AMERICAN PUBLIC POWER ASSOCIATION
Powering Strong Communities

ISSUE BRIEF June 2022

Sequestration of Build America Bond Credit Payments

Summary

Spending cuts ("sequestration") triggered by the Budget Control Act of 2011 have reduced payments to state and local Build America Bond (BAB) and New Clean Renewable Bond (New CREB) issuers by more than $2.4 billion. The American Public Power Association (APPA) estimates that an additional $1.4 billion in BAB and New CREB payments will be cut under sequestration through 2031. Seventy-nine public power utilities that issued more than $16 billion in BABs and $300 million in New CREBs have seen payment cuts totaling an estimated $220 million thus far, with another $120 million in cuts projected through 2031. Sequestration ignores Congress's intent for BABs and New CREBs and reneges on what the federal government promised in partnership with state and local governments. APPA believes Congress should act to prevent further cuts to BAB and New CREB credit payments.

Background

Creation of Build America Bonds

During the 2008 credit crisis, traditional municipal bond investors pulled out of the market and interest rates soared. To provide liquidity to these markets—and in turn encourage the sorts of infrastructure investments municipal bonds finance—the American Recovery and Reinvestment Act (ARRA) of 2009 created the BAB.[1]

A BAB meets the same requirements as any other government-purpose municipal bond, but instead of the interest being tax-exempt, the bond issuer receives a credit payment from the Treasury Department equal to 35 percent of the interest paid. These new direct payment bonds were intended to expand the pool of investors for municipal bonds to include investors willing to invest in taxable assets. The credit payment to issuers was intended to avoid any material increase in the cost of financing for the issuer.

In drafting ARRA, Congress sought to ensure that BAB credit payments were not vulnerable to year-to-year budget legislation enacted by Congress. First, ARRA clarified that a credit payment to a bond issuer is a refundable credit.[2] Second, ARRA specifically added BAB credit payments to the list of tax credit payments for which funds are permanently appropriated.[3] In the 21-month period (April 2009 through December 31, 2010) in which BABs could be issued, 2,275 BABs were issued worth $181 billion.[4] Of those issuances, 108 BABs worth $16 billion financed power-related projects.

New CREBs were authorized to finance renewable energy projects. These bonds function similarly to a BAB in that interest paid on these bonds is taxable to the bondholder, but the issuer receives a credit payment equal to 70 percent of the interest rate determined by the Treasury Secretary to allow the issuance of the bond without discount. In contrast to BABs, the amount of New CREBs that could be issued was limited, with issuers only allowed to make use after a lengthy prior approval process by the Internal Revenue Service. APPA estimates that just roughly $300 million in New CREBs were issued by public power utilities. The ability to issue New CREBs was repealed in 2017.

1 American Recovery and Reinvestment Act of 2009, Pub.L. No. 111-5 (123 Stat. 115) § 1531 (codified as 26 U.S.C. 54AA).

2 Refundable credits generally are exempt from sequestration (2 USC § 905(d)), although as discussed further in this report, the Office of Management and Budget (OMB) has interpreted this exemption narrowly and, as a result, OMB has not applied this exemption to BABs credit payments.

3 31 USC § 1324(b).

4 U.S. Department of Treasury, Treasury Analysis of Build America Bond Issuances and Savings, at 2 (May 16, 2011).

Sequestration of BAB Credit Payments

A failure to meet deficit reduction targets under the Budget Control Act of 2011 (BCA) triggered the Department of Treasury to implement automatic cuts to federal mandatory (entitlement) spending programs beginning March 1, 2013. This process of automatic cuts is called sequestration. These cuts were to continue through the end of fiscal year (FY) 2021. Tax credit payments to individuals are exempt from sequestration, but the White House Office of Management and Budget (OMB) decided in 2012 that credit payments to other entities—including BAB and New CREB credit payments to BAB and New CREB issuers—were not.[5] This interpretation contradicted earlier statements by the Treasury Department[6] and congressional intent.[7] Because Congress has repeatedly extended the period for sequestration beyond its originally intended FY 2021 expiration, these cuts will continue through FY 2031. According to OMB, BAB and New CREB credit payments have been cut by approximately $2.4 billion since 2013. APPA estimates that these payments will be cut by another roughly $1.4 billion before sequestration ends at the end of FY 2031.[8]

Additionally, under the Statutory Pay-as-You-Go Act of 2010 (P.L. 111-139)(PAYGO), any increase in the deficit caused by a new tax or entitlement spending law also triggers sequestration cuts to eliminate the deficit increase. These cuts are automatic unless PAYGO is waived, either as part of the new law or in subsequent legislation. The American Rescue Plan Act (Pub. Law 117-2), which was enacted in March 2021, added $1.9 trillion in deficit spending to the PAYGO "scorecard." As discussed below, Congress postponed the sequestration cuts that would have ensued in January 2022, but absent further action, sequestration will ensue. In fact, given the size of the deficit increase caused by American Rescue Plan Act, the Congressional Budget Office estimated that BAB and New CREB payments and other sequestrable accounts would be eliminated entirely starting January 1, 2023, through September 2026.

