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Budget Agreement Would Hurt BABs.

WASHINGTON — Municipal bond market participants said the two-year budget agreement announced Tuesday evening by House and Senate Budget Committee leaders would extend by two years the cuts to the federal subsidy payments issuers receive for Build America Bonds and other direct-pay bond programs.

The deal, called the Bipartisan Budget Act of 2013, was negotiated ahead of the budget conference committee's Dec. 13 deadline by House Budget Committee chairman Paul Ryan, R-Wis. and Senate Budget Committee chairman Patty Murray, D-Wash.

The agreement is a step toward avoiding another federal government shutdown in January. If it's passed by Congress, the agreement would allow the House and Senate Appropriations Committees to work on spending bills at agreed-upon levels before the current continuing resolution expires on Jan. 15.

The House is expected to take up the budget act first, and the Senate will follow. Ryan said that the intention is to bring the agreement to the House floor by the end of the week.

Muni market observers said they expect the deal to be approved by Congress.

The budget act would provide $63 billion in sequester relief for discretionary programs in fiscal 2014 and 2015, divided evenly between defense discretionary and non-defense discretionary programs, according to a news release from budget committee leaders.

But the sequester for mandatory programs, which includes the subsidy payments for BABs and other direct-pay bonds, remains the same for fiscal 2014 through 2021. And the agreement extends sequestration for mandatory programs by two years, requiring President Obama to sequester the same percentage of mandatory budgetary resources in 2022 and 2023 as will be sequestered in 2021. Doing so would reduce spending by $28 billion.

In total, the budget agreement would provide mandatory savings and non-tax revenue of about $85 billion. The deal would reduce the deficit by between $20 billion and $23 billion, the congressional leaders said.

The BAB program was created under the American Recovery and Reinvestment Act and allowed state and local governments to issue taxable bonds in 2009 and 2010 and receive subsidies from the federal government equal to 35% of interest costs.

State and local governments issued BABs with the assurance that the federal government would give them the full subsidy. But BABs have already taken a hit from sequestration and the budget agreement would cause subsidy payments to be less than 35% of interest costs for a longer period of time.

"It was bad enough when [the federal government] reneged on the deal the first time, and now they're doing it again." said Bill Daly, director of governmental affairs for the National Association of

Bond Lawyers.

Susan Collet, senior vice president of government relations for the Bond Dealers of America, said that the budget agreement is “a very disappointing way to treat a program that was designed to help state and local governments meet their financing needs.”

Michael Decker, Securities Industry and Financial Markets Association managing director and co-head of municipal securities said, “We commend congressional budget negotiators for reaching a compromise on difficult fiscal issues. The budget agreement will help minimize uncertainty for state and local governments and market participants. However, we believe it would have been appropriate for negotiators to have exempted direct-pay bond subsidy payments from automatic reductions under the sequester.”

John Godfrey, senior government relations representative for the American Public Power Association, said the reduction rate for the subsidy payments in 2022 and 2023 would be less than the 7.2% rate for fiscal 2014 because the amount of money cut from Medicare will be higher. Additionally, fewer BAB subsidy payments will face cuts in 2022 and 2023 because at least some of the bonds will have been redeemed by then, he said.

Godfrey said that it’s “crazy” that the federal government is “still renegotiating the terms of the financing of the BABs issued.” The muni market is learning just as it feared that the federal government wouldn’t make good on its promise to pay the full subsidy.

“All this makes it clear that Build America Bonds could not be a substitute for municipal bonds,” he said.

The higher spending on domestic discretionary programs under the budget agreement presumably will increase grants to states, Daly said. However, Godfrey said that he doesn’t think the sequester relief will be of much help to state and local governments because discretionary spending on state and local aid has been declining substantially.

The budget agreement does not include tax reform, but Collet noted that the deal doesn’t prevent future budget deals from making changes to the tax exemption for munis.

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