

Debt administration

[Finance](#)



Which bond in the following pairs of bonds is likely to bear the higher interest rate (yield) and why A corporate bond rated Aaa or a municipal bond rated Aaa

The two types of bonds are rated the same in terms of credit worthiness. The rating is in terms of Moody's rating, showing that the issuers of such bonds have unquestionable ability to repay the bond's face value at maturity. A municipal bond rated Aaa has a higher yield compared to corporate bond because the income they generate is usually exempt from federal income taxes whereas the corporate bond is not. Also, if the investor resides in the state that issued the bond, it may be exempted from state income tax.

2) A municipal bond rated Baa or a municipal bond rated Aa

A municipal bond rated Baa will bear higher interest rate than a municipal bond rated Aa. This is because, according to Moody's rating, a bond rated Aa has shows that credit worthiness of the issuer is high hence the issuer will have to pay less interest on the debt being issued, as opposed to a municipal bond rated Baa which are judged to be of medium grade and subject to moderate credit risk, meaning that credit worthiness of the issuer is somewhat good, but not as good as that of the one rated Aa. Municipalities with lower bond ratings ought to pay more interest on debt being issued to compensate for the greater perceived risk associated with the lower rating.

3) A general obligation bond issued by a city or a revenue bond issued by a city

Revenue bonds offer higher interest rates than general obligation bonds. This is because, they are somewhat riskier than general obligation bonds as they only rely on the revenue expected to be generated by the facility being built and secured by a specified source of revenue. The general obligation

bonds are backed by the full faith and credit of the issuing government and its taxing power, making it less risky thus offering the lowest yields.

4) A general obligation bond rated Aa issued by a city or a general obligation bond rated Aa by a county

A general obligation bond rated Aa issued by a city. This it is riskier than that issued by the county as it relies on few projects for its repayment. General obligation bonds issued by a county are less risky because they are secured by the county government hence less interest rate on the debt being issued, meaning less returns to the investor.

5) A municipal bond (term) with maturity in five years or a municipal bond (term) with maturity in 20 years.

A municipal bond with maturity in 20 years will attract high interest because the longer the credit period, the riskier the debt. This is due to the fact that the future is unknown and the longer the maturity period the higher the risk, hence the issuer has to pay higher interest to compensate for the risk being perceived.

References

Morse, D & Deely, C. (Nov. - Dec., 1983). Regional differences in municipal bond ratings. *Financial Analysts Journal*, 39(6), 54-59. Retrieved from <http://www.jstor.org/stable/4478699>