Congressional Action

In April 2021, Senators Roger Wicker (R-MS) and Michael Bennet (D-CO) introduced S. 1308, the American Infrastructure Bond Act. The bill would reinstate the ability to issue taxable direct payment American Infrastructure Bonds (AIBs), which are similar to BABs. However, in contrast to a BAB or New CREB, the American Infrastructure Bond Act includes a provision that would protect AIBs from sequestration. Conversely, Representative Terri Sewell (D-AL) introduced in April 2021, H.R. 2634, the Local Infrastructure Financing Tools (LIFT) Act, that would reinstate the ability to issue taxable direct payment bonds. In contrast to past versions of similar legislation, the bill does not protect payments to issuers from sequestration. Instead, the legislation proposes payments of up to 42 percent of interest expenses—the Wicker bill would pay 28 percent of interest—to overcome issuer reluctance. The provision to protect against sequestration was dropped from the LIFT Act due to objections from the House Budget Committee. Neither the American Infrastructure Bond Act nor the LIFT Act have advanced in Congress.

In March 2021, House Budget Committee Chairman John Yarmuth (D-KY) introduced H.R. 1848, a bill intended to prevent the American Rescue Plan from triggering additional sequestration cuts. The bill was passed in the House, but amended in the Senate (and enacted into law in April 2021) to instead only suspend any sequestration of Medicare payments through December 31, 2021. Subsequently, Congress took up and passed the Protecting Medicare and American Farmers from Sequester Cuts Act of 2021 (Pub. Law 117-71). The law exempted Medicare from any sequestration cuts through March 31, 2022, but also blocked PAYGO cuts to other programs—including BAB and New CREB credit payments—in calendar year 2022. This does not block the 5.7 percent cuts already triggered by the BCA.

APPA Position

Congress clearly did not intend for BAB credit payments to be subject to sequestration. It is tantamount to a breach of contract for bond issuers to have negotiated financial deals based on

5 Office of Mgmt. & Budget, Exec. Office of the President, OMB Report Pursuant to the Sequestration Transparency Act of 2012 (P.L. 112-155), at 157 (Sept. 24, 2012).

6 Tax Exempt and Taxable Government Bonds: Hearing before the H. Subcomm. on Select Revenues of the H. Comm. on Ways & Means, 111th Cong. 12 (2009) (Serial No. 111-22) (Statement of Alan B. Krueger, Assistant Sec'y. of Treasury of the United States).

7 John Buckley, Remarks at the Urban-Brookings Tax Policy Center and George Mason Center for State and Local Government Leadership panel discussion Fall- out from Federal Tax Reform: Implications for State and Local Revenues (Sept. 21, 2012) (http://www.taxpolicycenter.org/events/federal-tax-reform-and-the-states.cfm) (Buckley, who as chief tax counsel for the House Ways and Means Committee helped write the BAB provision in ARRA, called OMB's decision "extraordinary and strange").

8 APPA estimates based on prior year sequestration and estimates provided in Cong. Budget Office, Estimated Impact of Automatic Budget Enforcement Procedures Specified in the Budget Control Act, at 8 (Sept. 12, 2011). Statutory Pay-as-You-Go Act of 2010, Pub. L. No. 111-139 (124 Stat. 8) (codified as 2 U.S.C. 931).

the promise of a payment on which the federal government is now reneging. BAB-financed investments in power generation, distribution, and system improvements shored up critical infrastructure at a time when traditional tax-exempt bond investors were in short supply and state and local government access to municipal bond markets was impaired. It is wrong for the federal government to decide by fiat to renegotiate the terms of those deals. Every dollar cut means one dollar less that is available to build power plants, power lines, and systems needed to continue to deliver electric power to public power's customers. Every dollar cut also represents a dollar more that public power utilities' customers must pay to receive such power.

Reinstating the ability to issue taxable direct payment bonds would attract new investors, including pension plans and offshore investors, that do not benefit from the tax-exemption of a traditional tax-exempt municipal bond. And exempting payments from sequestration will allow states, localities, and public power utilities to issue these new infrastructure bonds with confidence.

Congress must act to block the elimination of BAB and New CREB credit payments that will begin after 2022 because of PAYGO. Congress should also act to prevent further credit payment cuts from the BCA, or at the very least stop extending the duration of sequestration.

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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 96,000 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.