Comments of the Honorable Stephen K. Benjamin
Mayor of Columbia, South Carolina

On behalf of Municipal Bonds for America

House Committee on Ways and Means Working Groups

Debt, Equity and Capital Working Group
Financial Services Working Group
Charitable/Exempt Organizations Working Group

April 15, 2013

Municipal Bonds for America (http://munibondsforamerica.org/) is a non-partisan coalition of municipal bond issuers, state and local government officials and other municipal market professionals working together to explain the benefits of the tax-exempt municipal bond market, which provides the bulk of the financing for building core infrastructure throughout the United States. A list of our coalition members is in Appendix A at the end of our testimony.

I serve as Mayor of the City of Columbia, the capital of South Carolina and home of the University of South Carolina and Fort Jackson, the army's premier training base. Like many cities, Columbia faces the dual challenges of maintaining and upgrading aging infrastructure that is vital to health, safety and our local economy and building new infrastructure to accommodate population and economic growth. Federal mandates and dwindling federal grants add to these challenges. I also sit on the Executive Committee of Municipal Bonds for America.

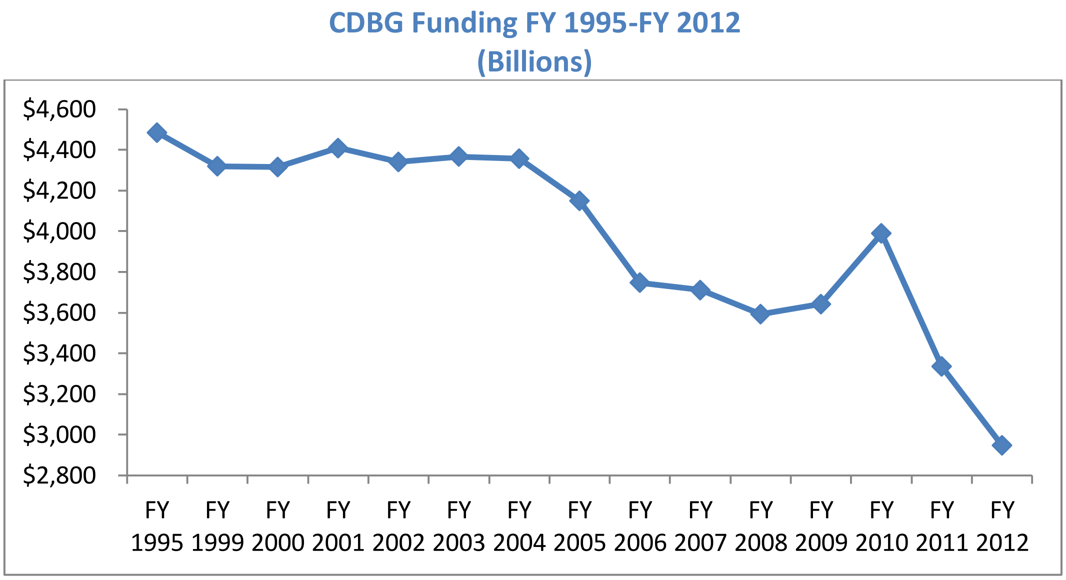
Tax exempt municipal bonds provide our nation with a stable, flexible and successful tool for financing infrastructure. Municipal Bonds for America urges the Committee to recognize their centrality to our nation's infrastructure investment and the impact that capping or eliminating the tax exemption would have on core infrastructure, state and local government budgets, state and local taxpayers, utility rate payer and investors.

In an era of federal austerity and budget stalemate, state and local governments are making most infrastructure investments, largely with tax-exempt municipal bonds.

