

Guide to investing in municipal securities

What you should know before you buy

Before you buy an investment, it is important to review your financial situation, net worth, tax status, investment objectives, risk tolerance, time horizon, diversification needs, and liquidity needs with your financial professional. This guide will explain the features, risk, rewards, and costs associated with investing in municipal securities as well as how your financial professional and our brokerage firm are compensated when you invest in municipal securities.

What are municipal securities?

“Municipal Securities” is a general term referring to debt obligations issued by governmental entities, such as states, towns, villages, counties, as well as special districts and agencies of the aforementioned. Typically, municipal debt is issued to raise money for essential or important projects, such as to build schools, highways, hospitals, sewer systems, water treatment plants, electrical generating plants, and airports, as well as less essential needs, such as infrastructure improvements for new shopping malls or new stadiums, to name a few. The debt is also issued to finance other needs, such as providing low-interest-rate home mortgages and student loans to low- and moderate-income individuals. Municipal securities can come in many forms, including individual bonds and notes, variable-rate and fixed, as well as via municipal bond mutual funds and 529 education plans.

When you buy a municipal security, you are lending money to an issuer that, in turn, pays you a specified (or floating in some cases) rate of interest which is usually paid semi-annually and returns the principal amount of the bond at a specified time. Interest income received is usually exempt from federal taxes (unless specifically stated as such), and in most cases, is exempt at the state and local level as well for a resident of the issuing state. In addition, interest income from municipal bonds issued by the U.S. territories of Puerto Rico, Guam, and the U.S. Virgin Islands is exempt for individuals regardless of the state they reside in. It is important to note that some municipal securities are taxable, such as those issued under the Build America Program (to be discussed later) or in some cases for individuals who are subject to the alternative minimum tax (AMT).

The purpose of this guide is to provide a broad overview of the types of municipal securities that are available as well as the general risks and characteristics of each. Investors should be aware that all municipal securities are not the same and do not act as such. It is extremely important that every investor reads in full the issuer’s official statement which describes every municipal security in detail. In addition, there may be updated disclosure documents or material events notices available which investors should read prior to making a purchase of any municipal security. Finally, investors need to always be aware of the overall market environment — more specifically, interest rate and economic developments that can affect the value of their securities.

We have a responsibility to consider reasonably available alternatives in making a recommendation. We do not need to evaluate every possible alternative either within our products or outside the firm in making a recommendation. We are not required to offer the “best” or lowest cost product. While cost is a factor that we take into consideration in making a recommendation, it is not the only factor.

You should consider factors such as those below prior to accepting a recommendation:

- The potential risks, rewards, and costs in purchasing and in the future selling of a security.
- Your age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, and risk tolerance.

Investment and Insurance Products are:

- Not Insured by the FDIC or Any Federal Government Agency
- Not a Deposit or Other Obligation of, or Guaranteed by, the Bank or Any Bank Affiliate
- Subject to Investment Risks, Including Possible Loss of the Principal Amount Invested

- The security's investment objectives, characteristics (including any special or unusual features), liquidity, volatility, and likely performance in a variety of market and economic conditions.
- For complex products, you should consider whether less complex or costly products achieve the same objectives.

By accepting a recommendation, you acknowledge that you have considered the above factors to your satisfaction.

Can you lose money in municipal securities?

Municipal securities are not guaranteed investments, therefore it is possible for an investor to lose some or all of their invested principal. Investors should consider their personal goals and investment objectives and seek to take on a level of risk that is appropriate to meet those needs.

Types of municipal securities

Municipal bonds and notes

Municipal securities include both long-term and short-term issues. Short-term securities, often called notes, typically mature in a year or less. Long-term securities, commonly known as bonds, typically mature later than one year from issuance.

Short-term notes are generally issued to raise money to cover irregular cash flows, unanticipated deficits, or for more immediate capital projects until long-term financing can be arranged. The notes are paid off with future known (or anticipated) cash flows, payable to the issuer within the next year. Examples of "anticipated" cash flow would include personal income taxes collected by the state and property taxes collected by a city, which are generally paid every April and December. A tax-anticipation note (or TAN) would be an example of a security backed by these cash flows.

Bonds are generally sold to finance capital projects over the longer term. The two basic types of municipal bonds are general obligation bonds and revenue bonds.

General obligation bonds

Most general obligation bonds are issued by states, cities, and towns and are secured by the full faith and credit of the issuer. In the case of government obligors, the bonds are backed by either income taxes or property taxes which the issuer pledges to raise (levy increased) if needed to payoff bondholders. Most general obligation bonds must be voter approved prior to issuance. Investors should note that under current law, U.S. states cannot file for bankruptcy, however, many municipalities can, depending on the laws of each state. Although the filing of bankruptcy by a municipality is extremely rare, it could potentially affect the general obligation pledge.

