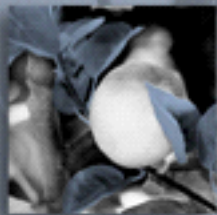


Fund Essentials®

investing for
tax-exempt
income



THE **Vanguard** GROUP

Vanguard® tax-exempt bond funds

*A convenient, low-cost choice
for tax-sensitive investors*



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Federal income taxes can erase a significant portion of your mutual fund returns. So if you're in one of the higher income tax brackets and feeling the tax bite, tax-exempt bond funds (also known as municipal bond funds) may be the solution. When you invest in tax-exempt bond funds, you'll **earn monthly income** free from federal (and sometimes state and local) income tax.*

Vanguard is the nation's leading bond fund manager, with more than \$155 billion in bond fund assets (as of December 31, 2003). With our experience and broad selection of no-load, low-cost tax-exempt bond funds, you're almost certain to find one or more funds to help **meet your goals**.

This brochure explains how tax-exempt bond funds help millions of investors, as well as how tax-exempt funds from Vanguard can help you take charge and keep more of your investment income.

Unless otherwise noted, all mutual fund industry data provided by Lipper Inc.

*Although the income from a municipal bond fund is exempt from federal income tax, capital gains realized either through a fund's trading or from your redemption of shares are taxable. For some investors, a portion of income from a municipal bond fund may be subject to the alternative minimum tax, as well as state and local taxes.

What Are Municipal Bonds?

Municipal bonds are a type of debt issued by state and local governments to finance public projects or support their financial needs.

The interest paid on municipal bonds is typically exempt from federal income taxes and, in some cases, from state and local income taxes. The stated yields of municipal bonds are typically lower than the stated yields of taxable bonds of comparable credit quality and maturity. When issued, municipal bonds are scheduled to mature (repay all principal) within periods ranging from 1 to 40 years.

Why Use Tax-Exempt Bond Funds for Your Income Needs?

Tax-exempt bond funds pool together the money of many investors so that a broadly diversified selection of bonds can be bought. Here are some reasons why tax-exempt bond funds may be appropriate for your investment goals.

Potential for higher after-tax yields. Although tax-exempt funds usually have lower stated yields than comparable taxable funds, the yields of these funds are often higher on an after-tax basis (depending on your tax bracket). On page 9, you'll find an example of how to compare the yield of a tax-exempt bond fund with the yield of a taxable bond fund.

Diversification. Purchasing a tax-exempt bond fund rather than a few individual tax-exempt bonds will help diversify your portfolio. Because tax-exempt bond funds may hold bonds from hundreds of different issuers, the poor performance of any one security or group of securities is less likely to have a significant impact on your investment.

Professional investment management. You can rely on professional fund managers—who have access to extensive research and market information—to decide which bonds to buy and sell. This service is valuable, because few individual investors have the time or expertise to manage portfolios of individual bonds.

Convenience. Tax-exempt bond funds offer daily liquidity—you can buy or sell your shares whenever you like. In addition, many let you write checks or redeem shares by telephone.

Key Characteristics of Tax-Exempt Bond Funds

When you consider an investment in tax-exempt bond funds, there are three important characteristics to keep in mind: average credit quality, average maturity, and average duration.

Average credit quality. Independent bond rating agencies, such as Standard & Poor's and Moody's, evaluate the ability of tax-exempt bond issuers to repay loans. These agencies then assign a letter rating, ranging from AAA or Aaa (highest quality and highly unlikely to default) to D (in default). The lower the rating, the higher the interest rate the borrower must pay to entice investors to purchase the bond. Tax-exempt bond funds can invest in a wide range of bonds having varying credit quality ratings. However, the weighted-average rating of all bonds in the fund provides a measure of the fund's average credit quality.

Average maturity. The average length of time before bonds in a fund reach maturity is known as the fund's average maturity. The average maturity affects the fund's yield as well as the risk to investors' principal. For example, prices of longer-term bond funds are substantially more volatile than those of shorter-term

funds because the long-term holders of bonds are lending money for longer periods—and thus taking a greater risk that their principal may not be repaid or the borrower may default.

