AMERICAN PUBLIC POWER ASSOCIATION
Powering Strong Communities

ISSUE BRIEF July 2017

Municipal Bonds and Public Power

Summary

Tax-exempt municipal bonds have financed $2 trillion in new investments in infrastructure in the last decade, including $112 billion in new investments in electric power generation, transmission, and distribution. Municipal bonds should be the cornerstone of any plan to address the significant challenges of funding and financing new investments in public infrastructure. Simply put: bonds build public power. The American Public Power Association (Association or APPA) opposes any efforts to limit or eliminate municipal bonds, efforts that would increase costs for public power utilities and raise rates for customers.

Background and History

State and local governments have issued municipal bonds to finance long-term projects for centuries. Today, there are $3.7 trillion in municipal bonds outstanding, more than $200 billion of which finance electric power related investments. These include investments in power generation, distribution, reliability, demand control, efficiency, and emissions control—all of which are needed to deliver safe, affordable, and reliable electricity.

In addition to infrastructure for public power utilities, these bonds finance roads, bridges, sewers, hospitals, libraries, schools, town halls, police stations, and every other sort of government-purpose investment made by state and local governments. In fact, nearly three-quarters of the infrastructure investment in the U.S. is financed by state and local government bonds.

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 tax. Since then, the federal government has taken steps to regulate municipal bonds—for example, requiring issuers to register bonds in order for the interest to be exempt from tax, and to tax the interest on bonds determined not to be for governmental purposes. To date, however, Congress has been unwilling to overturn decades of precedent—and perhaps face a Supreme Court challenge—by changing the tax treatment of government purpose bonds.

Strengths and Benefits of Municipal Bonds

The municipal bond market gives close to 42,000 governmental issuers access to investors. This is particularly important to smaller towns, counties, and publicly owned utilities that issue municipal bonds. Outside of municipal bonds, state and local governmental entities—including public power utilities—have limited means to raise funds for their communities' capital needs.

The federal tax exclusion of bond interest means issuers of all sizes can finance their investments affordably. For example, we estimate a $25 million project costs $9 million less to finance if financed with tax-exempt debt. A $250 million project 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.

Investors purchase municipal bonds in part because of tax considerations, accepting a lower rate of return because the interest is exempt from federal income tax. Municipal bonds are also valued for their ability to generate a steady stream of revenue for fixed-income households. Individual households are the investors in over 70 percent of municipal bonds. Nearly 60 percent of this household tax-exempt interest is earned by taxpayers over 65 years old. In 2012, 48 percent of all municipal bond interest paid to individuals went to those with incomes of less than $250,000.[1]

Recent market performance and the "flight to quality" underscore that municipal bonds are also valued as stable financial investments. Now more than 200-years old, the U.S. municipal bond market is well-established, with a robust and comprehensive federal legislative and regulatory system that protects investors. Likewise, municipal bonds themselves are typically

[1] Internal Revenue Service, "Statistics of Income—2010: Individual Income Tax Returns" (2012).[4]

extremely secure investment vehicles: 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.

Congressional and Administration Actions—Threats to Municipal Bonds

There are persistent calls to tax municipal bonds to pay for federal income tax rate cuts or deficit reduction. Most recently, the Senate Republican Policy Committee proposed a complete repeal of the tax exemption to encourage more "efficient" investments by the private sector. The truth is that limiting or eliminating the income tax exemption for interest from municipal bonds would reduce investments in vital infrastructure across the country and increase the cost of electricity for public power customers.

The numbers speak for themselves: had current investments been financed with taxable debt, utility rates would be as much as eight percent higher. A surtax on municipal bond interest to create a "cap" on the tax value of the exclusion for municipal bonds would impose similar cost. Again, a $250 million power plant would cost $80 million more to finance if the tax exemption for municipal bonds were repealed; $40 million more if the tax exemption were "capped;" and $30 million more if municipal bonds were replaced with direct payment bonds.

American Public Power Association Position

Municipal bonds are the single most effective tool for financing investments in public infrastructure and, as such, the federal tax exclusion for municipal bond interest should not be limited or replaced. Taxing municipal bonds would impose higher borrowing costs that would limit investment in critical infrastructure and, ultimately, impose higher electric rates on households and businesses. Ultimately, a disproportionate share of this burden will be shouldered by those who can least afford it. In sum, any such change would simply shift costs from the federal government onto the backs of state and local residents.

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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 to protect the interests of the more than 49 million people that public power utilities serve, and the 93,000 people they employ. Our association advocates and advises on electricity policy, technology, trends, training, and operations. Our members strengthen their communities by providing superior service, engaging citizens, and instilling pride in community-owned power.