Revenue bonds

Principal and interest are secured by revenues derived from tolls, fees, taxes, rents, etc., which are typically paid by users of the project supported by the proceeds from a bond issue. Public projects financed by revenue bonds include highways, bridges, airports, water and sewage treatment facilities, hospitals, and housing for low- to moderate-income individuals. Many of these securities are issued specifically for these purposes. Declining economic conditions, natural disasters, and competition from other providers are all risks that can negatively affect revenue streams for bondholders and thus may lead to a downgrade of a security's credit rating.

Bonds with special investment features

Insured municipals

Some municipal bonds may be backed by municipal bond insurance specifically designed to help reduce investment risk. It is important to understand insurance will only guarantee the timely payment of principal and interest and does not eliminate risk of loss from interest rate changes, extraordinary calls, etc. Furthermore, the insurance company itself can have financial problems, thus negatively affecting the value of the securities.

Floating-rate and variable-rate bonds

Sometimes referred to as “floaters,” these have interest rates which may be tied to a benchmark interest rate such as LIBOR or short-term T-bills. Interest on a floater typically resets daily, weekly, or monthly but can reset at longer intervals as well. Most variable rate demand notes (VRDNs) are backed not only by the issuer but also by a Letter of Credit provider that guarantees an investor can put their bonds back at par value on any interest reset date. Floating rate securities are generally below investment grade (high-yield securities) and carry increased risks of price volatility, underlying issuer creditworthiness, liquidity and the possibility of default in the timely payment of interest and principal which may impact their value. Floating rate securities and VRDNs are not money market equivalents. Most of these investments have a \$100,000 minimum investment.

Callable bonds

Many municipal securities allow the issuer to call, or retire, all or a portion of the bonds at a specified price prior to maturity. Typically, the first optional call is at a premium to par and then eventually declines to par over time. There are several different types of calls; four of the most frequent are described here.

- **Optional call.** An optional call allows the issuer to redeem a bond at its discretion on a specified future date at a specified price. Municipal bonds are generally issued with the first call date occurring eight to 10 years from issuance.
- **Extraordinary call (catastrophe call).** An extraordinary call can occur at an unknown point in time prior to maturity. The issuer has the right to call the bonds, generally at par, when a certain event occurs. This event can be a one-time event, such as a catastrophe, or it can occur numerous times as is the case for a housing bond whereby prepayments of mortgages are passed through to investors. Another potential event that is currently in the news is related to the Fiscal Cliff and Sequestration. In this event, on some Build America bonds if the Federal Government subsidy paid to the municipal issuer is reduced, the bonds could be subject to an extraordinary call. In all these examples, the exact timing is not known but it is extremely important to know what circumstances can trigger a call because it can affect the value of the municipal security and may affect the performance of the bonds in a falling interest rate environment.
- **Mandatory call.** A mandatory call is when an issuer is required to redeem all or a portion of an issue according to the call or prepayment provisions of the bond contract.
- **Make whole call provision.** A type of call allowing the issuer to pay off remaining debt early. The issuer makes a lump sum payment based on the net present value (NPV) of future coupon payments that will not be paid as a result of the call. The issuer generally doesn't expect to use this type of provision, but if used, investors will be “made whole.” Because the cost can often be significant, such provisions are rarely invoked.

Investors considering purchasing a municipal security should read the offering documents related to the specific bond issue carefully in order to understand what call provisions may exist. Almost all revenue bonds are potentially subject to an extraordinary call and again, it is important to know what circumstances can trigger this type of call.

Defeased and refunded bonds

When interest rates fall below the rate of interest currently being paid by an issuer on a given security, the issuer may look to the bond market to refinance the issue at lower rates similar to how an individual would want to refinance the mortgage on their house if they could get a new one at a lower interest rate. When an issuer refunds (refinances) an outstanding issue, they will typically issue a new bond and take the proceeds and place them in an escrow account to pay off the older higher-coupon bonds. Most of the time, but not always, the money from the new issue is actually invested in U.S. government securities. The older bonds will then either be called on their first optional call date (called prerefunded bonds), or if non-callable, will be paid as originally scheduled to maturity (called escrowed to maturity or ETM). When an issuer takes these actions, in most cases, the bonds are defeased and are no longer an obligation of the issuer. In certain cases the bonds are “economically defeased” which means they remain on the issuer’s books as a liability even though the escrow account will be making all the payments.

Zero coupon, compound-interest, and multiplier bonds

Zero coupon bonds are generally issued at a discount to their maturity value. They do not offer any cash flows except at maturity when both principal and interest are paid. Some zero coupon bonds are called multipliers. Rather than being issued at a discount, they are typically issued near par and then compound at a given interest rate for the life of the bond. Interest and principal are both paid at maturity as well.

