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# Municipal Bonds: A Sure Bet or Buyer Beware?

HARRISBURG, Penn. -- In the past, loaning money to governments has been one of the safest investments that could be made.

But in recent years, state and local governments have built up so much debt, it's throwing into doubt their ability to pay back investors who have loaned them money.

## Harrisburg's 'Incinerator'

Harrisburg, Pa., has less than 50,000 citizens, yet one-fourth of them are living in poverty. The city undertook a project to sell bonds to build and then retrofit a \$225 million incinerator. Officials thought the fees to use it would be a rich source of profit, but it hasn't been successful.

The debt from that project has put the small city on the brink of bankruptcy -- which would mean defaulting on payments to its municipal bond holders. Business people are angry with the city's politicians.

"The frustrating part is the elected officials have not taken any positive action to correct it and not come up with a plan that's going to address it," said Dave Black, president and chief executive officer of the Harrisburg Regional Chamber and Capital Region Economic Development Corp.

The city of Harrisburg is drowning in so much debt that it owes \$68 million in fees just to service its debt this year alone. The entire city budget is just \$65 million. That equals to about \$9,500 for every citizen in the city.

## A Warning Sign

Harrisburg's dire situation could be a warning sign to the nearly \$3 trillion world of municipal bond holders and investors.

"I think it is somewhat a sign of the times," Black said.

"A lot of municipalities are struggling in this economy," he added. "And it's across the board, large municipalities and small municipalities, and they all borrow."

Investor and entrepreneur Warren Buffett has warned of "a terrible problem" for state and municipal finances in the next five to 10 years.

"The amount of state and local debt has absolutely exploded over the last decade," said Chris Edwards, director of tax policy studies at the Cato Institute.

Economists like Edwards said muni-bond investors have to worry if governments will be able to pay them back.

"In the last decade state and local debt has more than doubled, up to about \$2.2 trillion," Edwards said. "So state and local governments are borrowing more than ever, and frankly they can't afford it."

## **City Bankruptcies: Rarity or Risky?**

Others aren't so concerned.

"Nineteen thousand cities and towns, if there are six or seven municipal bankruptcies in a given year, it's still a relative rarity," said Chris Hoene, director of the Center for Policy and Research at the National League of Cities.

Even with some defaults occurring, Hoene still supports muni-bonds.

"The big reason municipal bonds are a good investment is because they're safe -- because local governments aren't going out of business, right?" Hoene asked. "They're still going to be there. Even in the case of municipal bankruptcy, Harrisburg's still going to be there tomorrow."

Still, many local governments are facing serious problems, including the fact they've promised generous pensions to their 20 million public employees with little or no money saved to pay them.

"So all this debt and unfunded obligations are being pushed to the future," Edwards said. "So I think state and local finances are very risky."

## **Damaged Reputation**

Meanwhile, those who live and work around Harrisburg bemoan what their politician's free-spending ways have done to its reputation.

"It casts sort of a dark shadow on the entire region," Black said.

Though a citizen might still find a wonderful life in Harrisburg, investors need to worry about their money taking up residence in such cities during these times.

"We were named the second best place to raise a family by Forbes Magazine this year," Black said.

"They need to be a little more wary in this situation," Hoene said.

## **Taxed Out of Power**

Municipal bonds have historically been considered a safe investment, because governments have the power to have the power to tax -- so they could always pay bond investors back. But now these bonds are more of a gamble.

"Government taxing power isn't infinite," Edwards said. "We can see with some of these countries in Europe like Greece, they spend so much money, they're taxing their citizens so much already, that governments reach a tipping point. They simply can't tax anymore. And if that's the case, then they can't pay the bondholders back."

The sad fact is businesses go bust all the time -- so you can lose your investment in them. That's why municipal bonds have seemed like such a sure bet.

Cities and local governments don't go out of business. And they have the eternal power to tax to make sure you get your investment back.

But that's not such a sure bet anymore. Now, it's bond buyer beware.