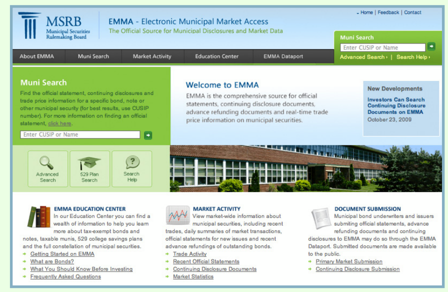
MSRB
Municipal Securities Rulemaking Board

FACT SHEET

SEVEN QUESTIONS TO ASK WHEN INVESTING IN MUNICIPAL BONDS

Potential investors in municipal bonds may have many questions when considering the purchase of a municipal security. The following information can serve as a starting point for an investor's discussion with a financial professional about investing in municipal securities.

EMMA
emma.msrb.org



The Electronic Municipal Market Access system, or EMMA, is a centralized online database operated by MSRB that provides free public access to real time trade data, disclosure and other information about municipal bonds and other municipal securities such as 529 college savings plans. EMMA offers a wealth of information, free of charge, that was once available only to institutional investors.

1 What Information is Available About a Municipal Bond?

Before investing in a municipal bond, an investor should carefully review the information available about the bond. Key sources of information, all of which are available on the MSRB's EMMA website at emma.msrb.org, include:

Official Statements – Disclosures made available by issuers that contain terms of a bond and other details such as credit ratings and financial information about the bond's issuer. When bond proceeds are used to make loans to other parties (such as hospitals or universities), the bond issues are generally secured by the loan payments, and the official statements contain financial disclosure about the borrowers (sometimes referred to as "obligated parties").

Continuing Disclosures – Ongoing disclosures released throughout the life of a bond that may provide routine information such as the issuer's or obligated party's annual financial statements, as well as changes in financial conditions and other events that could affect the value of a bond, such as credit rating changes.

Trade Data – Trade data can provide a valuable basis for evaluating the price of a bond investment.

Financial professionals are required, under MSRB rules, to disclose any information available from established industry sources that may be material to an investment. Investors should ask their financial professional whether they are being provided with the full range of information they are entitled to receive and any additional information that they should consider when making an investment in a municipal security.

2 What Should I Know About Credit Quality?

Investors should ask their financial professional to help them understand a bond's credit quality. Credit quality is an important factor that financial professionals must consider in determining whether a bond is suitable for an investor's strategy and risk appetite. Investors should discuss the following with their financial professional:

Source of Repayment – An important factor in a bond's credit quality is the source of repayment for the bond. There are three main sources of repayment, and bonds are classified by these sources:

General Obligation – A general obligation bond is paid through any revenues the issuer receives. This type of bond is also sometimes known as a "full faith and credit" bond. The issuer has agreed to levy taxes in an amount sufficient to make payments of principal and interest on outstanding bonds.

Revenue Bond – A revenue bond is repaid from the revenues of the project or system that the bond is financing rather than the municipal government's general funds.

Tax-Backed – A tax-backed bond is repaid from certain tax revenues.

Priority of Payment – To understand credit quality, investors should also discuss with their financial professional whether other obligations of the bond issuer take precedence for payment. For example, sometimes states put priorities such as education ahead of payments of bonds. Investors should also understand the difference between senior debt, which is paid first, and subordinate debt, which is paid after senior debt is paid. Finally, investors should understand whether funds for the payment of a bond must be appropriated annually by the issuer – known as "subject to appropriation." A bond's official statement, which is available on EMMA, will indicate the sources and priority of payment.

Credit Rating – A bond's credit rating is the grade rating agencies such as Standard & Poor's, Moody's and Fitch place on a security to indicate risk of default. While the rating is a valuable guide, investors should also discuss with their financial professional other aspects that affect credit quality, including credit enhancement such as bond insurance and the credit of the bond insurer; whether the credit rating has changed since the bond was issued; if the bond rating is based on credit enhancement, the underlying rating of the bond (if it did not have the credit enhancement); and the likelihood that the issuer will be able to make payments on the bond. A broker should provide the bond's credit rating and the underlying rating if available.

