AMERICAN PUBLIC POWER ASSOCIATION
Powering Strong Communities

**ISSUE BRIEF** April 2019

# 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) issuers by $1.6 billion. The American Public Power Association (APPA or Association) estimates that an additional $1.9 billion in BAB payments will be cut under sequestration through 2027. Public power utilities issued more than $16 billion in BABs and have seen payment cuts totaling an estimated $150 million thus far, with another $176 million in cuts projected through 2027. Sequestration ignores Congress's intent for BABs 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 credit payments. At the very least, Congress should stop extending the duration of sequestration as it did yet again in the Bipartisan Budget Act of 2018.


## Background

### Creation of Build America Bonds

In the last decade, public power utilities financed roughly $10 billion annually in electric system investments with tax-exempt municipal bonds. (See APPA issue brief, "Municipal Bonds and Public Power," for more information). 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.

## Sequestration of BAB Credit Payments

A failure to meet deficit reduction targets under the Budget Control Act of 2011 (BCA) triggered mandatory spending cuts (sequestration) beginning March 1, 2013. 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 decided in 2012 that credit payments to other entities—including BAB credit payments to BAB issuers—were not.[5] This interpretation

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).

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).

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Sequester Percentage | 8.7% | 7.2% | 7.3% | 6.8% | 6.9% | 6.6% | 6.2% | 6.1% | 5.8% | 5.5% | 5.5% | 5.5% | 5.5% | 5.5% | 5.5% |
| Sequester ($ millions) | $171 | $312 | $301 | $285 | $260 | $261 | $242 | $238 | $226 | $215 | $215 | $215 | $215 | $215 | $215 |

contradicted earlier statements by the Treasury Department[6] and congressional intent.[7] As a result, through 2018, BAB credit payments will have been cut by $1.6 billion. Additionally, Congress has repeatedly extended the period for sequestration beyond its originally intended FY 2021, most recently in the Bipartisan Budget Act of 2018. As a result, APPA now estimates that BABs payments will be cut by another roughly $1.9 billion before sequestration ends in 2027.[8]

In addition, BAB credit payments could face still deeper cuts under the Statutory Pay-as-You-Go Act of 2010 (PAYGO). Under PAYGO, any increase in the deficit triggered by a new tax or entitlement spending law triggers across-the-board spending cuts to eliminate the deficit increase. These cuts are automatic unless PAYGO is waived in the new tax or entitlement spending law or waived in a subsequent law. For example, enactment of the Tax Cuts and Jobs Act of 2017 (TCJA) will increase the federal deficit by an estimated $1.5 trillion over the next decade and would have triggered PAYGO sequestration cuts of $1.5 trillion over the same period. Congress acted later to prevent sequestration from being triggered by TCJA, but BABs may not be so lucky in the future.

## American Public Power Association Position

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

Congress should act to prevent further BAB credit payment cuts, including continued cuts due to Congress's inability to reach a budget deal in 2012 and potential cuts whenever Congress fails to meet "Pay-as-You-Go" obligations when enacting future legislation. At the very least, Congress should stop extending the duration of sequestration as it did yet again in the Bipartisan Budget Act of 2018.

## American Public Power Association Contact

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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.

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 Fallout 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).