Zero coupon bonds are an option for investors that have known future liabilities, such as a college education, which they need to save for. However, for those investors that may need to sell prior to maturity, it is important to understand that the price of a zero coupon bond will typically fluctuate more than a fixed coupon bond with the same maturity. This could cause a greater percentage loss of principal should interest rates rise and likewise, a greater gain if interest rates fall. Zero coupons may not be appropriate for all investors. In addition, although a zero coupon bond does not actually pay until maturity, the interest earned (phantom income) each year does need to be reported to the IRS and state income tax authorities even though no tax may actually be due.

Put bonds

Some bonds have a “put” feature which lets the investor redeem the bonds, usually at par value, on a specified date prior to maturity. There are also “mandatory” puts whereby the issuer calls the bonds at a specified date prior to maturity with no right of the investor to retain the bonds.

Taxable municipal bonds and Build America Bonds

Issuers will sometimes sell municipals that are subject to federal taxes. Taxable municipal bonds generally offer yields more comparable to those of other taxable bonds, such as corporate bonds or bonds issued by a U.S. governmental agency, rather than to those of tax-exempt municipals.

The American Recovery and Reinvestment Act of 2009 created the Build America Bond program. It was created to help state and local governments obtain financing for certain projects at lower borrowing costs while stimulating the economy and creating new jobs. Under this program, state and local governments were permitted to issue taxable bonds in 2009 and 2010 for capital projects for infrastructure needs in areas such as water, transportation, electricity, and education for which they could otherwise use tax-exempt government bonds. The issuer would then receive a new direct federal subsidy payment from the Treasury Department for a portion of its borrowing costs equal to 35% of the total coupon interest paid to investors. The federal subsidy is treated like a federal tax rebate to the issuer; it is in no way linked to the credit quality of the issuing municipality. It is important to note that Build America Bonds are not a direct or implied line to the Treasury, nor are they backed by the U.S. government should an issuer have credit problems.

In addition, Build America Bonds have some features and structures that equate more to traditional taxable issuers. They are typically long-term bonds that do not pay any portion of the principal until maturity (also known as a bullet maturity). Also, many contain call provisions and catastrophe calls at a predetermined spread to Treasury securities. Such features can make these bonds more appealing to taxable bond investors than municipal investors.

Non-rated bonds

Non-rated bonds are fixed income securities that do not currently have a rating assigned to them by one of the major credit rating agencies. Bonds are not required to have a credit rating. A non-rated bond is not necessarily of low credit quality, however, it cannot technically be deemed investment grade when no rating has been assigned.

Issuers generally have two main reasons for issuing non-rated bonds. First, some issuers are considered creditworthy borrowers, but the rating is foregone because the size or placement of the issue is such that the cost of being reviewed by a rating agency outweighs the benefit. A non-rated bond will generally offer a yield higher than a comparable rated bond, so if the cost of receiving a rating is higher than this additional cost of borrowing, an issuer may opt for issuing non-rated bonds. Second, an issuer may feel their bonds would not meet the rating criteria of the rating agencies, or, if rated, would be classified below investment grade.

Because non-rated bonds tend to be smaller issues, these securities may have less liquidity than rated bonds that have a larger float (the total number of securities publicly owned and available for trading). Additionally, investors may be more likely to incorporate a buy-and-hold strategy, thus minimizing the available market in these bonds. In the municipal bond marketplace, many non-rated bonds are revenue bonds rather than general obligation bonds. Revenue bonds are typically backed by the income stream of the project the bonds finance, rather than the full faith and taxing power of the municipality. Understanding the project and the revenue stream backing the bonds are key factors to understanding the credit risk associated with the bonds. You should always review the official statement, specifically those sections that cover the description of the project, the use of bond proceeds, and the risks associated with the issue, before investing.

High yield municipal bonds

High yield municipal bonds are securities that do not qualify for an “investment grade” rating by one of the major rating agencies (see credit ratings for an explanation of investment grade). These agencies assign ratings based on their opinion whether or not an issuer will be able to meet their obligation to pay principal and interest on a bond as scheduled. Issuers with a high risk of not meeting those obligations are generally assigned ratings below investment grade. These bonds will almost always pay higher rates of interest as compared to investment-grade bonds to compensate investors for the increased credit risk they are accepting.

High yield municipal bonds are considered volatile and speculative in nature and offer increased risks compared to investment-grade municipal bonds. Investors should understand these risks as well as issue-specific risks available in the offering documents, from your financial professional, or the Municipal Securities Rulemaking Board (MSRB). For more information on high yield bonds, see the *Guide to Investing in High Yield Bonds*.

