

# **Bond Case Briefs**

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## **Pressure Builds on Congress to Raise Debt Limit, Which Would Reopen SLGS Window.**

The Treasury window for trading State and Local Government Securities will not reopen to the municipal bond market, though pressure is building on Congress to raise the federal debt limit before its August recess.

The SLGS window has been closed since March 1 when Treasury began taking extraordinary measures to avoid breaching the debt limit, and an increase would reopen it.

The deadline for avoiding a potential default on the nation's debt obligations has not been expected to be until early October, but the Bipartisan Policy Center said Monday the risk has moved up to early September.

The Washington-based think tank said the most likely deadline remains early October but it cannot rule out a September date because federal revenue growth has run lower than earlier expectations.

That leaves the House with only three weeks to act prior to its plan for a seven-week legislative break that would begin July 26, while the Senate is planning to end its legislative session a week later.

Both chambers plan to return for legislative work on Sept. 9, but that might be too late to avoid the disruption to financial markets and other cascading effects that a default would cause.

Senate Appropriations Chairman Richard C. Shelby, R-Ala., acknowledged the new urgency to act on Monday.

"That could change the dynamic," Shelby told The Washington Post. "We cannot default. That would send chaos through the financial markets."

Shelby told The Wall Street Journal, "It's time now for a serious conversation."

Senate Majority Leader Mitch McConnell, R-Ky., told reporters Tuesday he is "in close communication" with Treasury Secretary Steven Mnuchin on the deadline for acting. "I don't think there is any question that we won't default," McConnell said.

SLGS are typically used by state and local governments and other entities that issue tax-exempt municipal bonds because of yield restrictions and arbitrage rebate requirements under the Internal Revenue Code.

The role of SLGS has been significantly diminished by the termination of advance refundings on Jan. 1, 2018, under the Tax Cuts and Jobs Act, with the amount of SLGS outstanding declining more than 49%.

There were 13,147 SLGS bonds and notes with a combined value of \$47.9 billion at the end of June

compared to 21,015 SLGS bonds and notes valued at \$94.4 billion at the end of 2017, according to the Treasury.

There still are three uses for SLGS.

First, they are sometimes used for escrows in current refundings.

They are also sometimes used for equity defeasance escrows which are yield restricted.

The third use is for longstanding advance refunding escrows.

Michael Cullers, a public finance tax lawyer and partner at Squire Patton Boggs in Cleveland, said that based on what he's seen the closing of the SLGS window "hasn't created a lot of difficulties."

Because advance refunding of tax-exempt bonds is no longer allowed, a lot of the pressure to use SLGS has been alleviated, Cullers said.

"I would say it's now definitely more a bump in the road," said Cullers. "Even if you use them to refund taxable bonds, and you end up with positive arbitrage, you can make a yield reduction payment. It's really made it a lot less difficult."

Cullers noted that Treasury regulations on yield reduction payments were modified a few years ago to allow the use of yield reduction payments to comply with yield restriction where a defeasance escrow funded with proceeds of an advance refunding bond issue have a materially higher yield than the yield of the advance refunding issue, and the issuer was unable to subscribe for SLGS on the date that it entered into the agreement to purchase the escrow investments because the Bureau of Fiscal Service had suspended the sale of SLGS.

An agreement on raising the debt limit is expected to be part of a larger deal that would raise defense and domestic spending limits for the 2020 fiscal year that begins Oct. 1.

Without an agreement, budget caps would force onerous spending reductions.

CBO reported Monday the federal budget deficit was \$746 billion for the first nine months of the 2019 fiscal year that began Oct. 1.

The deficit through June 30 was \$139 billion more than the deficit recorded during the same period the previous year, CBO said. Outlays were \$208 billion higher than during the first nine months of fiscal 2018 while revenues were only \$69 billion higher.

Over the first nine months of the fiscal year total receipts have increased by 3%. The \$69 billion increase in receipts included an additional \$37 billion in payroll withholding for workers and a \$20 billion decline in income tax refunds.

By Brian Tumulty

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