AMERICAN PUBLIC POWER ASSOCIATION
Powering Strong Communities

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Municipal Bonds and Public Power

- The American Public Power Association (APPA) believes that tax-exempt municipal bonds are the single most effective tool for financing investments in public infrastructure, including the generation, transmission, and distribution used to serve public power utility customers.
- APPA believes that the federal tax exclusion for municipal bond interest should be strengthened through commonsense reforms, including:
    - o Reinstating the ability to issue tax-exempt advance refunding bonds;
    - o Simplifying municipal bond private-use rules; and
    - o Increasing the current small-issuer exception limit from $10 million to $30 million.

Background

A municipal bond is a debt instrument issued for a year or longer, under which the bond holder typically receives annual or biannual interest payments (coupons) until the bond principal is repaid on a specified date (maturity). An issuer can redeem (i.e., "call") a bond before maturity but generally only after a certain period of time. For example, a 10-year call date is typical for a bond with a 30-year maturity.

State and local governments have issued municipal bonds to finance long-term projects for centuries. Today, there are $3.2 trillion in outstanding municipal bonds.[1] Historically, nearly three-quarters of the core infrastructure investment in the U.S. has been financed by state and local government bonds. This includes more than $60 billion in municipal bonds issued to finance public power investments.[2] These include power generation, distribution, reliability, demand control, efficiency, and emissions control—all of which are needed to deliver safe, affordable, and reliable electricity.

Since the creation of the federal income tax in 1913, interest on government-purpose municipal bonds has been exempt from federal income tax, just as federal bonds are exempt from state and local taxes. Since then, the federal government has taken steps to regulate municipal bonds, including taxing the interest on bonds determined to be for "private," not governmental use, and to limit the ability to refinance existing debt.

Investors purchase municipal bonds from nearly 42,000 state and local issuers. In part, investors are driven by tax considerations, accepting a lower rate of return because the interest is exempt from federal income tax. These savings are used to make further investments or are passed on to residents in the form of lower rates. Investors also value municipal bonds for their ability to generate a steady stream of revenue for fixed-income households. Individual households own roughly 70 percent of municipal bonds either directly or through bond funds.[3] And, more than 60 percent of this household tax-exempt interest is earned by taxpayers over 65 years old.[4] Investors also appreciate the protections afforded by the municipal bond market. This market is well-established, with a

1. The Bond Buyer, 2022 in Statistics, Annual Review (Feb. 13, 2023)(at A8).
2 Board of Governors of the Federal Reserve System, Financial Accounts of the United States, First Quarter 2023, (June 8, 2023), at 84.
3 Supra note 1 (at 121).
4 Internal Revenue Service, Statistics of Income Division, Publication 1304 (November 2022).

robust and comprehensive federal legislative and regulatory system. Additionally, the default rate for investment-grade municipal bonds is far less than 0.1 percent, a fraction of the default rate for comparably rated corporate bonds.

Prior to enactment of the Tax Cuts and Jobs Act of 2017, states and localities used tax-exempt advance refunding bonds. Such bonds were used to refund debt to lock in rates or restructure debt prior to a bond's typical 10-year call date. As a result of the Tax Cuts and Jobs Act, issuers now must either wait for a bond's call date to refund it or issue an advance refunding bond as taxable debt; combined this can mean higher costs and less flexibility.

The federal tax exclusion of bond interest means issuers of all sizes can finance their investments affordably. For example, APPA estimates that a $25 million project would have cost $9 million less to finance if it had been financed with tax-exempt debt. A $250 million project would have cost roughly $79 million less. These savings result in more critical investments in infrastructure and essential services by state and local governments and lower costs for the services they provide. Also, municipal bonds are ideally suited to finance capital-intensive and long-lived public infrastructure, such as the assets of a public power utility, with the cost of investments repaid over time by the customers who use the infrastructure.

Smaller issuers receive an additional benefit under current tax laws. Under current rules, banks generally cannot deduct the carrying cost for tax-exempt bonds. A small-issuer exception to these rules is provided for bonds issued by a locality intending to issue $10 million or less in debt in any given year. This gives banks better access to a secure investment vehicle and more importantly creates a greater appetite for debt issued by small state and local entities that might otherwise have difficulty finding affordable financing for critical projects.

Congressional Action

In March, Representative David Kustoff (R-TN) and House Municipal Finance Caucus Co-Chairman Dutch Ruppersberger (D-MD) introduced H.R. 1837, the Investing in Our Communities Act. This legislation would reinstate the ability to issue tax-exempt advance refunding bonds. In May, Senators Roger Wicker (R-MS) and Debbie Stabenow (D-MI) introduced S. 1453, the Lifting Our Communities through Advanced Liquidity for Infrastructure Act, which is identical in effect to H.R. 2288, though drafted differently. APPA strongly supports enactment of these bills.

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The American Public Power Association is the voice of not-for-profit, community-owned utilities that power 2,000 towns and cities nationwide. We represent public power before the federal government and protect the interests of the more than 49 million people that public power utilities serve and the 96,000 people they employ.