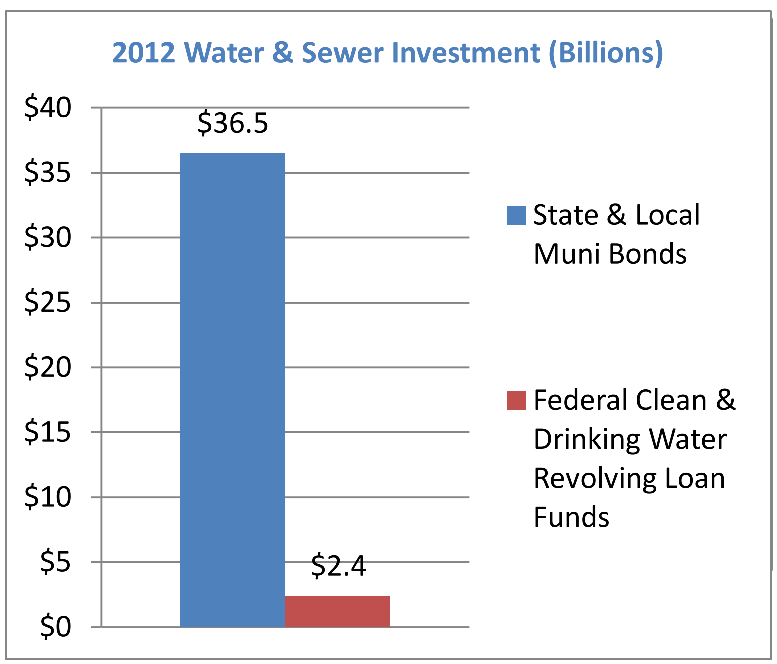
The era of fiscal cliffs, debt ceiling showdowns and budget stalemates in Washington has many Americans wondering whether our government institutions are equipped to tackle the major issues of our day. However, at the state and local level, government continues to accomplish the routine tasks we often take for granted: sanitation, patrolling city streets, responding to fires and other emergencies, inspecting buildings and educating our children. While Washington holds hearings, fights ideological battles about infrastructure funding sources and otherwise wrings its hands about our nation's aging infrastructure, state and local governments are also taking the lead in infrastructure investment, creating jobs and laying the foundation for future prosperity by building, renovating and maintaining the core infrastructure that serve as the backbone of civilized society and are essential to our economy, public safety and, most importantly, public health: schools, hospitals, airports, roads, affordable housing, bridges, highways, transit and water and wastewater systems.

I and most of my fellow state and local leaders are therefore increasingly concerned, if not alarmed, about proposals that would cap or even eliminate the primary tool that state and local governments use to finance these basic infrastructure investments: tax-exempt municipal bonds. In an era of ever-increasing federal mandates on local governments and increasingly scarce federal grants, capping or removing the tax exemption for municipal bonds would make little sense. Indeed, with the federal government facing tight discretionary spending caps for the foreseeable future and the Highway Trust Fund and other "off-budget" infrastructure trust funds suffering from dwindling reserves and stagnant or declining revenues, capping or eliminating the tax exemption for municipal bonds would essentially signal a federal divestment in infrastructure.

One need look no further than the Community Development Block Grant, which states and cities use to upgrade infrastructure in low- and moderate-income neighborhoods, for evidence of how federal grants for infrastructure have dried up. Congress and successive Administrations have cut funding for this vital block grant by 34 percent since FY 1995. These cuts are even more severe when measured for inflation and population increase: *Congress would have to increase funding by 270 percent to bring funding back to where it was in 1978!*



Similarly, federal funding for water and wastewater infrastructure has fallen from over 70 percent of such investments in the 1970's to a negligible share today. The federal funding that remains available for water and wastewater infrastructure investments comes mostly in the form of loans and is accompanied by so much paperwork and red tape that most utilities prefer to go to the bond market to finance improvements. This decline has been accompanied by increasingly stringent clean water mandates that place the burden of achieving our nation's clean water goals almost entirely on cities and their utility ratepayers.



Tax–exempt municipal bonds provide a stable, safe and flexible tool for financing core infrastructure investments; critics of the tax exemption fail to offer a realistic alternative.

Tax-exempt municipal bonds are a stable, flexible and successful financing tool that are among the safest securities in the world; the default rate on investment grade municipal bonds is less than 0.1 percent. (The rare municipal default garners such broad and intense media coverage *because* of the rarity of such defaults.) The tax exemption for municipal bonds dates to the creation of the income tax. Its elimination would break a century-old commitment to local governments, the public and investors. It makes little sense to break this commitment in an era of ever-increasing federal mandates on local governments and increasingly scarce federal grants.