529 plans

First authorized by Congress in 1996, qualified state tuition programs, or 529 educational savings plans, allow states to offer investors professionally managed tax-advantaged portfolios to help meet rising educational expenses. 529 plans are deemed municipal fund securities by the U.S. Securities and Exchange Commission (SEC) Division of Market Regulation and are governed by the rules of the MSRB. When you are saving for higher education, 529 plans may provide a valuable tax-efficient alternative. There are two types of 529 plans: prepaid college tuition plans and savings plans. All 50 states and the District of Columbia sponsor at least one type of 529 plan. In addition, a group of private colleges and universities sponsor a prepaid tuition plan. These plans are authorized under Section 529 of the federal Internal Revenue Code but are established by individual states. As such, each 529 plan may differ significantly in features and benefits. To help identify if a 529 plan is appropriate for your situation, you should consult your tax advisor and consider your individual objectives and circumstances in light of the plan’s features and benefits. Contact your financial professional or reference *A Guide to Investing in 529 Plans* for more details regarding risks, costs, and compensation on 529 educational savings plans.

Please consider the investment objectives, risks, tax considerations, charges, and expenses carefully before investing in a 529 plan. The official statement, which contains this and other information, can be obtained by calling your financial professional. Read it carefully before you invest.

Tax advantages may be conditioned upon meeting certain requirements.

How are municipal bonds purchased?

Municipals can be purchased in the primary market or traded between dealers in the secondary market. In the municipal marketplace, bonds are sold to investors via a competitive or negotiated underwriting process and come to market much like initial public offerings of stock.

A competitive underwriting works as a sealed-bid auction that takes place on a specific date at a specific time. A number of dealers or groups of dealers submit their bids to buy the bond issue. The group willing to provide the issuer with the lowest net interest cost will buy the bond issue.

In a negotiated underwriting, an issuer chooses a dealer or group of dealers to sell the bonds and negotiates the terms that will satisfy the issuer's needs at the lowest interest cost.

Characteristics of municipal bonds

Taxable equivalent yields

Interest generated from tax-exempt municipal bond coupon payments is not subject to federal income tax unless it is a private activity bond and the investor is subject to the AMT. In addition, most municipal interest is exempt from taxes for residents of the state in which the issuer resides, but this should be verified with your financial professional or CPA prior to purchase. A taxable equivalent yield is the return that is required on a taxable investment to make it equal to the return on a tax-exempt investment, assuming that the investor is not subject to the AMT. Municipal bonds generally offer lower interest rates than similar taxable corporate bonds, so taxable equivalent yields should be considered when evaluating taxable versus tax-exempt bonds.

Example

	5% tax-exempt bond	7% taxable bond
Cash investment	\$30,000	\$30,000
Interest	\$1,500	\$2,100
Federal tax (35%)	\$0	\$735
Net return	\$1,500	\$1,365
After-tax yield	5.00%	4.55%

If you invested your money in the tax-exempt municipal bond, you'd earn \$1,500 in interest (a 5% yield) and pay no federal income taxes. The taxable investment, however, would provide you only \$1,365 in income (a 4.55% yield) after federal income taxes have been deducted. As you can see, the tax-exempt municipal bond would provide the better yield after taxes are taken into account. The tax-exempt return would be higher if you accounted for the possible state and local income tax exemptions.

Reporting requirements

All tax-exempt interest must be reported on tax returns. This is simply a reporting requirement and does not affect the tax-exempt status of the security.

Minimum investment

Most tax-exempt municipal bonds and notes are issued in denominations of \$5,000 or multiples of \$5,000.

Price quotes and disclosures

Financial newspapers and business pages of major daily newspapers will generally list prices of widely traded municipal securities. Because the prices are typically based on \$1 million lots and reflect a discount based on large dollar transactions, purchases and sales of smaller amounts may differ according to the size of the order. You can also receive price quotes from your financial professional. You can find disclosure documents, official statements, material events, and quotes on the Municipal Securities Rulemaking Board-operated EMMA website at emma.msrb.org.

Marketability

Holders of municipal securities can sell their notes or bonds in the secondary market. Municipal bonds are sold in the over-the-counter (OTC) market instead of on an organized exchange. If you sell your bonds before their maturity date, you will receive the current market price, which may be more or less than what you paid for the bonds.

Municipal bond risks

Municipal bonds vary in risk based on the issue. It is important to read the full official statement for a list of issue specific risks. In general, municipal bonds are subject to the risks listed below.

State/municipality risk

The risk that extreme economic, budgetary, and financial stress can result in weakened revenue performance for the state of issuance and its agencies or municipalities. These events may adversely impact the liquidity, values, and ability to pay interest due on the securities issued by a state and agencies or municipalities.

Credit risk

The potential for loss resulting from an actual or perceived deterioration in the financial health of the issuing municipality. While many municipal bonds will be rated by an independent rating agency, some municipalities may choose not to be rated as the cost to do so may outweigh the benefit. Two subcategories of credit risk are default risk and downgrade risk.

