Municipal Bonds 101: Par, Discount and Premium Bond

By Brent Sheehan, Summer 2020

One Rockefeller Plaza
12th Floor
New York, NY 10020
Phone: (212) 332-1600
Fax: (212) 332-1601
www.16thAdvisors.com

A bond's price is what investors are willing to pay for an existing bond. A bond price is usually represented as a percentage of par value. For example, if a bond has a par of $1,000 and is sold for $1,000, the price is published as $100.00. If a bond has a par value of $1,000 and is sold for $950 then that price is published as $95.00. If a bond is priced at $100.00, that bond is considered priced at Par. If a bond is priced at $95.00, that bond is priced at a discount. And if a bond is priced at $102.00, that bond is priced at a premium.

PAR BONDS

When a bond is purchased at par value $1,000 at $100.00 (**TABLE 1**) per bond, the bond will not have any capital gains at maturity. If the bond is sold prior to maturity and there is a change in its value, the investor may be subject to a taxable capital gain or loss as with any other investment.

DISCOUNT BONDS

A market discount bond is a bond that is selling in the secondary market at a discount price to par. A market discount price would occur when the yield on the bond has risen since the bond was issued. For example, if a bond were issued at par with a 4.00% coupon and subsequently the yield on that bond rose to 4.05% with a secondary price of $95.00 (**TABLE 1**), this bond would have 5 points of market discount. If the bond were originally issued at a discount (an "OID") the market discount would be the discount below the accreted OID price at the time of purchase. If the bond were originally issued as an original issue premium, the market discount would be the discount below par. If an investor were to purchase a market discount bond in the secondary market, the investor would be taxed on the accretion of the market discount. The accrued market discount is the price change that would occur as the bond approached maturity if the bond yield stayed the same as when it was purchased. (Please refer to 16th Amendment Advisors Memo regarding Market Discount Bonds for further detail on discount bonds and the possible tax consequences of purchasing market discount bonds).

PREMIUM BONDS

A premium bond is a bond that is selling in the secondary market at a premium price to par. A premium price would occur when a bond yield drops since the bond was originally issued. For example, if a bond were issued at par ($100.00) with a 4.00% coupon and subsequently the yield on that bond dropped to 3.95% with secondary price of $105.00 (**TABLE 1**), this bond would have 5 points of market premium. The amortization of the premium on a bond priced above par is not considered a capital loss. There would only be a capital loss (gain), however if the bond were sold prior to maturity at a price below (above) its amortized value.

TABLE 1

ILLUSTRATION: PAR, DISCOUNT AND PREMIUM BONDS

BOND TYPE	YIELD	BOND PRICE
Discount Bond	4.05%	$95.00
Par Bond	4.00%	$100.00
Premium Bond	3.95%	$105.00