The arguments against the tax exemption suffer from significant flaws. In arguing that the tax exemption only benefits high-income taxpayers, critics fail to recognize that the tax exemption broadly benefits every American in the form of basic infrastructure, lower state and local taxes and lower utility rates. Other critics fail to appreciate the centrality to our economy and to public health and safety of state and local investments in water, wastewater, transportation and other core infrastructure. Most importantly, none of the proponents of eliminating or capping the exemption offer a realistic replacement to pay for basic infrastructure investments in a manner that does not burden state and local taxpayers and utility ratepayers with crippling tax and rate increases.

As illustrated above, we are in an era of federal budget austerity. While grants may be an efficient means of assisting state and local infrastructure investment, state and local governments clearly cannot count on them.

Similarly, while Build America Bonds and other direct subsidy and tax-credit bonds are a good complement to traditional tax-exempt municipal bonds, they would be a poor replacement for numerous reasons:

- They have a narrower market than traditional municipal bonds,

- Programs to date have been too small to meet our nation's infrastructure needs,
- Their underwriting costs are more expensive than traditional municipal bonds, making them a poor choice for small issuers; and
- In the case of direct subsidy bonds, sequestration has eaten into the subsidy, creating mid-year budget difficulties for many issuers.

The majority of taxpayers who report tax-exempt interest have annual adjusted gross incomes of less than $250,000. In addition, everyone in the community benefits from the infrastructure investments made with municipal bonds. And, the tax exemption lowers local government borrowing costs. Capping or eliminating the tax exemption for municipal bonds would:

- Lead to rate and tax increases that would disproportionately impact low- and moderate-income households,
- Delay or reduce much-needed investments in core infrastructure,
- Rob us of tens of thousands of solid middle class jobs and
- Eliminate an important investment tool for millions of middle class households and retirees.

The cost of capping or eliminating the tax exemption for municipal bonds on state and local governments is real and significant.

Although variable over time and dependent upon market conditions, the yield investors receive from municipal bonds can be as much as 200 basis points lower than what they would receive on a taxable bond. But, because of the tax benefit, municipal bonds become a comparable investment, allowing state and local governments to borrow at a lower rate, saving billions of taxpayer dollars. In addition, the cost to the federal government for not taxing these investments is insignificant compared to the jobs they create and sustain and the overall benefit that tax-exempt bonds provide for citizens in every community.

The City of Columbia provides a good example. In the next decade, our capital improvement plan will require the City of Columbia to issue well in excess of $500 million in bonds. Removing or capping the tax exemption for municipal bonds would increase our borrowing costs significantly, an increase that would impact our taxpayers and utility ratepayers directly.

According to a study by the Government Finance Officers Association (GFOA), in 2012, capping the tax exemption for municipal bonds at the 28 percent tax bracket as the Administration has proposed would have increased our borrowing costs by $2.1 million or 15 percent. Limiting the tax exemption would have increased our borrowing costs that year by $6.2 million or 42 percent. Either way, that is a big hit on a city with an annual budget of approximately $100 million! More information about the impact of capping or eliminating tax-exempt bonds is available in Appendix B.

Simply put, if either proposal were enacted, we would have to choose between delaying needed investments or pushing these higher costs on to our taxpayers and ratepayers. (On water and sewer, where we must meet federal mandates, *we would have no choice: we would have to pass those higher costs on to ratepayers.* It is important to note that none of these costs take pending EPA stormwater rules into account; when finalized, those rules are expected to place hundreds of millions of dollars of unfunded mandates on local governments.)

State and local governments and their agencies use tax-exempt municipal bonds for a wide variety of public purposes, and these include qualified private activity bonds.

Questions have recently been raised by Ways and Means Committee members about why one class of tax-exempt bonds – qualified private activity bonds – are sometimes used for privately owned projects. Some infrastructure facilities that meet public needs are operated by private companies, or benefit in other ways from private investments or public-private partnerships. For example, some cities run their own water and sewer authorities while others find private operators more beneficial. In such instances, a qualified private activity bond may be used to finance the facility.

Qualified private activity bonds must meet strict requirements in the Code in order to qualify for a tax exemption, and are also subject to public hearing and approval requirements, bond volume caps and other significant restrictions. These bonds must finance specifically prescribed public purposes such as airports, water-supply systems, waste disposal, residential mortgages, student loans, and expenditures of hospitals and educational institutions, just to name a few.

