

6-1967

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Recommended Citation

Canter, Heloise Brown (1967) "Municipal Securities," *Woman C.P.A.*: Vol. 29 : Iss. 4 , Article 1.
Available at: <https://egrove.olemiss.edu/wcpa/vol29/iss4/1>

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MUNICIPAL SECURITIES

Heloise Brown Canter, CPA

Never, in this generation—actually not since the depression days of the 1930's have municipal bonds come so cheaply to the investor as they did during the latter part of 1966. It was the other side of the coin in the so-called 'tight money market' and investors with available cash found bargain basement buys in municipal securities. Many individuals, who prior to this time had planned their investment portfolio around common stocks, considered for the first time tax-exempt municipal bonds because of the high yield at which these bonds were being offered.

While municipal bonds are generally considered as second only to bonds of the United States in security, there are differences in the security behind the various types of municipal obligations. Municipal bonds include (1) general obligation bonds which are secured by the issuer's pledge of its full faith, credit and taxing power for the payment of the bond; (2) revenue bonds which are payable from the net revenues of a particular facility; and (3) special tax bonds which are payable only from the proceeds of a special tax. Within each of these areas there are also factors that should be considered when one is analyzing a municipal credit for consideration by a client or for one's own portfolio.

Ratings have assumed considerable significance in determining eligibility of bonds by certain types of investors such as trusts, commercial banks and insurance companies. Two of the major investment advisory services have a system of rating municipal bonds. Moody's Investors Service rates bonds of issuers which have \$600,000 or more of debt, with certain exceptions such as bonds of educational institutions, projects under construction, enterprises without established earnings records and situations where current financial data

is lacking. Their ratings are as follows:

- Aaa Best quality, carrying the smallest degree of investment risk
- Aa High quality
- A Higher medium grade, many favorable investment attributes
- Baa Lower medium grade, neither highly protected nor poorly secured
- Ba Have speculative elements
- B Generally lack characteristics of the desirable investments
- Caa Poor standing
- Ca Speculative in high degree
- C Lowest rated class

Standard & Poor's rates all governmental bodies having at least \$1,000,000 of outstanding debt as long as adequate information is available. Standard & Poor's ratings range from AAA (highest grade obligation) down to a C rating (defaults).

Also, in many of the states there are local organizations which assemble detailed financial information on municipalities within their respective states. These organizations render a valuable service to the municipalities in their state and to the investor.

However, there are many high quality issues available in today's market which are not rated because the outstanding indebtedness of the issuer is less than the minimum for which ratings are available or because adequate financial information was not available to the services to allow them to give a rating. Thus, it is to these situations that we direct our attention.

Statistical information may be derived from a number of sources. Your investment banker can be helpful in securing information for you or it may be available from Dun & Bradstreet.

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From this data, the accountant can prepare a municipal debt statement that can be used to analyze the debt structure of a specific muni-

cipal entity. The form of the debt statement can be presented as follows:

MUNICIPAL DEBT STATEMENT
(as of January 1, 1967)

1966 Actual Valuation of Taxable Property		\$27,443,469.00
1966 Assessed Valuation (33 1/3 % of Actual)		\$ 9,147,823.00
Total Bonded Debt		\$ 1,114,000.00
Less: Self-supporting Debt	\$206,000.00	
Less: Interest and Sinking Fund*	35,890.50	241,890.50
Net Bonded Debt		\$ 872,109.50
Plus: Floating Debt		0.00
Net Direct Debt		\$ 872,109.50
Ratio of Net Direct Debt to 1966 Assessed Valuation	9.54%	
Ratio of Net Direct Debt to Actual Valuation	3.18%	
Net Overlapping Debt		
County	\$ 223,763.00	
County Drainage District	19,314.00	
School District	1,141,921.00	1,384,998.00
Net Overall Debt		\$2,257,107.50
Ratio of Net Overall Debt to Assessed Valuation	24.6%	
Ratio of Net Overall Debt to Actual Valuation	8.2%	
Population 1960 Census	5,448	
Population 1966 Estimated	8,683	
Per Capita Net Debt on Basis of 1966 Population		\$100.43
Per Capita Assessed Valuation		1,053.53

* Other than self-supporting debt

The computations required in this form are relatively simple. However, some items listed may require additional discussion. For instance, to arrive at Net Bonded Debt on the above statement, you are allowed to deduct any indebtedness which is self-supporting (such as municipal utility revenue bonds). An additional deduction is allowed for Interest and Sinking Funds for other than the self-supporting debt that has been included.

