International City/County Management Association
National Association of Counties
National League of Cities
U.S. Conference of Mayors
Government Finance Officers Association
National Association of State Auditors, Comptrollers and Treasurers
National Association of State Treasurers
American Public Gas Association
American Public Power Association
Council of Development Finance Agencies
Council of Infrastructure Financing Authorities
Education Finance Council
International Municipal Lawyers Association
Large Public Power Council
National Association of College and University Business Officers
National Association of Health & Higher Education Facilities Authorities
National Association of Local Housing Finance Agencies
National Association of School Administrators
National Council of State Housing Agencies
National School Boards Association
Bond Dealers of America
Investment Company Institute
National Association of Bond Lawyers
National Association of Independent Public Finance Advisors
Securities Industry and Financial Markets Association

April 23, 2012

The Honorable Max Baucus
Chairman, Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Orrin Hatch
Ranking Member, Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Chairman Baucus and Senator Hatch:

The state and local government associations and other organizations listed above representing participants involved in the municipal bond market, commend you for holding a hearing on the impact of tax reform proposals on state and local governments. Our associations look forward to testifying in future hearings as government representatives and market participants. This submission is limited to a discussion of the importance of tax-exempt bonds. We urge Congress' continuing support and commitment to tax-exempt bond financing in recognition of the critical role it plays in the ability of state and local governments to fund national priorities, particularly infrastructure.

Maintaining the tax-exempt status of municipal bonds is essential to help our national economy grow, create jobs, and best serve the constituencies of every community. Three-quarters of the total United States investment in infrastructure is provided by state and local governments, and tax-exempt bonds are the primary financing tool used by over 50,000 state and local governments to accomplish these infrastructure goals.

Our citizens and communities benefit in many ways from the issuance of tax-exempt bonds. They are used to build and maintain elementary and secondary schools, as well as colleges and universities, which help develop an educated workforce. They are used to build our roads and airports, all of which are essential for supporting commerce. They address the country's water infrastructure, electric utility and affordable housing needs. Tax-exempt bonds also finance public safety infrastructure that ensures local and national security. Nearly four million miles of roadways, 500,000 bridges, 1,000 mass transit systems, 16,000 airports, 25,000 miles of intercoastal waterways, 70,000 dams, 900,000 miles of pipe in water systems, and 15,000 waste water treatment plants have been financed through municipal bonds. (National League of Cities)

States and localities determine if bonds should be issued to meet the needs of their citizens, generally through a vote by elected officials or through voter referenda. Placing the decision-making at the state and local levels ensures effective resource allocation and avoids inefficient decisions due to federal bureaucracy, cumbersome grant programs, earmarking and similar processes. An extensive federal legislative and regulatory regime exists under the Internal Revenue Code to ensure that tax-exempt bonds are used properly.

State and local governmental bonds have been issued since the mid-1800s, and the federal tax exemption was included in the country's income tax code since its promulgation in 1913. Through the tax-exemption, the federal government continues to provide critical support for the development and maintenance of essential facilities and services, which it cannot practically replicate by other means. Without the tax-exemption, state and local governments would pay more to raise capital, a cost that ultimately would be borne by taxpayers, through reduced infrastructure spending, decreased economic development, higher taxes or higher user fees.

The ability to sell bonds with interest exempt from federal income taxes reduces the interest paid for borrowed funds by approximately 25 percent (SIFMA). Tax-exempt bond issuance has remained stable compared to GDP over the past 10 years, averaging around 14.8%, and has actually declined since the 1980s. State and local governments are not overextended in debt. In fact, debt service is typically only about 5% of the general fund budgets of state and municipal governments. The tax-exemption represents a fair allocation of the cost of projects between the federal and state/local levels of government. State and local borrowers are responsible for repaying the principal and interest on a bond. The federal contribution is provided in the form of theoretically foregone tax revenue and represents an important, but relatively small portion of total project costs. As a result, the federal contribution is significantly leveraged.

Municipal bonds offer a healthy investment for American families in America's communities. Seventy percent of municipal bonds are held by individuals, directly or through mutual funds (Thompsen Reuters). Investors choose to purchase municipal bonds, even though the investment return is less than if they purchased corporate or other taxable bonds, because the tax-exemption results in an equivalent after-tax benefit. Furthermore, as a class of investment, all investment grades of municipal bonds have proven to be safer investments than AAA corporate bonds (Municipal Market Advisors).

Our experience informs that tax-exempt financing is a well-established market providing a cost-effective mechanism for financing infrastructure and meeting needs of our citizens. Any changes that would replace, compromise, dampen or eliminate tax-exempt financing immediately or retroactively, particularly those offered as deficit reduction alternatives, should be carefully and cautiously analyzed by the committee.

Thank you again for the opportunity to comment on this important issue. We look forward to continuing conversations with you and your staff about these important issues.

Sincerely,

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