelines for Municipal Bonds are issued by SEBI.

This article will give details about Municipal Bonds within the context of the Civil Services Examination

Overview of Municipal Bonds

A municipal bond is a debt obligation that is issued by a nonprofit organization, private sector or any entity that is involved in public projects for construction of vital infrastructure.

Municipal bonds may be general obligations of the issuer or secured by specified revenues.

Types of Municipal Bonds

Municipal bonds are categorized based on the source of its interest payments and principal repayments. It is structured in ways that can offer benefits such as risks and tax treatments. Income generated by a municipal bond may be taxable.

Keeping the above in mind Municipal Bonds are of the following types:

1. General obligation bond (GO) is issued by government agencies and not exalt backed by revenue from a particular project. There are some GO bonds which are supported by dedicated property taxes and some by payable general funds.
2. Revenue municipal bonds secure principal and interest payments through sales, fuel, hotel occupancy, and other taxes. When a municipality is a conduit issuer of bonds, a third party covers interest and principal payments.

Characteristics of Municipal Bonds

Characteristics of municipal bonds are as follows:

1. Taxability

What makes municipal bonds different from other bonds is that they are able to provide income that is exempted from tax.

Bonds issued for certain purposes are subject to the alternative minimum tax as an item of tax preference.

The type of projects are funded by a bond affects the taxability of income on the bonds Interest earning on bonds that fund projects that are constructed for the public good are generally exempt from federal income taxes

The type of project or projects that are funded by a bond affects the taxability of income received on the bonds. Interest earnings on bonds that fund projects that are constructed for the public good are generally exempt from federal income taxes, while interest earnings on bonds issued to fund projects partly or wholly benefit only private parties.

2. High Interest Rates

Municipal bonds have much higher interest rates compared to other other financial instruments like savings accounts, money market accounts, and others. From 2011 to 2016, the average interest rate return on municipal bonds has hovered around 4.5%, while CDs of similar lengths have been at 1.5%.

Among other factors, this is a result of the longer, fixed return periods. Unlike stocks and other non-dated investments, municipal bonds have fixed rates and are far less liquid. As a general rule, municipal bonds with longer time to maturity have higher coupon rates.

3 Liquidity

Historically, municipal bonds have been one of the least liquid assets on the market. While stocks can be bought and sold within seconds on exchange platforms, given the current absence of widespread secondary market platforms for the exchange of stocks, municipal bonds are much harder to maneuver.

The historical default rate for municipal bonds is lower than that of corporate bonds. The Municipal Bond Fairness Act (HR 6308), introduced September 9, 2008, included a table giving bond default rates up to 2007 for municipal versus corporate bonds by rating and rating agency.

Municipal Bonds in India

The following cities have issued Municipal bonds in India. Lucknow became the ninth city in India to issue a municipal bond when the state government of Uttar Pradesh on December 2, 2020, announced it as part of the AMRUT Scheme

Cities	Amount
Amravati	Rs. 2000

Visakhapatnam	Rs. 80
Ahmedabad	Rs. 200
Surat	Rs. 20
Bhopal	Rs. 175
Indore	Rs. 140
Pune	Rs. 495
Hyderabad	Rs. 200
Lucknow	Rs. 200

Facts about Municipal Bonds

- Municipal bonds are debt investments issued by state and local government entities to raise money to fund operations or certain projects.
- Muni bonds are around 20 times less likely to default than corporate bonds with similar credit ratings.
- The bonds can be issued by states, cities, counties, utility providers, transit authorities, school districts, hospitals, and more.

What are the risks associated with Municipal Bonds?

Compared to corporate bonds, the risk of default is low when it comes to Municipal bonds. Yet, revenue bonds are more vulnerable to change due to consumer whims or general economic downturns than GO bonds. For example a sewage treatment plant or a waste disposable unite has more better streams of revenue than homeless shelters

Since municipal bonds are fixed-income securities, the market price of municipal bonds fluctuates with changes in interest rates: When interest rates are on the rise, bond price declines, and when interest rates decline bond prices rise. In addition, a bond with a longer maturity is more susceptible to interest rate changes than a bond with a shorter maturity period causing even greater changes in the municipal bond investor's income.

Furthermore, the majority of municipal bonds are illiquid; an investor needing immediate cash has to sell other securities instead.

Many municipal bonds carry call provisions, allowing the issuer to redeem the bond prior to the maturity date. An issuer typically calls a bond when interest rates drop and reissues municipal bonds at a lower interest rate. When a bond is called, investors lose income from interest payments and face reinvesting in a bond with a lower return.