Comments of the

Municipal Bonds for America Coalition

to the

U.S. House Ways and Means Committee

Hearing on How Tax Reform Will Grow Our

Economy and Create Jobs

(Submitted May 22, 2017)

The Municipal Bonds for America Coalition[1] (MBFA) appreciates the opportunity to comment on how reform of the federal income tax system may affect the economy and employment. MBFA is a non-partisan stakeholder coalition including municipal bond issuers, state and local government officials, and regional broker dealers working together to explain the many benefits of municipal bonds. We strongly believe that the more than 100-year old tax exemption of municipal bond interest has allowed state and local governments to build and maintain vital infrastructure projects at the lowest cost. State and local governments use municipal bonds to finance roads, bridges, schools, hospitals, airports, sewers, affordable housing, utilities, and other public projects. These investments make commerce possible and our communities livable.

In the last decade alone, state and local governments have made approximately $2 trillion in bond-financed infrastructure investments.[2] State and local governments build nearly three-quarters of the nation's core infrastructure, utilizing low-cost borrowing in the tax-exempt bond market to provide a large majority of the financing. As a result, to ensure that tax reform grows our economy and creates jobs, it is vital that it not impose an unprecedented federal tax – in any form – on these investments.

Bonds Build America

State and local governments have issued tax-exempt municipal bonds for more than 200 years to finance construction and maintenance of public facilities and infrastructure. 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. Capital investments financed with municipal bonds build communities and grow our economies. In 2015, state and local governments issued roughly $400 billion in municipal bonds. Of those issuances: about $85 billion financed repair and construction of primary and secondary schools; $39 billion financed investments in community colleges, colleges, and universities; $50 billion financed investments in roads, bridges, ports, airports, mass transit, and other transportation facilities; $38 billion financed water and sewer investments; $27 billion financed hospitals

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[1] A full list of MBFA coalition members joining in these comments are listed, along with contact information for the MBFA, at the end of these comments.
[2] "Bond Buyer Thomson Reuters 2016 yearbook," Feb. 2016.

and clinics; and $18 billion financed electric power utilities. These bonds also financed bridge repairs, convention centers, police and fire stations, solid waste facilities, seaports, flood control, libraries, and museums. These are the investments that make commerce possible and our communities strong and livable.

One type of municipal bond is a qualified activity bond (also known as a private activity bond, a qualified facility bond, or Alternative Minimum Tax bond), which is used to finance certain qualifying public-private projects or other qualifying uses. These bonds allow state and local governments to join with the private sector to best achieve project and program goals. In 2015, about $8 billion of these bonds were issued to finance transportation-related investments (airport terminals, toll roads and bridges, ports and the like). Another $6.7 billion financed affordable rental housing properties, and $4.6 billion financed affordable mortgages for working families. In addition, $700 million helped finance state and local government student loan programs. Qualified activity bonds also provide critical financing to non-profit hospitals and schools ($1 billion in financing to non-profit schools alone), and support community and economic development – with roughly $250 million in industrial development, farm, and related bonds issued in 2015. Qualified activity bonds are exempt from federal income tax, but can be subject to the alternative minimum tax (AMT).[3]

There is overwhelming consensus that for the foreseeable future there will be substantial and sustained demand for the sorts of infrastructure investments financed with municipal bonds. A failure to make these investments could have significant negative economic consequences. The American Society of Civil Engineers estimates that by 2025 insufficient infrastructure investments will lead to a $3.9 trillion decline in GDP; $7 trillion in lost business sales; and 2.5 million in lost jobs. [4]

Policymakers are looking for innovative ways to finance these investments, or to spur investments by privatizing some of these public facilities. These could be helpful at the margin – a complement to bond-financed projects. However, policymakers should not lose sight of the fact that state and local governments financed approximately $2 trillion in new infrastructure investments in the last decade and will invest $2 trillion to $3 trillion more over the next decade. They did so with the support of state and local residents (roughly 82 percent of bond referenda in the last election were approved) and while controlling overall debt (in real dollars and as a percentage of GDP, state and local borrowing has actually declined in the last decade).[5]

<u>No Better Alternative</u>

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[3] Qualified hospital facility, 501(c)(3), residential rental, and mortgage revenue bonds are private activity bonds, but are not subject to the AMT.