3 What Should I Know About Yield?

Yield is the annual return an investor should expect on a bond. Investors should understand the various factors that affect yield. Yield will vary depending on how much the investor pays for the bond – the higher the price, the lower the yield. Investors can determine how the price and yield on a bond compare to recent trade prices of the same or similar bonds by reviewing real-time price information on EMMA.

Yield will also vary with credit quality. Generally, higher yields mean lower credit ratings and greater risk. Investors should work with their financial professional to determine how yield affects their appetite for credit risk.

Yield will also vary with the maturity of the bond. Bonds with longer maturities usually pay higher interest rates than bonds with shorter maturities to account for the greater element of market risk over the longer life of the bond. Investors should discuss with their financial professional when they expect to need the principal amount of their bonds repaid. If a bond must be sold before it matures, its value at the time of sale may be less than the investor paid for it, depending on a variety of market factors, including prevailing interest rates.

Additionally, in the case of a bond that is subject to redemption – or "callable" – yield may be reduced when an issuer redeems a bond before maturity because the investor will not receive the full payment of interest expected over the life of the bond.

4 Is the Price I am Being Offered Fair?

Brokers, dealers and banks selling municipal securities are subject to the MSRB's fair pricing rules when they trade with investors. Investors should not hesitate to ask their financial professional about the pricing of their trades. Additionally, real-time trade information on EMMA allows investors to find both recent and historical prices for a bond, which can help investors evaluate whether they are being offered a fair price.

5 How is My Financial Professional Compensated?

Investors should understand how their financial professional is compensated and should feel free to ask about any fees, charges or other basis for compensation. It is unusual for a financial professional to charge a commission for trading a municipal security. Instead, when an investor purchases a municipal security through a financial professional, the professional typically will "mark up" the price of the security from the price at which his or her firm originally acquired it. Similarly, when an investor sells a municipal security, the price received from a dealer generally will be "marked down" from the price at which the dealer hopes to later resell that security. In some cases, instead of relying on transaction-based markups or markdowns, financial professionals may charge their customers an account-based fee that compensates the professional based on the amount of an investor's assets under management.

6 Is the Investment Appropriate for My Tax Status?

Tax considerations are especially important for municipal bond investors. Many municipal bonds are tax-exempt; however some, such as Build America Bonds, are taxable. Investors should discuss with their financial professional the difference between taxable and tax-exempt municipal bonds and the advantages and disadvantages of each for their investment strategy.

The tax treatment of tax-exempt bonds may vary depending on where an investor lives. A bond may be exempt from federal income taxes but not from state and local income or other taxes. Some states exempt from taxes only their own debt, while others also exempt that of other states. Investors should discuss with their financial professional how the bond they plan to buy would be taxed in their state.

Additionally, investors should discuss with a financial professional the implications of their individual tax bracket on the suitability of an investment. In general, the higher an individual's tax bracket, the greater the after-tax yield of a tax-exempt bond.

Also, tax-exempt bonds may not be an efficient investment for certain tax-advantaged accounts, such as an IRA or 401k, as the tax-advantages of such accounts render the tax-exempt features of municipal bonds redundant. Furthermore, since withdrawals from most of those accounts are subject to tax, placing a tax-exempt bond in such an account has the effect of converting tax-exempt income into taxable income. Finally, if an investor purchases bonds in the secondary market at a discount, part of the gain received upon sale may be subject to regular income tax rates rather than capital gains rates.

7 Is the Bond Callable?

A bond is "callable" when an issuer reserves the ability to redeem a bond before the bond's stated maturity. Bonds are most commonly called because the bond is paying a higher interest rate than current market rates. Under such conditions, issuers may find it advantageous to call a bond and reissue identical bonds paying a reduced interest rate in a process known as refunding.

When a bond is called, investors in the bond generally receive only the principal and interest accrued so far – with the addition of a small premium in some cases – and will not receive the full interest due over the stated term of the bond. This is an important consideration for investors who plan to rely on the interest generated over the full life of a bond. If prevailing interest rates are lower when a bond is called, investors will find it difficult to replace the bond with an equivalent investment paying a similar interest rate to the called bond. Investors can learn whether a bond is callable and the terms under which it may be redeemed by reviewing a bond's official statement on EMMA.