Average duration. This measurement can be used to judge how much a tax-exempt bond fund's share price may rise or fall in response to a change in interest rates. To calculate the estimated percentage change in the fund's share price, simply multiply a change in interest rates by the fund's average duration. An increase in interest rates will cause share prices to fall; likewise, a decrease in interest rates will cause share prices to rise. For example, suppose you own a tax-exempt bond fund that has a duration of 6.4 years. If interest rates increase by 1%, you can expect the price of the bond fund to decrease by 6.4%.

Segments of the municipal bond market

		Average Maturity . . .			
		Short	Medium	Long	
Credit Quality	High				Most tax-exempt bond funds tend to fall into one of the nine boxes in this grid, showing the focus of a fund in terms of two attributes, average maturity (short, medium, or long) and average credit quality (high, medium, or low).
	Medium				
	Low				

What Are the Risks?

As with any type of investment, tax-exempt bond funds carry certain risks. Here's a closer look.

Interest rate risk. Share prices of bond funds decrease when interest rates rise, and they increase when interest rates fall. The longer the average maturity or duration of a tax-exempt bond fund, the higher the risk of significant price fluctuations caused by changes in market interest rates.

Credit risk. Tax-exempt bonds can lose value if a state, county, or other municipal borrower's credit rating is lowered or if the issuer defaults by failing to make principal or interest payments. However, because a tax-exempt fund invests in bonds from many different issuers, the impact of a downgrade or default by any one issuer is significantly lessened.

Income risk. Income from tax-exempt bond funds may fall because of declining interest rates. If you want current income from this type of fund, you should be able to tolerate a fluctuating yield. Income risk is higher for short-term funds and lower for long-term funds.

Tax-Exempt Bond

Funds: Are They Right for You?

Before you select a specific tax-exempt fund, ask yourself the following questions to be certain that tax-exempt funds are appropriate for you.

Are you in a high tax bracket?

Investors in higher tax brackets are most likely to benefit from owning tax-exempt bond funds. The chart below shows whether such a fund may be right for you. You may wish to consult a tax adviser to discuss your specific tax situation.

Your federal income tax bracket	Is a tax-exempt bond fund appropriate?
15%	Unlikely
25%	Likely
28%	Quite likely
33%	Highly likely
35%	Highly likely

Is the investment being made outside of a tax-advantaged retirement plan?

Tax-exempt bond funds are not suitable for tax-advantaged investments (such as IRAs and 401(k) plans), which already enjoy a current tax benefit. In addition, the yields on tax-exempt funds are typically lower than taxable bond funds of comparable quality and average maturity.

Does a tax-exempt fund offer higher after-tax yields than a taxable fund?

To identify whether you should invest in a tax-exempt or taxable bond fund, determine which one will provide a higher after-tax yield. You can do this by figuring the taxable-equivalent yield of a tax-exempt investment.

If the taxable-equivalent yield of a tax-exempt bond fund is greater than the yield of a taxable fund, then the tax-exempt fund is likely the better choice. To calculate a taxable-equivalent yield, use this formula:

$$\frac{\text{Yield of Tax-Exempt Fund}}{1.00 - \text{Your Tax Bracket}} = \text{Your Taxable-Equivalent Yield}$$

This example shows you how to do the calculation.

Suppose you are considering whether to invest in one of two bond funds:

- 1) A taxable bond fund that has a current yield of 4.0%.
- 2) A tax-exempt bond fund that has a current yield of 3.0%.

Follow these four steps to obtain a taxable-equivalent yield.

- 1) Convert your marginal tax rate to a decimal figure (for instance, 0.28 if you are in the 28% bracket).
- 2) Subtract the decimal figure from 1.00 ($1.00 - 0.28 = 0.72$).
- 3) Divide the tax-exempt yield by the result calculated in Step 2 ($3.0\% \div 0.72 = 4.17\%$).
- 4) Compare the taxable-equivalent yield of the tax-exempt bond fund to the yield of the taxable bond fund (4.17% versus 4.0%).