- **Default risk** is the risk that an issuer will be unable to pay interest or principal when due. Many factors can contribute to a default — downturns in the economy or a particular industry, downturns in a local economy, etc. Liquidity for bonds in default is almost nonexistent, and the prices of bonds in default tend to be very low.
- **Downgrade risk** is the risk that the independent rating agencies will lower their ratings on a particular bond. A municipality's rating, for example, could be downgraded from A to BBB if the rating agency believes the issuer has become less able to meet its debt obligations. A downgrade is normally accompanied by a decline in the prices of the bonds. When the marketplace anticipates a downgrade, the price often declines before the actual downgrade. Often, the rating agencies will place an issue on "credit watch" status before a downgrade; this also normally brings a price decline.

Credit ratings

Credit quality	Rating service		
	Moody's	Standard & Poor's	Fitch
Prime	Aaa	AAA	AAA
Excellent	Aa	AA	AA
Upper Medium	A	A	A
Lower Medium	Baa	BBB	BBB
Speculative	Ba	BB	BB
Very Speculate	B, Caa	B, CCC, CC, C	B, CCC, CC, C
Default	Ca, C	D	DDD, DD, D

For a complete explanation of credit ratings, see “Credit rating explanations” before the Glossary section of this investor guide.

Market risk (interest rate risk)

If you sell a municipal bond prior to maturity, it may be worth more or less than your original investment. When interest rates are moving higher, bond prices will normally fall. The opposite is also true when rates are moving lower, bond prices will normally move higher. The longer the maturity date of the bond and the lower the coupon, the more prices fluctuate as a percent of the amount invested. Broker-dealers are not obligated to buy back bonds at all times, and a market under stress may result in few or no transactions occurring in some municipal bonds.

Inflation risk

Inflation is a general upward movement in prices, which thereby reduces the ability of a consumer to purchase the same amount of goods at the same cost. In other words, inflation reduces purchasing power, which is a risk for investors receiving a fixed rate of interest. High inflation or even expectations for higher future inflation will cause higher interest rates as investors demand higher rates of return to compensate for higher prices of goods and services.

Call risk

Many municipal bonds are structured to allow the issuer to call, or retire, all or a portion of the bonds at a premium or at par prior to maturity, while some bonds are non-callable for the life of the bond. Callable bonds may actually be non-callable for a period of time after issuance, but once they reach a specified date, the issuer may be able to call the bonds, at a specific price anytime and for any reason, prior to maturity. As a practical matter, an issuer will generally decide to call a bond when it can issue a new bond at a lower rate than the existing bond. Investors considering an investment in municipal bonds should note that under this scenario it is unlikely that they would be able to replace their called bond with one that pays an equivalent rate of return for the same maturity. In addition, potential near-term bond calls can negatively affect price performance in a declining-interest-rate environment.

Liquidity risk

Liquidity risk is the risk that an investor may not be able to sell a bond at the time and price they choose. When a bond is termed “liquid,” an investor can sell it before maturity through an active network of broker-dealers willing to bid on the particular security. However, when concerns about an issuer arise, some dealers will no longer provide bids, thus creating less liquidity, bigger spreads between bids and offers, and a chance clients will receive lower prices for their securities. With some municipal bonds, concerns related to the issuer may decrease the liquidity, and as a result, fewer broker-dealers are willing to buy or sell a particular bond at any given time. Characteristics that may affect a bond’s liquidity include: how well recognized the name of the issuer is in the market place, the purpose of the bond, current float in the marketplace, size of the trade, and the rating.

Event risk

A change in local government, shifts in the marketplace, new regulations, adverse news headlines, or any other event that has a broad effect on an entire industry or municipality can affect the ability of bond issuers to pay interest and principal when due.

Economic risk

A bond's vulnerability to downturns in the overall economy presents a risk. During economic downturns, many investors get nervous and begin a "flight to quality" — selling lower-rated bonds or equities in order to buy much higher-rated debt, such as U.S. Treasury bonds or investment-grade corporate bonds.

Reinvestment risk

When investing in fixed income products, investors could face reinvestment risk. Reinvestment risk results from the fact that an investor may not be able to reinvest in such a way as to earn the same rate of return currently earned. For example, falling interest rates may prevent an investor from earning the same interest rate they are earning on a maturing bond. Bond laddering strategies can help reduce reinvestment risk.

Enhancement risk

Some municipal issuers may choose to enhance the credit of their offerings by having an insurance policy that promises to make timely principal and interest payments if the issuer is unable to meet its obligations. Companies that offer such insurance to municipal issuers are also credit rated and subject to a change in credit ratings due to financial difficulties, economic environments, etc. A downgrade in a municipal bond insurer may increase price volatility and will negatively affect the price and liquidity of any bonds insured by that company.

Taxation

Currently, tax-exempt municipal bonds are free from federal and, in some cases, state and local taxes — but they may not be exempt from all tax liabilities, such as capital gains or the AMT. It is important for investors to note that taxable municipal bonds are also available. These bonds are taxed at ordinary income tax rates.

