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Tax-free income from your N.H. city or town

Investment Strategies

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Interest rates are at record lows and the stock market is at record highs. There is much confusion among the investing public about where they should put their money. Because of this confusion, there are record amounts of money being held in bank accounts earning little or no income.

Individual municipal bonds offer a more attractive investment opportunity for many people. They also provide local communities, perhaps your own, with funding for growth and capital improvements.

Most investors want certainty with their investments and appreciate the fixed income generated by bonds. A favorite investment of many is the individual municipal bond. I have been warning about the risks in bonds for a number of years now. That risk can be reduced by investing in individual bonds with a fixed maturity date rather than investing in a bond mutual fund. Bond funds don't have fixed maturity dates, so investor losses can be permanent when interest rates rise.

Losses occur in bond holding primarily when interest rates rise. If you buy a 10-year government bond paying 2.5 percent and then rates go up to 3 percent, your bond will lose value because of the rise in rates. Who would want your bond if a new bond can be bought with a higher yield? However, that loss will be temporary, as your bond will regain its full value when it matures at the end of the 10-year term.

So far this year there have been bonds issued by quite a few New Hampshire cities and towns, including Derry, Dover, Concord, Londonderry, Nashua and Salem. All of these bonds were general obligation bonds, meaning they were backed by the full taxing power of the issuing city or town. The money goes toward important local infrastructure and capital improvements, improving life in the community.

Most newly issued bonds are issued with a series of maturities that can range from one year to 30 years. The bonds from these cities and towns had average yields of 1.33 percent for the five-year maturities, 2.36 percent for the 10-year maturities and 3.43 percent for the 20-year year maturities. All of the bonds were very highly rated, with ratings of AA or better.

Almost all municipal bonds generate income that is free from federal tax, and an investment in a bond from your state of residence will also be free from state tax. Note that some municipal bonds are taxable, while some bonds generate income that is subject to the alternative minimum tax. Your financial or tax advisor should be consulted before investing in municipal bonds to confirm they are appropriate for your situation.

Many factors

At the time of this writing, U.S. Treasury bonds were yielding 1.69 percent for five-year maturities and 2.61 percent for 10-year maturities. Considering the yields available for the tax-free municipal bonds issued in 2014, anyone in the 25 percent tax bracket or higher would be better off investing in five-year tax-free municipal bonds than in Treasury bonds, which are federally taxable.

For longer-term investors, tax-free municipal bonds can make sense for anyone in the 10 percent tax bracket or higher. An investor in the maximum tax bracket of 39.6 percent would clearly be better off investing in tax-free municipal bonds, since the tax equivalent yield of 3.91 percent for a 10-year bond beats the rate on Treasuries of the same maturity.

Investors who plan to hold their bonds until they mature should consider tax-free municipal bonds.

There are many factors to consider when choosing an appropriate bond in which to invest, including credit rating, type of bond, coupon rate, price, call risk and more, so it is important to consult with an advisor with experience with municipal bond direct investments.

As with any type of investment, it is always wise to diversify your holdings. It is fine to own bonds from your favorite New Hampshire city or town, but also consider owning bonds from other highly rated cities, towns, counties or states from around the country.

Diversifying your municipal bond holdings helps you dilute the potential risk of a default from an unpredictable local event.

Perhaps you'd like to see your money help improve infrastructure and support growth in specific areas of your state or the country while you enjoy your regular, tax-free income. Individual municipal bonds provide you that opportunity.

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