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This Infrastructure Program Ended Up Costing Governments Millions. Trump Might Bring It Back.

States and localities are wary of the president's support for the Build America Bonds program.

A popular Obama-era infrastructure financing program may get revived this year as President Trump moves forward on his pledge to invest $1 trillion in infrastructure. But this time around, state and local governments might not be as excited about it.

The program, Build America Bonds (BABs), was created in 2009 as one of many recession-era initiatives aimed at jump-starting the economy. Unlike tax-exempt municipal bonds, BABs are taxable, and, as a result, open up the municipal market to new investors, such as pension funds or those living abroad. But BABs are also more expensive for governments. So to defray the added cost, the federal government offered a direct subsidy of 35 percent of state and local governments' interest payments on BABs.

But the program became a casualty of sequestration: cutbacks in federal subsidies promised under the program left state and local governments scrambling to fill the void. A recent estimate by the Institute of Government and Public Affairs at the University of Illinois found that so far Illinois and its localities have had to pay out a collective $70 million to offset the higher costs of BABs.

The study comes as economic advisors to Trump have expressed support for the BABs program as a financing tool. While details are light on the president's plan to incentivize infrastructure investment, most experts agree that taxable and tax-exempt municipal bonds are likely to play a role. And that has states and localities wary.

"With direct subsidy bonds, until the bond matures, you're exposed to the federal process," says Martin J. Luby, the author of the study. "So the question is, is the lower borrowing cost worth the risk that it could increase [should the federal government defund the program]?"

Dan White, senior economist at Moody's Analytics, predicts that the answer is no. "[The feds] could theoretically design a program that protects states against this," he says. "But states know this has the potential to be changed at a moment's notice by policymakers in Washington."

Back when BABs started, few — if any — considered the baked in exposure to federal policy. Therefore, the program was largely heralded as a success. All told, state and local governments sold more than $151 billion in BABs between 2009 and 2010. The program even propelled total bond issuance in 2010 to $433 billion, a record that still holds today.

But when sequestration hit in 2013, the mandated cutbacks in federal appropriations included the federal subsidies for the popular program. Annual subsidies for BABs dropped by anywhere from about 7 percent to nearly 9 percent. In addition, notes Luby, most BABs were not eligible for refinancing, so governments were stuck with the higher bills for the life of the bond. In Illinois, he estimates that will cost governments $400 million over the next two decades for roughly $11 billion in BAB debt. Cash-strapped Chicago would lose out on $56 million alone.

Nationwide, Luby figures the total subsidy losses are in the billions. “It’s stressing out these governments one way or the other,” he says. “And the expectation is, it’s just going to continue.”

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