February 26, 2015

Senator Dean Heller
Senator Michael F. Bennet
Community Development & Infrastructure Tax Reform Working Group
Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Chairman Heller and Chairman Bennet:

As you weigh policy alternatives to improve the nation's federal income tax system as it relates to community development and infrastructure, we, the undersigned members of the Municipal Bonds for America Coalition (MBFA), write in strong support of the current law tax-treatment of municipal bonds.

State and local governments build the vast majority of our nation's core infrastructure: the roads, highways, and bridges; public transportation; seaports and marine terminals; airports; water and wastewater facilities; schools; acute care hospitals; multi-family housing; libraries; parks; town halls; electric power and natural gas facilities and supply for publicly-owned utilities; and other public projects that make commerce possible and our communities livable. Tax-exempt municipal bonds are how we finance these investments. In fact, tax-exempt municipal bonds financed $1.7 trillion in new infrastructure investments in the last decade.

It is no exaggeration to say that bonds build America.

Interest paid on a municipal bond is generally exempt from federal income tax (just as interest paid on Treasury bonds is exempt from state and local tax). This exemption dates to the 1800s and was incorporated into the modern income tax when it was created in 1913. Qualified private activity bonds are a type of municipal bond that finances certain qualifying public-private projects or other qualifying uses, such as state-based student loan programs. Interest on qualified private activity bonds is exempt from the federal income tax, but subject to the Alternative Minimum Tax.

The financial strength of bond issuers coupled with the stability of the bond market and the federal tax exclusion of bond interest reduce borrowing costs for state and local governments. Projects financed with municipal bonds over the last decade cost $495 billion less than if they had been financed with taxable debt. Lower borrowing costs for bond-financed projects allow for greater investment, reduce tax and utility rates for residents, and help create jobs and economic growth. Alternatives to bond financing exist, but each has substantial shortcomings, predominantly increased cost of borrowing. So, while these could supplement bond financing, they could never replace bond financing.

Generally, bonds are approved by voter referendum or an affirmative vote of a governmental body (a city council, county council, utility board, or the like) and principal and interest on these bonds are paid by state and local residents. As a result, while the federal debt continues to grow, state and local debt has remained stable. Moreover, the 40-year default rate for municipal bonds is 0.13 percent (by comparison the 40-year default rate for comparably-rated corporate bonds is 11 percent).

Finally, about 72 percent of bond interest is paid to individuals, either directly or through mutual funds and similar investment vehicles. About 60 percent of household bond income goes to investors over the age of 65; and about half of household bond income goes to investors with incomes of less than $250,000. Households purchase bonds because of the stability of the municipal bond market and the safety of the investment. The federal exemption of municipal bond interest protects this income from federal tax. However, investors accept a lower rate of return on these bonds in exchange for the benefit of the tax exemption—reducing or eliminating any tax "windfall." The 28 percent of bond interest that isn't paid to households is paid to U.S. businesses, indirectly benefiting American households by providing a steady and safe source of income to property & casualty and life insurance companies.

In conclusion, state and local governments have issued municipal bonds for centuries to help build our communities and our economy; municipal bonds are a safe, reliable, and stable investment for millions of Americans; and, just as state and local governments should not—and could not—shift their costs by taxing federal bonds, the federal government should not try to shift its costs to state and local governments—and our state and local residents—by imposing an unprecedented tax on municipal bonds.

We welcome the opportunity to discuss this issue further, including opportunities to simplify and improve the tax code's treatment of municipal bonds. For more information please contact Steve Benjamin, Mayor of the City of Columbia, South Carolina, and MBFA Chairman, at skbenjamin@columbiasc.net.

Sincerely,

American Public Gas Association

American Public Power Association

American Public Transportation Association

Airports Council International—North America

African American Mayors Association

Bond Dealers of America

Council of Development Finance Agencies

Education Finance Council

Large Public Power Council

National Association of Bond Lawyers

National Association for County Community and Economic Development

National Association of Local Housing Finance Agencies

National Council of State Housing Agencies

Southern California Public Power Authority

Cc: Senator Dan Coats
Senator Maria Cantwell
Senator Tim Scott
Senator Bill Nelson