In this example, it is advantageous to invest in the tax-exempt bond fund, because you receive a higher taxable-equivalent yield. Note that this hypothetical example does not represent the yield of any particular investment.

If a tax-exempt fund **is not appropriate for you**

Consider one of Vanguard's taxable bond funds listed at the end of this brochure. You will find more information about these funds in our Fund Essentials brochure, *Investing for Income*. Vanguard is a leading provider of taxable bond funds and offers an extensive selection of funds to meet your needs. For more information, call us at 1-800-662-7447 or visit our website at www.vanguard.com.

How to Choose the Right Tax-Exempt Bond Fund

Once you determine that a tax-exempt bond fund is right for you by answering yes to the questions in the preceding section, consider the following questions to help you focus on the right type of tax-exempt bond fund to meet your goals.

How much risk can you live with? The degree of risk you can comfortably tolerate dictates whether you should invest in a short-, intermediate-, or long-term tax-exempt fund. If you're worried about price fluctuations, you may want to consider funds that have shorter average maturities, because they exhibit lower price volatility than longer-term funds. If you have a long-term time horizon, you seek stable income, and you can live with greater price swings, you are more likely to choose a long-term fund.

How much income do you need? Your income needs influence the degree of risk that you can comfortably take on in your investment. If your income needs are substantial, you will choose a fund with a longer average maturity—and so take on greater risk to your principal. Or you might decide to invest in a high-yield fund, which invests in bonds that have lower credit quality. If a high level of income is not a priority, then you can invest in a fund having a shorter average maturity and higher-rated securities.

Which is more important—credit quality or yield?

If you are seeking a fund that holds bonds of the highest credit quality, you will have to settle for a somewhat lower yield. On the other hand, if you prefer higher yields and are comfortable with the price volatility, you may want to consider high-yield tax-exempt funds or funds having a longer average maturity.

Is a single-state fund appropriate? A fund that invests solely in bonds issued by municipalities in one state offers residents of that state income that is exempt from both federal and state income taxes. Income from funds that invest exclusively in these bonds may also be exempt from local income taxes assessed by municipalities within the state. The tax savings realized by investing in single-state bond funds depend on that state's income tax rate and the yields of securities issued in the state relative to the national average. Yields of state-specific funds may be quite close to or vary considerably from those of national funds.

If you're considering an investment in a state-specific fund, keep in mind that investing in municipal bonds from only one state brings a greater risk of default than investing in a more diverse selection of bonds. Events such as changes in local laws or regional recessions can impair the ability of some municipalities to meet their financial obligations.

Why Vanguard Tax-Exempt Bond Funds?

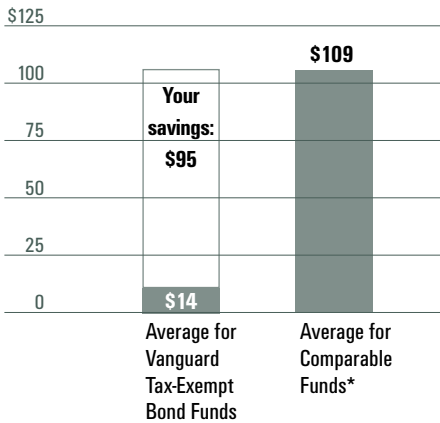
When you compare Vanguard tax-exempt funds with those of competitors, you'll find that the Vanguard funds have several important advantages.

High credit quality. Each of our tax-exempt bond funds maintains high credit quality standards relative to comparable funds. In fact, mutual fund industry data confirm that our tax-exempt funds hold a higher percentage of "investment grade" bonds (those rated BBB or better by Standard & Poor's) than their peer funds.* So when you invest in these funds, you won't have to worry that your higher returns are the result of investments in riskier, lower-rated holdings.