One example of the use of tax-exempt private activity bonds to achieve a public purpose while meeting strict, Congressionally mandated criteria is in the area of affordable housing. Local Housing Finance Agencies, and their state agency counterparts, use tax-exempt Mortgage Revenue Bonds to provide mortgage assistance to first-time homebuyers. In addition to being a first-time homebuyer, borrowers must have incomes no greater than 115% of the area median for households of three or more persons or 100% of median income for households with less than three persons. The homes must have a purchase price no greater than 90% of the average area purchase in the area where it is located. HFAs also issue tax-exempt multifamily housing bonds and Low-Income Housing Tax Credits to finance construction and preservation of affordable rental housing in order to stimulate construction and substantial rehabilitation of rental housing meeting certain targeting requirement set forth in the Internal Revenue Code. Local HFAs use these programs to stabilize and improve neighborhoods through homeownership, promoting new affordable housing construction, stimulating housing rehabilitation and home improvements.

Conclusion: Tax-Exempt Municipal Bonds Are the Essential Tool to Finance State and Local Infrastructure and Should Not be Eliminated or Diminished

Whether financing a sewer system, road, bridge, airport or affordable housing, or many other applications, traditional tax-exempt municipal bonds are a reliable and effective financing tool for small and large issuers, and attractive to investors. This underpinning of the national landscape should not be tampered with at any time – and should not be viewed as interchangeable or replaceable with bond programs with more limited appeal, or programs requiring federal appropriations and control. Local control and effective financing through tax-exempt bonds are the foundation for national economic success, and proposals to alter them are a distraction from taking actions that could truly simplify and appropriately reform the tax code.

Appendix A
Municipal Bonds for America Coalition

- Airport Council International – North America (http://aci-na.org)
- American Public Gas Association (http://apga.org)
- Association of Metropolitan Water Agencies (http://amwa.net)
- Bay Area Toll Authority (http://bata.mtc.ca.gov)
- Business Oregon (http://oregon4biz.com)
- California Special Districts Association (http://csda.net)
- Chester County Economic Development Council (http://cceconomicdevelopment.com)
- Chicago Regional Transportation Authority (http://rtachicago.com)
- Cleveland-Cuyahoga County Port Authority (http://potofcleveland.com)
- Colorado Municipal League (http://cml.org)
- Council of Development Finance Agencies (http://cdfa.org)
- CPS Energy (http://cpsenergy.com)
- CSDA Finance Corporation (http://csdafinance.net)
- Education Finance Council (http://efc.org)
- Escambia County Housing Finance Authority (http://escambiahfa.com)
- Florida League of Cities (http://floridaleagueofcities.com)
- International City/County Management Association (http://icma.org)
- International Economic Development Council (http://iedconline.org)
- Investment Company Institute (http://ici.org)
- Kentucky School Boards Association (http://ksba.org)
- Large Public Power Council (http://lppc.org)
- National Association of Local Housing Finance Agencies (http://nalhfa.org)
- National League of Cities (http://nlc.org)
- National School Boards Association (http://nsba.org)
- South Carolina Jobs Economic Development Authority (http://scjeda.org)
- Texas Association of Local Housing Finance Agencies (http://talhfa.org)
- The Associated General Contractors of America (http://agc.org)
- The League of Minnesota Cities (http://lmnc.org)
- Bond Dealers of America (http://bdamerica.org)
- Salt River Project (http://srpnet.com)

APPENDIX B

Municipal Bonds for America

DO NOT DAMAGE MUNICIPAL BOND FINANCING:
A SYSTEM WORKING WELL TO BUILD AMERICA'S FUTURE

Overview

Municipal bonds have been the chief engine for infrastructure growth in American for over 100 years. Today, roughly 75% of the infrastructure in this country was funded with the help of municipal bonds, making them the cornerstone of America's infrastructure strategy. Over time, municipal bonds have built 4 million miles of roads, 500,000 bridges, 16,000 airports and 900,000 miles of pipe in water systems. They fund the building blocks of a competitive, modern American economy.

Proposals to alter or replace the municipal bond tax exemption threaten to damage this essential financing tool. These proposals come in essentially two forms: 1) curtailing the benefits of the tax exemption; and 2) replacing municipal bonds with direct pay bonds (i.e., taxable bonds receiving a direct subsidy from the federal government). All of these proposals would raise borrowing costs, hurt middle income Americans and their communities, and disproportionately hurt retirees and smaller, rural communities. It makes no sense to derail a system that has worked so well for communities throughout America for 100 years.

