WHY ARE MUNIS GETTING SUCH BAD PRESS?

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Municipal bond defaults are down even though most of the press lately has been negative when it comes to the municipal bond market. According to Richard Lehmann of the *Distressed Debt Securities Newsletter*, there were 72 issues totaling $2.5 billion in default in the year through November 2010. That is down from 204 issues totaling $7.3 billion for all of 2009 and from the record of 162 issues totaling $8.2 billion for 2008.

Municipal bankruptcies are down also. There have been five Chapter 9 filings so far in 2010, down from ten in 2009, according to James Spiotto, a partner at the law firm Chapman & Cutler LLP in Chicago. If you have been reading all of the news on how bad things are in municipal debt these days, you would have been as surprised as I was on hearing these figures. What is the municipal market telling us? I believe it is saying that governmental entities that make up most of the market are doing everything they can to repay their debts. Their ability to pay may have been compromised by the recession. Their willingness to pay is as strong as ever and that is what counts when tax revenue falls. The nation's states and municipalities have been cutting costs, firing employees, and raising taxes and fees in order to honor their commitments.

That should be reassuring to bondholders and all those investors who have been thinking about buying municipals and who have been barraged by speculation for the past two years that the market is on the verge of collapse. To be sure, the federal government's economic stimulus has helped. Most of that money remained with the states, where you shouldn't look for defaults. None of the 50 states has reneged on debt since Arkansas did during the Great Depression. Why are they so eager to make their debt payments? The result of not doing so — being shut out of the credit markets — would be catastrophic. And, as a November report by Fitch Ratings said, "Debt service is a relatively small part of most budgets, so not paying it does not do much to solve fiscal problems." States don't even think about defaulting on bonds.

The nation's cities and towns have been doing the cutting and paying their bills which include their debt service. Since August 2008, states have fired 39,000 employees, or 0.7% of the 5.2 million they carried at the peak of employment. Localities have fired 368,000 workers, or 2.5% of their peak number of employees, also reached in August 2008. By comparison, companies fired 8.5 million, or 7.3% of the 115.6 million they employed in December 2007. They have since hired back 1.1 million, according to the Bureau of Labor Statistics.

Remember, the last thing that local and state governments do is fire people. They exhaust every possibility before that step. It may be old-school thinking, but it's a good idea to pay off one's debts. In the municipal market right now, default and repudiation (refusal by public authorities to acknowledge a contract or debt) are very bad words. They are the reason for the creation of the bond counsel industry in the late 19th century, and why in the 20th century such things as outright, mass repudiation became all but nonexistent. Bond lawyers ensure that the borrowing done by states, cities, and towns is valid and complies with tax law. In other words, it's a lot harder now for municipalities to run out on their debts than it was in the 19th century.

As the old saying goes, there are only two things for sure in this world — death and taxes. If you are in a high tax bracket, municipal bonds deserve a second look.

Research and other statistical information mentioned in this article are provided by Bloomberg.