MUNICIPAL CAPITAL MARKETS GROUP, INC.

Why Use Tax-Exempt Municipal Bonds to Borrow Money? – Muni Bonds Lesson 1

Tax exempt municipal bonds typically have a lower interest rate than taxable loans (such as a bank loan) would have for the same credit. Here is one example:

- Borrower A wants to borrow money for a new facility. He goes to his local bank, and they say they will loan him the money at 4.0% interest.
- Borrower A decides to issue tax-exempt municipal bonds for the same project and finds that the same bank will buy the municipal bonds at a rate of 3.0% because they do not have to pay federal income tax on the interest income.
- How does this work??? The bank is in the 25% tax bracket. If they earn 4.0% interest but must pay 25% federal tax which nets the bank only 3.0%. This is a 25% savings in interest for Borrower A.

Note that the tax advantage to the borrower depends on the tax bracket of the investor buying the bonds so savings typically range from 20% to 30% but can go even higher at times.