Curtailing the municipal bond tax exemption would impose a crippling blow on America's communities. Recent proposals would limit the municipal bond tax benefit, such as the Administration's cap on deductions and exemptions that would limit the value of the municipal bond exemption to 28%. Such proposals strike at the heart of municipal bond financing for several reasons:

- **Higher Borrowing Costs:** Reducing the tax benefit of the exemption means states and localities would need to offer higher rates to sell their bonds, raising borrowing costs significantly for communities. For example, a retroactive 28% cap would impose an increase in borrowing costs of as much as 20%[1] - effectively, a tax on local governments. This is comparable to an individual's home mortgage interest costs suddenly skyrocketing by 20%. This burden will be imposed on state and local governments already struggling to recover from the weak economy. Fewer projects will be built and those built will cost more. Middle Americans would suffer lost jobs. Essential services will be cut - and there will be higher taxes/fees on those services that remain.

- **Retirees Hurt Especially:** Retirees disproportionately purchase these bonds. In fact, roughly 59% of municipal bond interest is paid to those 65 years and older. Many of these individuals count on both the bond interest and the principal investment to fund their retirement, precisely because they

[1] Assuming a 70 basis point increase on an average yield of 3.2%.

believe these bonds are stable and secure. A federal step retroactively undermining the value of those bonds shakes that sense of stability, hitting those most vulnerable.

Direct pay bonds cannot be a substitute for municipal bonds. The second type of proposal suggests using taxable bonds that receive a direct federal subsidy to offset some of the state/local borrowing costs ("direct pay bonds"). Build America Bonds ("BABs") are one example. The President recently has proposed similar "America Fast Forward Bonds". These bonds can be a supplement to existing infrastructure financing tools, but if they are seen as a substitute for tax exempt municipal bond financing, it would deal a severe blow to the nation's infrastructure efforts. The reasons are clear:

- **Breach of Trust**: The Federal government is now entering a period of tighter funding as it seeks to reduce the federal deficit, raising doubt whether Congress will be able to honor Federal commitments to replace the tax exemption with a direct federal payment. The sequester brings this into sharp focus: it actually reduces federal payments to issuers of direct pay bonds that issuers had relied upon to plan budgets and finance projects. This action took local planning and control away from fiscally responsible state and local governments and placed it in the hands of the federal government, shifting federal burdens to local taxpayers. In that context, it is inconceivable any direct pay bond program could be a substitute for the financing power of municipal bonds.

- **Small, Rural Communities Disadvantaged**: Direct pay bonds overwhelmingly have been used by large and well-known cities and states who can compete in global, taxable markets for investors. Smaller issuers, such as in small towns, are likely to be hit with dramatically higher borrowing costs, coupled with a declining pool of investors willing to purchase their bonds. They could be shut out of the market as buyers naturally gravitate to bigger government issuers, favoring Dallas, Texas over Richardson, Texas. Traditional tax-exempt municipal bonds work for all issuers to permit decisions about local projects to be made by local officials at the local level.

- **More Costly**: For shorter maturity borrowing (*e.g.,* 5-10 years), direct pay bonds, such as BABs, have typically had higher net interest costs *(i.e*,costs even after receiving the federal subsidy) than municipal bonds. Increasing direct pay bonds, while curbing the attractiveness of municipal bonds, would only make this shortfall worse, costing state and local governments even more to meet their shorter-duration financing needs. It is also noteworthy that some proposals to reintroduce direct pay bonds have assumed a relatively low federal subsidy rate, which would reduce the attractiveness for issuers with longer maturities as well (e.g., out to 15 years).

Conclusion

Either type of proposal undermines what has been the dominant force for infrastructure improvement over the last 100 years – a force that offers to help build America's future in the 21st Century. For decades, municipal bonds have been the means for state and local governments to raise capital to meet pubic infrastructure needs critical to keeping America connected and competitive. Over 50,000 government issuers issue municipal bonds. This amounts to an average of roughly 920 issuers per state, underscoring that no part of America would be exempt from the devastating effect of these proposals. Municipal bonds are the building blocks of a competitive, modern American economy. It is system that has functioned remarkably well and should be allowed to continuing performing its vital function.