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Municipal Bond Upgrades: Balancing Perceived Risks With Real Opportunities

When it comes to safety, municipal bonds have long been a go-to investment for income seekers. After all, in theory, a state or a local town has the ability to raise taxes to help pay for coupon payments – and history suggests just that. However, some investors have begun to worry about municipality and state revenues in the face of the dwindling economy.

The truth is, those worries may be all in investors' heads. Municipal credit continues to improve. Upgrades have far outweighed downgrades, while defaults remain low and concentrated in a few high-risk sectors. The reality is that munis are still offering very advantageous high yields at great credit quality.

Worries Mount

It's all about taxes, and that's the cause of the worries currently affecting municipal bonds. Munis are issued by state and local governments to fund their operations, launch special projects and provide their citizens with various programs. In order to pay for those bonds, it's often taxes – payroll, sales and property – that help pay the interest and pay off debt. And while states and towns have the ability to raise taxes, there is a limit to what they can collect. A family or a business can easily move to a lower tax state. Because of this, analysts and investors watch state revenues like a hawk to determine municipal bond health.

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by Aaron Levitt

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