SPFG
STRENGTHENING YOUR BONDS

COMMON BOND TERMS

Below are definitions of several bond terms referenced in our materials. For further questions, please contact your financial advisor.

- **Average Life -** On a bond with sinking funds, this denotes the average length of time that each principal dollar is expected to be outstanding. For a mortgage bond this is based on certain assumptions about prepayment speeds.
- **Basis Point -** One one-hundredth of one percent (.01%). Yield spreads are often quoted in basis points (bps). Example: 150 Basis points = 1.5%.
- **Callable Bonds -** Bonds that are redeemable by the issuer prior to the maturity date, at a specified price, typically at or above par.
- **Coupon -** The yearly rate of interest paid to the bondholder as a percent of the bond's face value.
- **Credit enhancement -** The use of the credit of a stronger entity to strengthen the credit of a weaker entity in bond or note financing. This term is used in the context of bond insurance, bank facilities and government programs.
- **Credit ratings -** Designations used by ratings services to give relative indications of credit quality.
- **Credit spread -** A yield difference, typically in relation to a comparable U.S. Treasury security or benchmark.
- **Discount Bond -** A bond sold at less than par (i.e. less than $100).
- **Duration -** The approximate effect that each 1% change in interest rates has on a bond's market value. Duration takes into account a bond's interest payments in measuring bond price volatility and is stated in years.
- **Face value -** The par value of a security, as distinct from its market value.
- **General Obligation(GO) -** A muni bond secured by the pledge of the issuer's full faith, credit & taxing power.
- **Issuer -** The entity obligated to pay principal and interest on a bond it issues.
- **Laddering -** A technique for reducing the impact of interest-rate risk and re-investment risk by structuring a portfolio with different bond issues that mature at different dates over a defined period of time.
- **Odd Lots –** Usually refers to block of bonds of $100,000 or less.
- **Par -** Price equal to the face amount of a security (face value price is typically $100).
- **Premium Bond -** Bonds priced greater than par (i.e. greater than $100).
- **Principal -** The face amount of a bond, exclusive of accrued interest and payable at maturity.
- **Revenue Bond -** A municipal bond secured with dedicated revenues generated by a specified entity associated with the purpose of the bonds. Examples include water & sewer, utilities, univerisity projects, ports, and various revenue streams.

- Risk - A measure of the degree of uncertainty and/or of financial loss inherent in an investment or decision. There are many different risks, including but not limited to:
    - *call risk* - The risk that declining interest rates may accelerate the redemption of a callable security, causing an investor's principal to be returned sooner than hoped. As a consequence, investors may have to reinvest their principal at a lower rate of interest.
    - *credit risk* - The risk that the issuer of the bonds will be unable to make debt service payments due to a weakening of their credit.
    - *reinvestment risk* - The risk that future cash flows – either coupons or the final return of principal – will need to be reinvested in lower-yielding securities. Shorter duration bonds carry higher reinvestment risk.
    - *market risk* - Potential price fluctuations in a bond due to changes in the general level of interest rates. Longer duration bonds carry greater market risk.
- Sinking Fund - a type of redemption provision whereby an issuer must redeem (call away) a certain percentage of a bond issue at specific dates prior to final maturity. From an investor's standpoint, this can be viewed as a partial call, typically at par (100 price).
- Taxable Municipal Bond - A municipal bond whose interest is taxable for federal income tax purposes. These are useful in accounts with no (or low) tax liabilities, such as retirement accounts.
- Tax-Exempt Bond - A municipal bond in which the interest on the bond is tax-exempt for federal income tax purposes. Municipal bonds that are also exempt from state and local as well as federal income taxes are said to have double or triple tax exemption.
- Yield - refers to the earnings generated and realized on an investment over a particular period of time, and is expressed in terms of percentage based on the invested amount or market value. There are a few types of yield calculations:
    - Current yield – The ratio of the coupon to the actual market price of the bond, stated as a percentage. This is useful for showing yearly cash flow but not relative value between two bonds.
    - Yield to Call (YTC) – The yield calculation assuming that interest is paid until the the bond is called (and principal is repaid) on the next call date.
    - Yield to Maturity (YTM) – the yield calculation assuming that the interest is paid until maturity, upon which principal is repaid. This metric does not adjust for call provisions.
    - Yield to Worst (YTW) – This is the lower of the YTM and YTC. *This is the best metric for bond comparisons, as it shows the worst-case yield (assuming the bond does not default) including call provisions.*
- Zero-Coupon Bond - A bond which does not make periodic interest payments; instead the investor receives one payment, which includes principal and interest, at redemption (call or maturity).