Low costs. Cost is the most significant difference between bond funds that hold securities having similar credit quality and maturity. As the chart on page 14 shows, the average expenses of Vanguard's tax-exempt bond funds are *one-seventh* the industry average. So when you invest at Vanguard, more of your money stays in your account, where it can continue to work for you.

*Source: Morningstar, Inc., as of 12/31/2003.

The Vanguard low-cost advantage



Low costs allow Vanguard tax-exempt bond funds to pass along more of their investment returns to you. The chart at the left illustrates the amount deducted annually from a \$10,000 investment.

*Data as of 12/31/2003.

Experienced management. Vanguard oversaw nearly \$45 billion in tax-exempt bond fund assets as of December 31, 2003. The professionals at the helm of our tax-exempt bond funds have an average tenure of 7.6 years, longer than the tenure of peer funds' managers.* They are skilled at evaluating and selecting tax-exempt bonds that satisfy our high credit quality standards and also offer attractive yields.

Vanguard Tax-Exempt Bond Funds to Meet Your Needs

Our broad selection of low-cost tax-exempt bond funds can help meet the needs of many investors. Each of the funds on the following pages seeks to provide a high level of tax-exempt current income.

Short-Term Tax-Exempt Fund invests in high-quality municipal bonds having an average maturity of 1 to 2 years.

Limited-Term Tax-Exempt Fund invests in high-quality municipal bonds having an average maturity of 2 to 6 years.

Intermediate-Term Tax-Exempt Fund invests in high-quality municipal bonds having an average maturity of 6 to 12 years.

Insured Long-Term Tax-Exempt Fund invests in insured municipal bonds having an average maturity of 12 to 25 years.*

Long-Term Tax-Exempt Fund invests in high-quality municipal bonds having an average maturity of 12 to 25 years.

High-Yield Tax-Exempt Fund invests in medium-quality municipal bonds having an average maturity of 15 to 25 years.**

Request the Vanguard® Municipal Bond Funds prospectus for more information on all of these funds.

*Bond insurance guarantees only the creditworthiness of the bonds held in the fund. It does not protect shareholders from fluctuations in bond prices. Also, it is possible that an insurer may not be able to meet its commitments.

**Because high-yield bonds are considered speculative, investors should be prepared to assume a substantially greater level of credit risk than with other types of bonds.

The following funds are available only to residents of the states indicated:

California Intermediate-Term Tax-Exempt Fund invests in California municipal securities having an average maturity of 6 to 12 years.

California Long-Term Tax-Exempt Fund invests in California municipal securities having an average maturity of 12 to 25 years.

Florida Long-Term Tax-Exempt Fund invests in Florida municipal securities having an average maturity of 12 to 25 years.

Massachusetts Tax-Exempt Fund invests in Massachusetts municipal securities having an average maturity of 12 to 25 years.

New Jersey Long-Term Tax-Exempt Fund invests in New Jersey municipal securities having an average maturity of 12 to 25 years.

New York Long-Term Tax-Exempt Fund invests in New York municipal securities having an average maturity of 12 to 25 years.

Ohio Long-Term Tax-Exempt Fund invests in Ohio municipal securities having an average maturity of 12 to 25 years.

Pennsylvania Long-Term Tax-Exempt Fund invests in Pennsylvania municipal securities having an average maturity of 12 to 25 years.

Consider Vanguard's **tax-exempt money market funds**

Vanguard also offers a national tax-exempt money market fund, as well as state-specific money market funds for residents of five states. These funds seek to offer tax-exempt income along with stability of your principal. For more information about these funds, visit our website at www.vanguard.com or call us at 1-800-662-7447.

National

Tax-Exempt Money Market Fund (included in the Vanguard Municipal Bond Funds prospectus)

State-Specific

California Tax-Exempt Money Market Fund

New Jersey Tax-Exempt Money Market Fund

New York Tax-Exempt Money Market Fund

Ohio Tax-Exempt Money Market Fund

Pennsylvania Tax-Exempt Money Market Fund

An investment in a money market fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although a money market fund seeks to preserve the value of your investment at \$1 per share, it is possible to lose money by investing in such a fund.

