Sequestration of Build America Bond Credit Payments

Summary
Congress’s failure to meet federal deficit reduction targets in 2012 have, to date, triggered more than $1.3 billion in payment cuts (“sequestration”) to state and local issuers of Build America Bonds (BABs). Sequestration of an additional $1.6 billion (estimated) in cuts is scheduled through 2025. Public power utilities issued more than $16 billion in BABs and have seen payment cuts totaling an estimated $120 million thus far. Sequestration ignores Congress’s intent for BABs and reneges on what the federal government promised in partnership with state and local governments. We believe Congress should act to prevent further cuts to BAB credit payments. We also strongly object to an Administration proposal to extend sequestration through 2027.

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’s Municipal Bonds and Public Power” issue brief 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 of any other government-purpose municipal bond, but instead of the interest paid to the bondholder 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
In 2012, automatic federal spending cuts known as “sequestration” were triggered by the failure of Congress to meet Budget Control Act of 2011 (BCA) deficit reduction targets. These cuts began to take effect on March 1, 2013, and were intended to remain in effect until the end of fiscal year 2021. In implementing sequestration, the Office of Management and Budget (OMB) concluded tax credit payments to individuals were exempt from sequestration, but credit payments to other entities—including BAB credit payments to BAB issuers—were not.⁵ This interpretation contradicted earlier statements by the Treasury Depart-

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).
Sequestration of Build America Bond Credit Payments

PublicPower.org

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.

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 unfair 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. At the very least, Congress should reject President Trump's proposal to extend sequestration an additional two years through 2027.

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Sources: 2013 through 2018 sequestration data from the Office of Management and Budget; 2018 through 2025 sequestration estimates are APPA calculations based, in part, on OMB data and past Congressional Budget Office projections of sequestration percentages.