Interest payments

The interest that you receive from tax-exempt municipal bonds is generally free from federal income tax. In addition, tax-exempt municipal bonds may also be free from state and local taxes if you are a resident of the state that issued the bonds or if you own a bond issued by a territory of the United States, such as Puerto Rico, Guam, or the U.S. Virgin Islands.

Gains and losses

You may generate capital gains on a tax-exempt security what if you sell it at a profit in the secondary market prior to maturity. If you sell your security for less than what you paid for it, you could incur a capital loss. In certain circumstances, the amount of gain or loss that you realize may be affected by required cost-basis adjustments. Please consult your tax advisor for more information. Under current law, up to \$3,000 of net capital losses can be used annually to reduce ordinary income. Capital losses can be used without limit to reduce capital gains.

The De Minimis Tax Rule

De minimis concerns are more likely to occur in a rising rate environment due to the resulting decline in bond prices.

The rule sets the threshold at which a discount bond should be taxed as a capital gain rather than as ordinary income. The rule states that a discount that is less than a quarter-point per full year between its time of acquisition and its maturity is too small to be considered a market discount for tax purposes. Instead, the accretion from the purchase price to the par value should be treated as a capital gain, if it is held for more than one year.

In addition to the tax implications, liquidity issues may increase depending upon unique bond related characteristics such as coupon and maturity.

Retirement Accounts

The tax advantages of municipal securities are eliminated when held in a tax advantaged account such as a Traditional IRA, SEP, SIMPLE or qualified plan account given funds withdrawn from these accounts are generally subject to ordinary income taxes at the time of withdrawal and if withdrawn prior to age 59 ½ may be subject to a 10% federal additional tax. All qualified distributions from Roth IRAs are tax-free regardless of the underlying investment.

The alternative minimum tax (AMT)

Under the Tax Reform Act of 1986, interest on most tax-exempt private-activity bonds is a tax preference item for individuals subject to the AMT. A preference item is an income source that is not included in the normal tax calculations but is included as income when making AMT calculations. One of the benefits to investors in private-activity bonds (or AMT bonds) is that the range of yields will tend to be higher than for non-AMT bonds. This extra yield is an advantage for individuals who are not subject to the AMT. Bear in mind that as tax law changes, you may be subject to the AMT at some point. For more information on the tax treatment of municipal bonds, please contact your tax professional.

Our brokerage firm is not a legal or tax advisor. However, our financial professionals will be glad to work with you, your accountant, tax advisor, and/or lawyer to help you meet your financial goals.

Costs of investing in municipal bonds

Municipal bonds are generally bought and sold between dealers and investors, much like other fixed income instruments. Dealers trade the securities at a net cost, which includes their own spread, or profit, on the transaction. Upon purchase and sale of a fixed income security, you will generally incur a commission or mark-up in processing the transaction. Municipal bonds purchased during the initial public offering (IPO) period have a sales concession built into the purchase price, a portion of which is paid to your financial professional.

Other ways to access municipal bonds

Municipal bond funds

Municipal bond funds are actively managed mutual funds or closed-end funds that invest primarily in municipal bonds. Municipal bond funds are generally bought for their favorable tax implications and are a popular fixed income investment for people in higher income tax brackets.

It is important to note that dividends issued from a municipal bond fund may still be subject to the AMT. Municipal bond funds may invest in a narrow group of holdings, and your diversification may be limited. Municipal bond funds carry fund operating expenses not associated with an individual municipal bond. They are subject to the same risks associated with municipal bonds and are also subject to manager risk, the possibility that an actively managed fund's investment adviser will fail to execute the fund's investment strategy effectively, resulting in the failure to meet stated objectives. Contact your financial professional or reference *A Guide to Investing in Mutual Funds* or *A Guide to Investing in Closed-End Funds* for more details regarding risks, costs, and compensation on mutual funds and closed-end funds.

Municipal money market funds and cash sweep programs

A municipal money market fund is an open-end mutual fund that invests primarily or exclusively in short-term municipal securities. These funds typically have lower risk than traditional mutual funds and provide the diversification of pooled investments and potentially tax-exempt returns. They are generally liquid securities due to the short-term nature of the underlying investments and are typically used by investors who have a low risk tolerance or want a conservative, tax-exempt alternative for their discretionary money. The goal of a municipal money market fund is to provide a conventional, tax-exempt investment while attempting to maintain preservation of capital, liquidity, and return on principal.

Municipal cash sweep programs allow your otherwise uninvested cash holdings to “sweep” automatically from your brokerage account into a municipal money market fund sweep program that offers SIPC insurance. These sweep options are generally considered lower risk and are liquid in nature, giving investors the ability to earn a return on cash holdings or funds being set aside for a future purchase.