Floating debt of a municipality which may become a charge against future tax levies must be added to the Net Bonded Debt to ascertain the Net Direct Debt of the municipality. Ordinary tax anticipation borrowing which is to be paid off during the current year is not included since taxes have already been levied to satisfy that obligation. However, bond anticipation notes or other items which will be a charge against future year tax revenues should be included.

The debt trend as indicated by whether the municipality's ratio of debt to assessed and

actual valuation has been progressively increasing or progressively decreasing furnishes a good indication to the fiscal policy of the taxing entity.

In some instances, the net direct debt of a municipality may be relatively small but the overlapping debt of the county or perhaps a drainage district may be extremely large. Therefore, the municipal debt statement should also give consideration to the net debt of continuous, underlying and overlapping units. Except for the special assessment debt, the amount of debt of each unit applicable to the reporting unit is arrived at (1) by determining what percentage of the total assessed value of the overlapping jurisdiction lies within the limits of the reporting unit, and (2) by applying this percentage to the total debt of the overlapping jurisdiction. Special assessment debt is allocated on the basis of the ratio of assessments receivable in each jurisdiction which will be used wholly or in any part to

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pay off the debt to total assessments receivable which will be used wholly or in part for this purpose. This overlapping debt figure, when determined, is entered on the statement and totaled with the net direct debt of the municipality to furnish the net overall debt.

The ratios determined by dividing the net overall debt by the assessed and actual valuation of real property in the municipality furnish a percentage estimate of the overall debt burden. It is difficult to name a percentage figure that could be used as a dividing line between the conservative and the too-high debt ratio. Conditions and resources in mu-

nicipalities differ so widely that a percentage of debt which might be an undue burden in one city might cause little difficulty in another. The average community, however, when the ratio of net overall debt to estimated actual valuation passes 10%, is usually considered to be getting out of the conservative class.

Additional information can be secured by placing the net debt and the assessed valuation of the community on a per capita basis. This is represented by the last two figures on our municipal debt statement.

Data on tax collections, which is available most often in the following form, affords an opportunity to analyze certain trends.

Tax Year	Assessed Valuation	Tax Rate	Tax Collections		Year Ending
			% Current	% Total	
1963	\$7,240,409	\$1.80	90.70	96.41	6-30-64
1964	7,596,508	1.80	91.28	99.41	6-30-65
1965	8,475,562	1.80	87.85	93.08	6-30-66
1966	9,147,823	1.80	(In Process)		

Conditions in communities are constantly changing. There can be population shifts, new businesses may enter, others may leave, with a resultant population change and a change in the municipality's credit rating. So in addition to the statistical figures covering valuations on taxable property, the determination of net over-all debt and the trend of tax collections, there will be other factors you will want to consider in analyzing a municipal credit. You will want to review the historical background of the community and its attitude to-

ward debt in prior years. You will want to know if the municipality has ever defaulted. If so, determine the reason for the default and the manner in which this was worked out with the bondholders. The integrity of its public officials and the strength of the local banks are both important factors to be considered. So too is the type of activity on which the municipality's prosperity is dependent. Obtain information on retail sales per capita, average wealth, average monthly rental of dwellings, etc. Chart utility connections, postal receipts, and bank deposits as follows:

Year	Water & Sewer	Gas	Electric	Postal	Bank
	Connections	Connections	Connections	Receipts	Deposits
1966	2406	2433	2751	\$85,955	\$8,365,823
1965	2310	2246	2689	81,455	7,899,096
1964	2217	2170	2770	75,736	7,735,828
1963	2145	2113	2667	64,259	7,470,648

Building permits can also give good statistical data on the prosperity of a community. Diversification of industry and/or agricultural crops in the area are important factors too.

Changes in the value of money in the general market cause changes in the investment yield that a purchaser of tax-exempt municipals demands for his money. Changes in the financial condition of the issuer of municipal

bonds may increase or lessen the risk involved in the investment.

When an investment program in municipal bonds, either for temporarily idle funds or of a long-term nature, is being considered, the accountant working in cooperation with the broker can be of material benefit to the investor.