To request an information kit for any of the state-specific funds on these two pages, select that state's tax-exempt fund kit on the enclosed reply card, call us at **1-800-662-7447**, or visit **www.vanguard.com**.

Key Fund Facts

	Interest Rate Risk	Credit Risk	Income Risk	Average Credit Quality*	Average Maturity**	Average Duration**	Fund Expense Ratio***	Average Competitor Expense Ratio**
Short-Term Tax-Exempt Fund	Low	Low	High	Aa1	1.2 Years	1.1 Years	0.17%	0.98%
Limited-Term Tax-Exempt Fund	Low	Low	High	Aa1	2.7 Years	2.5 Years	0.17%	0.82%
Intermediate-Term Tax-Exempt Fund	Medium	Low	Medium	Aaa	8.2 Years	6.5 Years	0.17%	0.94%
Insured Long-Term Tax-Exempt Fund	High	Negligible	Low	Aaa	7.6 Years	6.1 Years	0.17%	1.20%
Long-Term Tax-Exempt Fund	High	Low	Low	Aa1	8.3 Years	6.9 Years	0.17%	1.14%
High-Yield Tax-Exempt Fund	High	Medium	Low	A	7.3 Years	5.6 Years	0.17%	1.26%

Note: The minimum initial investment for each fund is \$3,000. The funds are not suitable for IRAs. Each of the six funds also offers Admiral™ Shares, a separate share class that offers lower expenses. The minimum initial investment for this share class is \$250,000.

*Source: Moody's Investors Service, Inc., as of 12/31/2003.

**As of 12/31/2003.

***For the fund's latest fiscal year.

Explanation of Quality Ratings

Aaa: Bonds judged to be the best quality, carrying the smallest degree of investment risk.

Aa: Bonds regarded as high quality; together with Aaa bonds, known as high-grade bonds.

A: Bonds considered to be high medium-grade, possessing many favorable investment attributes.

Note: Moody's often applies numerical modifiers in its rating classifications. The modifier "1" indicates that the bond ranks in the higher end of its category, "2" indicates a midrange ranking, and "3" indicates a ranking in the lower end of the category.

Invest With a Leader

Vanguard's strength and experience in tax-exempt bond fund investing make us an ideal choice for your investment. You can get more details about all of our funds by visiting our website at www.vanguard.com, calling us at **1-800-662-7447**, or returning the enclosed postage-paid reply card.

▶▶ *web*link

Once you've selected the funds that best meet your needs, you can open your account online using secure e-signature technology. Visit our website at www.vanguard.com/?invest to get started.

Other Vanguard Bond Funds

If you've determined that a tax-exempt bond fund isn't appropriate for you, consider Vanguard's wide selection of taxable bond funds shown below.

Vanguard® Bond Funds

Request the Vanguard Bond Funds prospectus for details on these eight actively managed funds.

Short-Term Corporate Fund
Short-Term Federal Fund
Short-Term Treasury Fund
GNMA Fund
Intermediate-Term Corporate Fund
Intermediate-Term Treasury Fund
Long-Term Corporate Fund
Long-Term Treasury Fund

These two funds are in separate prospectuses.

High-Yield Corporate Fund
Inflation-Protected Securities Fund

Vanguard® Bond Index Funds

Request the Vanguard Bond Index Funds prospectus for details on these four index funds.

Short-Term Bond Index Fund
Intermediate-Term Bond Index Fund
Total Bond Market Index Fund
Long-Term Bond Index Fund



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For more information about Vanguard funds, visit www.vanguard.com, or call 800-662-7447, to obtain a prospectus. Investment objectives, risks, charges, expenses, and other important information about a fund are contained in the prospectus; read it carefully before investing.