An investment in a municipal money market fund or a municipal cash sweep program differs from having a traditional bank deposit money market account and is not insured by the FDIC. Similar to municipal bond funds, municipal money market funds and municipal sweep program options carry fund operating expenses not associated with an individual municipal bond and are subject to the risks of municipal bonds discussed above as well as manager risk. Before investing in any money market fund or cash sweep program, you should discuss your investment goals and objectives with your financial professional and understand the features, characteristics, risks, and costs associated with the investment vehicle. For more information on money market mutual funds and cash sweep programs, contact your financial professional or reference *A Guide to Investing in Cash Alternatives*. For more information on the cash sweep program, reference the Cash Sweep Program Disclosure Statement.

An investment in any money market fund is neither insured nor guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the fund seeks to preserve the value of your investment at \$1 per share, it is possible to lose money by investing in the fund.

Investor characteristics

Purchasers of municipal bonds are generally income investors seeking to earn a stated interest rate for a specified time. Due to the potential tax advantages of municipal bonds, they are generally most popular with investors in higher tax brackets. Further, you should only purchase municipal bonds after consulting with your financial professional to ensure you understand the associated risks.

Diversification

For investment diversification, it is recommended that investors observe an asset allocation strategy and not overweight their overall portfolio in any one class of securities. Although asset allocation can be an effective investment strategy, it cannot eliminate the risk of fluctuating prices and uncertain returns.

How are your financial professional and our brokerage firm paid on municipal bonds?

For helping you invest in municipal bonds, our brokerage firm and your financial professional are compensated in ways that vary depending on the selected investment. If the purchase is made during the IPO period, a financial professional may be paid a sales concession. This sales concession is built into the bond price and is passed along to the financial professional. Your financial professional will receive compensation in the form of a commission or mark-up from most transactions. For most purchases, a financial professional’s compensation is based on the dollar amount purchased or sold. In certain fee-based accounts, a financial professional’s compensation is based on a percentage of assets in the account rather than on the concession, as mentioned above. The compensation formula that determines the amount of payment is generally the same for most municipal bonds.

What you should know

The ratings shown are not a forecast or guarantee of investment results. They are assigned by Moody's and Standard and Poor's at the time of their analysis of the longer term debt instrument reviewed and subject to change based on economic, issuer or other factors. The issue ratings definitions are expressed in terms of default risk. The ratings should only be considered as an opinion by the organizations to credit quality of the proposed investment. These organizations have different rating systems for other types of investments that are not included here. Information has been obtained from sources considered reliable but its accuracy and completeness are not guaranteed. Additional information is available upon request.

Credit Rating Explanations

Moody's investment grade		S&P investment grade	
Aaa	Considered to be the best quality. They carry the smallest degree of investment risk. Principal is secure and interest payments are protected by large stable margin.	AAA	Have the highest rating. Ability to meet principal and interest payments is extremely strong.
Aa1	Judged to be of high quality by all standards. They are rated lower than the best bonds because margins of protection may not be as large.	AA+	Vary from the highest rating in a small degree. Ability to meet principal and interest payments is very strong.
Aa2		AA	
Aa3		AA-	
A1	Possess many favorable investment attributes and are to be considered as upper-medium-grade obligations.	A+	Are somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher rated categories. The issuer's responsibility to meet its financial commitment on the obligation is still strong.
A2		A	
A3		A-	
Baa1	Are considered medium-grade obligations. Interest payments and principal are secure for the present, but may not be reliable over a long period of time.	BBB+	Exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to affect the capacity of the issuer to meet its financial commitment on the obligation.
Baa2		BBB	
Baa3		BBB-	

Moody's non-investment grade		S&P non-investment grade	
Ba1	Judged to have speculative elements. Their future is not considered as well-assured. Interest and principal payment may be very moderately protected.	BB+	Are less vulnerable to nonpayment than other speculative issues. However, it faces major ongoing uncertainties, which could lead to the obligor's inadequate capacity to meet its financial commitment.
Ba2		BB	
Ba3		BB-	
B1	Generally do not carry the same characteristics of the desirable investment. There is a minimal assurance of principal and interest payments over a long period of time.	B+	Are more vulnerable to nonpayment than obligations rated 'BB', but the obligor currently has the capacity to meet its financial commitment on the obligation. Adverse business, financial, or economic conditions will likely impair the obligor's capacity or willingness to meet its financial commitment on the obligation.
B2		B	
B3		B-	
Caa1	Are of poor standing. Such issues may be in default or there may be present elements of danger with respect to principal or interest.	CCC+	Are currently vulnerable to nonpayment, and is dependent upon favorable business, financial, and economic conditions for the obligor to meet its financial commitment.
Caa2		CCC	
Caa3		CCC-	
Ca	Represent bonds that are speculative to a high degree. These issues may also be in default.	CC	Are currently highly vulnerable to nonpayment.
C	Represent bonds that are speculative to a high degree. These issues may also be in default.	C	A subordinated debt or preferred stock obligation rated 'C' is CURRENTLY HIGHLY VULNERABLE to nonpayment. This rating may be used to cover a situation where a bankruptcy petition has been filed, but payments on this obligation are still being continued. A 'C' rating also will be assigned to a preferred stock issue in arrears on dividends or sinking fund payments, but that is currently paying.
NR	Indicates there is insufficient information on which to base a rating, or that no rating has been requested.	D	A bond rated 'D' is in payment default. When payments on an obligation are not made on the date due, even if the respective grace period has not expired, the 'D' rated category is used. In addition, this rating is used upon the filing of a bankruptcy petition.
		NR	This indicates that there is insufficient information on which to base a rating, that no rating has been requested or that S&P does not rate a particular obligation.

