ISSUE BRIEF June 2021

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 $2 billion. The American Public Power Association (APPA) estimates that an additional $1.7 billion in BAB payments will be cut under sequestration through 2030. Seventy-nine public power utilities issued more than $16 billion in BABs and have seen payment cuts totaling an estimated $182 million thus far, with another $151 million in cuts projected through 2030.[1] Sequestration ignores Congress's intent for BABs and New Clean Renewable Energy Bonds (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

In the last decade, public power utilities financed roughly $7 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.[2]

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.[3] Second, ARRA specifically added BAB credit payments to the list of tax

1 Payments to issuers of New Clean Renewable Energy Bonds (New CREBs) are also being cut as a result of sequestration. However, the cuts to public power utility issuers are relatively modest compared – totaling roughly $8 million since 2013. As a result, this issue brief largely focuses on BAB issuers, but APPA's concerns for issuers of New CREBs are the same.

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

3 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.

credit payments for which funds are permanently appropriated.[4] 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.[5] 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.[6] This interpretation contradicted earlier statements by the Treasury Department[7] and congressional intent.[8] As a result, through 2020, BAB credit payments will have been cut by $2 billion.

Congress has repeatedly extended the period for sequestration beyond its originally intended FY 2021 expiration, most recently in the Coronavirus Aid, Relief, and Economic Security Act of 2020 (CARES Act). As a result, APPA now estimates that BABs payments will be cut by another roughly $1.4 billion before sequestration ends in 2030.[9] Additionally, because of the $1.8 trillion in deficit spending authorized by the American Rescue Plan (Pub. Law 117-7), BAB credit payments and other sequestrable accounts could be eliminated entirely by sequestration cuts starting January 1, 2022, as mandated by the Statutory Pay-as-You-Go Act of 2010 (PAYGO). [Under PAYGO, any increase in the deficit caused 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.] The House has made one attempt to waive PAYGO for the American Rescue Plan (H.R. 1868), but the bill was instead amended to prevent near-term cuts to Medicare. We still believe that Congress will eventually act to block these cuts as they did under similar circumstances with the Tax Cuts and Jobs Act of 2017 (TCJA), which was set to trigger PAYGO sequestration cuts of $1.5 trillion. However, there is no guarantee Congress will do so now.

Congressional Action

On March 12, 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 amended in the Senate to instead provide a temporary reprieve from current sequestration cuts for Medicare.

4 31 USC § 1324(b).

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

6 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).

7 Tax Exempt and Taxable Government Bonds: Hearing before the H. Sub-comm. 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).

8 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").

9 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).

On April 22, Senators Roger Wicker (R-MS) and Michael Bennet (D-CO) in introducing S. 1308, the American Infrastructure Bond Act. The bill would reinstate the ability to issue taxable direct payment American Infrastructure Bonds (AIBs) similar to a BAB. 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 on April 16, 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 staff that argue that if any programs get relief from the current sequestration, all programs should get that relief.

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 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 should also act to prevent further BAB credit payment cuts. That includes both continued cuts due to Congress's inability to reach a budget deal in 2012 and the "Pay-as-You-Go" cuts, which now loom in the wake of enactment of the American Rescue Plan. At the very least, Congress should stop extending the duration of sequestration as it did yet again in the CARES Act.

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