[4] American Society of Civil Engineers., *Infrastructure Report Card*, (pg. 4). 2017.

[5] Board of Governors of the Federal Reserve System, Data Download Program,https://www.federalreserve.gov/datadownload/Choose.aspx?rel=Z.1 (providing access to historic state and local financial data from the Financial Accounts of the United States reports (Table L. 107, State and Local Governments)); OFFICE OF MANAGEMENT AND BUDGET, "Budget of the U.S. Government, Fiscal Year 2017, Historical Tables" (Feb. 9, 2016)(providing figures for annual Gross Domestic Product(GDP) and GDP (Chained) Price Index).

It is a given that a tax on municipal bond interest will increase state and local borrowing costs. That would mean state and local governments making fewer investments for much needed infrastructure and/or passing these higher costs onto state and local residents.

Alternatives to tax-exempt bond financing exist, but each has substantial shortcomings—predominantly increased borrowing costs, increased complexity, and a lack of access to capital for smaller issuers. In the case of public-private partnerships, where a for-profit company operates or maintains a project after construction is completed, the ability to provide an ongoing equity-like rate of return to the company's investors or partners must be considered, as well. While alternatives could supplement tax-exempt bond financing, they do not replace bond financing.

Similarly, some suggest that a surtax on bond interest could raise revenue for the federal government without increasing the interest rate demanded by bond buyers and impose additional taxes on the wealthy. Such a surtax (or "cap") would reduce the value of *all* bonds in the secondary market by as much as $200 billion.[6] About half of this loss would fall on households with income of *less* than $250,000.[7] It would also disproportionately hurt seniors. About three-fifths of bond interest paid to individuals is paid to those aged 65 years and older, and 84 percent is paid to those aged 55 and older.[8]

This cap/surtax would also increase the cost of borrowing when state and local governments seek to issue a new bond. Investors will demand a higher rate of return:

- To accommodate this new surtax;
- To reflect the bond's loss of value in the secondary markets; and
- To compensate for the risk that Congress will expand the tax to hit more bondholders, increase the tax rate imposed, or both.

The real-world example of qualified activity bonds, most of which are subject to the AMT, proves this point. The AMT is, effectively, a surtax beyond the regular income tax that is paid by taxpayers above a certain minimum income level—similar to the "cap" or limits being proposed by some lawmakers for municipal bonds. And, in fact, a qualified activity bond typically costs issuers as much as 50 basis points (0.5 percentage points) more in interest rates than a similarly rated municipal bond. Take, for example, Dallas/Fort Worth International Airport, which under tax law must use qualified activity bonds to finance its massive Terminal Improvement Project. The qualified activity bonds (subject to the AMT) financing $3.1 billion of this project are costing $268 million more than if they'd been issued as fully tax-exempt municipal bonds. And yet, the Treasury derives no benefit, because investors who actually pay the AMT avoid these bonds.

Conclusion

MBFA strongly encourages the Committee to support tax-exempt municipal bonds, including qualified activity

6 Michael Kaske, Tax Cap Threatens $200 billion Muni Loss, Citigroup Says, Bloomberg, Dec. 7, 2012 (reporting analysis that limiting the tax value of the exclusion for municipal bond interest will reduce the value of existing bonds in the secondary market); Brian Chappatta, Tax-Status Threat Fuels Worst Losses Since Whitney: Muni Credit, Bloomberg, Dec. 21, 2012.
7 Internal Revenue Service, Statistics of Income—2012: Individual Income Tax Returns, (Publication 1304 (Rev. 08-2014)) at 40 (2012) (showing that 48 percent of bond interest paid to individuals is paid to households with income of $250,000 or less).
8 Id. at 73.

bonds. The investments financed with these bonds have a proven track record to help our economy grow and create jobs. Conversely, a tax – in whole or in part – on these investments would hurt economic growth and job creation.

Municipal Bonds for America coalition members joining in these comments include:

African American Mayors Association

American Public Power Association

Bond Dealers of America

Capital Edge

Court Street Group

Education Finance Council

Investment Company Institute

Large Public Power Company

National Council of State Housing Agencies

National Development Council

National League of Cities

National Water Resources Association