What a Bond Actually Is

Read a bond's terms, compare the main types and how they are taxed, and weigh credit rating against yield.

Name: _____ Date: _____

OBJECTIVE
Identify the parts of a bond, calculate its interest payments, compare Treasury, municipal, and corporate bonds, and explain why lower-rated bonds must pay higher yields.

1. Read the bond

This is a made-up bond, but its terms are written the way a real one is described.

BOND SUMMARY
Riverbend County School District, General Obligation Bond

Face value: $5,000 · Coupon: 3.5%, paid twice a year · Matures: June 1, 2036 · Credit rating: AA

Question	Answer
Who is borrowing the money (the issuer)?	
How much interest does it pay per year?	
How much is each twice-a-year payment?	
What does the investor get back on June 1, 2036?	
What type of bond is this?	
Is AA a strong or weak credit rating?	

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2. Four families of bonds

Read the table, then rank the risk of not being paid back: 1 = lowest, 4 = highest.

Type	Who borrows	How interest is taxed	Risk rank
U.S. Treasury	The federal government	Federal tax, but no state or local tax	___
Municipal	States, cities, counties, school districts	Usually no federal tax; often no state tax in-state	___
Investment-grade corporate	Companies rated BBB or higher	Federal, state, and local tax	___
High-yield ("junk") corporate	Companies rated below BBB	Federal, state, and local tax	___

Why might a person in a high tax bracket prefer a municipal bond that pays a lower rate than a corporate bond?

3. Rating vs. yield

Four 10-year bonds, all with a $10,000 face value. Ratings run from AAA (strongest) down through BBB (lowest investment grade) to B and below (high-yield).

Bond	Rating	Yield	Interest per year on $10,000
U.S. Treasury	Backed by the U.S.	4.0%	_____
Corporate A	AAA	4.6%	_____
Corporate B	BBB	5.4%	_____
Corporate C	B	7.9%	_____

a) How much more per year does Corporate C pay than the Treasury? _____

b) The extra yield over a Treasury is called the spread. What is the spread on Corporate B? _____ percentage points

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c) What is an investor being paid extra for when they choose Corporate C?

4. Hold or sell?

An investor buys a $1,000 bond and plans to hold it until it matures. A year later, interest rates rise and the bond's market price drops to $940. If the issuer does not default, how much does the investor get back at maturity, and did the price drop actually cost them anything?

DISCUSS

Stocks have historically earned more than bonds over long periods. Why might someone a few years from retirement still choose to hold a large share of bonds?

STANDARD NOTE

SSEPF3 asks students to evaluate the risk and return of savings and investment options, and bonds appear on the core worksheet's risk-return ladder. This Level 2 sheet opens up that one rung: what a bond is, how the main types are taxed, and how credit risk sets the price of borrowing.