Expert's Quote

"Stock market bubbles don't grow out of thin air. They have a solid basis in reality, but reality as distorted by a misconception." – George Soros

NSE *at a glance*
(For week ended April 20th, 2009)

Index:	19,954.15	-0.6%
Cap:	N4.514trn	-0.76%
Volume:	1.7 bn	-37.86%
Value:	N9.75bn	-28.0%

Municipal Bonds and Municipal Mutual Bond funds

Municipalities (state, city or local government), whether big or small are often in need of huge funds to meet the needs of its citizens. Whether they want to provide infrastructures, such as roads, sewerage, hospitals, schools etc, or it is just to meet certain aspects of their day-to-day activities they require financial resources, which can sometimes be larger than what they can generate from taxes, allocations and other internally generated revenues. At times like this they always look for ways to raise the funds elsewhere, usually, as debts whose repayment would be tied to future income or the revenue expected to be generated from the project (if the project is revenue-generating, e.g a mass transit or toll-collecting road etc.). Because of the technicalities of borrowing funds from the conventional banks, particularly if the project requires long-term funding, floating a municipal bond is one sure way of borrowing funds for projects today and tying repayment to future incomes.

What are Municipal Bonds?

Municipal bonds are debt obligations issued by states, cities, counties and other governmental entities, which use the money to build schools, highways, hospitals, sewer systems, and many other projects for the public good.

When you purchase a municipal bond, you are lending money to a state or local government entity, which in turn promises to pay you a specified amount of interest (usually paid semiannually) and return the principal to you on a specific maturity date.

Why Insure Municipal Bonds?

Municipal bonds often come with an insurance policy which is underwritten by a private insurance company. Insurance provides investors with the security that no matter what happens to the finances of the government that issues the bond, the bond's interest and principal payments will be made.

Insuring a municipal bond also increases the bond's marketability. The insurance helps smaller issuers who are unknown or do not issue bonds frequently to be taken seriously by investors.

When a municipal bond is first issued, it may come with a condition called a sinking fund requirement.

Like other bonds, municipal bonds have certain risks associated with them. A bond's primary risk is that of default. If a bond defaults, it means the government that issued the bond does not have the funds to make timely payments of interest and principal.

Municipal bonds also count on the projects they finance to bring in expected revenues. The governments that issue municipal bonds often rely on these revenues to pay back the bonds they issue. Municipal bonds therefore also run the risk that these projects will fail to produce the revenue needed to pay off the bonds.

Bonds with low default risk are given high credit ratings, which influence the market prices of the bonds. A bond that is insured will have a higher credit rating than a non-insured bond. Insured bonds receive the highest credit rating possible: AAA. The higher credit rating enables the bond issuer to pay a lower interest rate on the bonds when they are sold.

Types of Municipal Bond

There are two common types of municipal bonds: general obligation and revenue. General Obligation (GO) bonds are unsecured municipal bonds that are simply backed by the full faith and credit of the municipality. Generally, these bonds have maturities of at least 10 years and are paid off with funds from taxes or other fees.

Revenue bonds are used to fund projects that will eventually create revenue directly, such as a toll road or lease payments for a new building. The revenues from the projects are used to pay off the bonds. In some cases the issuer is not obligated to pay interest unless a certain amount of revenue is generated.

To pay off its bond debts, a municipal bond issuer may be required to make regular cash payments to a sinking fund trustee. This condition requires the bond issuer to pay off a certain amount of the bond debt each year by making payments to the fund's trustee. Municipal bond insurance also covers sinking fund payments, making sure the fund is kept up to date and that no payments are missed.

Municipal Bonds in Nigeria

Though the bearish situation in world stock markets have made bonds and other fixed income securities more popular in other parts of the world, the bond market in Nigeria is still largely dominated by the federal and state governments. Local governments are yet to take advantage of bond issuance to fund projects. The only known local government bond in Nigeria is the 1st Lagos Island LGA 1992-1996 100 million revenue bond for the Development of Sura Shopping Complex. However many state governments have accessed the bond market.

Advantages and disadvantages of municipal bonds

Municipal bonds aid development at the local level since it is generally used to fund infrastructure in different localities.

For the investor, its major attraction is that interests on these bonds are generally exempt from federal tax. In the case that the bond is bought by a resident of the state that issued the bond, the interest payments are also exempt from state tax. Interest payments are further exempt from local tax if they are bought by residents of the locality that issued the bond. However, capital gains are taxable.

Another advantage is that even if you sell a municipal bond before its maturity date, you'll receive the current market price of the bond — which may be more or less than the original price — without any additional penalties.

Since municipal bonds pay interest twice a year, they can also supply a predictable, tax-free income stream for retirees.

In general, municipal bonds are considered safer than corporate bonds, since a municipality is far less likely to fold-up than a company.

The only real disadvantage of municipal bonds is that they carry relatively low interest rates compared to other types of securities. This is particularly true when the economy is strong and interest rates for Treasury bills are high. Even after adjusting for taxes, it is often hard for municipal bonds to keep up with the competition. But in economic downturns, all bond rates are low, so the tax-free status makes a bigger difference.

Municipal Bond Funds

A mutual fund that invests in municipal bonds is called Municipal Bond Fund. Municipal bond funds invest in debt securities issued by state and local governments to pay for local public projects, such as bridges, schools, and highways. In the US, these bond funds are popular among investors with high incomes because they are exempt from federal taxes and, in some cases, from state taxes as well.

Advantages

A bond mutual fund is a convenient way to invest in bonds and diversify your bond portfolio. Managed by experts who invest in many different bonds, a fund does not invest all its money in one corporation or municipality, one interest rate, or one maturity. By investing in shares in the fund, you own a percentage of all the fund's investments. Unit-holders make a profit by selling units when the price has risen higher than what they paid for them.

Another advantage of investing in a bond mutual fund is that you don't have to try to choose the bonds yourself. Professionals who are trained to analyze the quality of bonds choose them for you. They use analytical skills to find bond issuers who are likely to pay off the bonds on time, and who pay an interest rate in the meantime.

However, there are risks associated with investing in a bond fund rather than in bonds themselves. An investor can lose money by selling units that have dipped below the purchase price. And a bond fund does not have a definite maturity, as a bond does. Consequently, bond fund investors are vulnerable to such market risks as rising interest rates. Also, bond funds charge annual management fees, while some impose initial sales charges or fees for selling shares.

State Bonds Issued in the last 10 years

Year	Amount	State	Purpose
1999	N1bn	Edo	Housing
2000	N3.5bn	Delta	Various Projects
2001	N2.5bn	Yobe	Various Projects
2002	N4bn	Ekiti	Various Projects
2002	N15bn	Lagos	Various Projects
2003	N4bn	Cross River	Tourism (Obudu Ranch)
2004	N6bn	Akwa Ibom	Various Projects
2006	N2.5bn	Kebbi	State University and irrigation project
2008	N275bn	Lagos	Roads etc

> "Local governments are yet to take advantage of bond issuance to fund projects. The only known local government bond in Nigeria is the 1st Lagos Island LGA 1992-1996 100 million revenue bond for the Development of Sura Shopping Complex. However many state governments have accessed the bond market."