Glossary

Book-entry issuance

Many municipal bonds are issued in book-entry form, just as U.S. government securities are issued. Ownership is recorded through data entry at a central clearing house. Your confirmation of purchase from your bank or brokerage firm provides you with a written record of the transaction. This eliminates the need for the physical transfer of certificates. Registered and book-entry bonds can offer a number of protections and conveniences for bondholders: protection from loss or theft of physical certificates, automatic payment of interest, notification of calls, and ease of transfer, among others.

Bullet maturity

A coupon paying bond with no repayment of principal until maturity.

Call

A decision of the bond issuer to repurchase the bond from the holder at a specified date and price. Most bonds are callable at par or a premium to par (par is generally \$1,000). Some bonds are non-callable.

Coupon

The part of a bond that denotes the amount of interest due, on what date, and where the payment is to be made. Bearer coupons are presented to the issuer's designated paying agent or deposited in a commercial bank for collection. In the case of registered coupons, the interest payment is mailed directly to the registered holder. Coupons are generally paid semiannually.

Current yield

The annual return on the dollar amount paid for a bond. Current yield is equal to the annual interest payments divided by the price of the bond.

Discount

The amount by which the purchase price of a security is less than the principal amount or par value.

Interest payments

Bond interest is usually paid semiannually. On notes or zero coupon bonds, interest is typically paid at maturity.

Maturity

The date when the bondholder will receive the final interest payment and the repayment of principal.

Official statement

A document prepared for or by the issuer that gives, in detail, security and financial information about the issue.

Original issue discount (OID)

A bond issued at a dollar price less than par that qualifies for special treatment under federal tax law. If the bond is held to maturity, the difference between the issue price and par is treated as tax-exempt income rather than as a capital gain.

Par value

The principal amount of a bond or note due at maturity, usually \$1,000. Most municipal bonds have a face value of \$1,000 and a minimum denomination of \$5,000.

Additional information

Municipal bonds can be a valuable part of your fixed-income portfolio. Before making an investment decision, it is important to review your financial situation, investment objectives, risk tolerance, time horizon, diversification needs, and liquidity objectives with your financial professional. To learn more about municipal bonds, ask your financial professional or visit the following websites:

Municipal Securities Rulemaking Board
[msrb.org](https://www.msrb.org)

Financial Industry Regulatory Authority (FINRA)
[finra.org](https://www.finra.org)

U.S. Securities and Exchange Commission
[sec.gov](https://www.sec.gov)

Securities Industry and Financial Markets Association

(SIFMA) [sifma.org](https://www.sifma.org) or
[investinginbonds.com](https://www.investinginbonds.com)

Premium bond

A bond that is trading for more than its face value. Premium bonds will generally offer coupons higher than those found on comparable bonds trading at par value or at a discount. Bonds can be issued at premiums, or may begin to trade at premiums due to a decline in interest rates. While an investor will pay more than face value for a premium bond due to its higher coupon, such bonds will return only their face value at maturity.

Principal

Principal is the face amount of a bond. Once a bond has been issued, it may sell at more or less than its face amount, depending upon changes in interest rates and the riskiness of the security. At maturity, however, the bond will be redeemed for its principal amount.

Registered issuance

As a result of federal tax-law changes, starting in July 1983, municipal bonds were issued in registered form only and bearer bonds became obsolete. With a registered security, your name is registered on the issuer's books and appears on the bond and interest payments come directly to you. A bond can be registered as to principal and interest or as to principal only. Today, even registered bonds have become a rarity as almost all new issues are in book-entry only form.

Yield to Maturity (YTM)

The rate of return to the investor based on the initial amount paid and the future cash flows to be received. The calculation assumes that all cash flows received prior to maturity can be reinvested at the same rate of return and are paid and compounded semi-annually. If cash flows are not reinvested or are reinvested at a lower rate, the investors true YTM for the time held will be less than the yield originally stated.

Be advised that there is a brochure available on the Municipal Securities Rulemaking Board (MSRB) website that describes the protections available under MSRB rules and how to file a complaint.