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Budget Deal Would Suspend Debt Limit, Extend Sequestration for BABs.

WASHINGTON – A budget deal negotiated by key members of Congress and administration officials would suspend the debt limit through March 15, 2017, but also extend sequestration of direct-pay bond subsidies by an additional year, through fiscal 2025.

The Bipartisan Budget Act of 2015, which would be a House amendment to a Senate amendment of H.R. 1314, was released late Monday, days before the Nov. 3 deadline to address the debt limit. It may be considered by lawmakers this week, according to the House's website, and municipal bond experts expect it to be enacted prior to the debt-limit deadline. H.R. 1314 was previously a trade bill, but is to be used as a vehicle for the budget measure, which would suspend rather than raise the debt limit through March 15, 2017.

Then on March 16, 2017, the debt limit would be raised to the amount of obligations outstanding at the time.

A suspension of the debt limit until 2017 would mean that Congress would not have to revisit the debt-limit issue until after the next presidential election. Once the debt limit is suspended, sales of State and Local Government Series securities (SLGS) will resume.

When the debt limit was reached in March, the Treasury Department suspended sales of SLGS as one of the extraordinary measures it takes to preserve the nation's borrowing capacity. State and local governments often purchase SLGS for their advance refunding escrows.

Bill Daly, director of governmental affairs for the National Association of Bond Lawyers, said that the reopening of the SLGS window would relieve issuers of having to solicit bids for open market Treasuries in lieu of purchasing SLGS. Purchasing Treasuries "can get expensive, particularly for small issues," he said.

Frank Shafroth, director of the Center for State and Local Leadership at George Mason University, said the reopening of the SLGS window is a "big plus" because anything that increases the efficiency of the muni market could reduce issuance costs.

He also said that the long debt-limit suspension removes the threat of a downgrade of the United States' credit rating and the ratings of state and local governments.

Securities Industry and Financial Markets Association president and chief executive officer Ken Bentsen said that the group "strongly supports efforts to avoid any default on our nation's debt."

The budget agreement would raise discretionary spending caps for fiscal years 2016 and 2017. Doing so likely removes the threat of a federal government shutdown in December, Shafroth said. The current continuing resolution funding federal agencies expires in the middle of that month.

But the agreement would reduce spending in fiscal 2025 by extending to that year sequestration of mandatory spending, which would mean cuts to federal subsidy payments for Build America Bonds and other direct-pay bonds.

Sequestration of mandatory spending was initially supposed to last through fiscal 2021, but it was extended through fiscal 2023 under a 2013 budget agreement. It was then extended through 2024 in February 2014 in a bill that repealed reductions in cost of living increases for younger military retirees.

Daly said that when Congress wants offsets, mandatory sequestration is a "little piggy bank they keep going to."

John Godfrey, senior government relations director for the American Public Power Association, expressed disappointment with the extension of sequestration for direct-pay bonds. He added that extending mandatory sequestration to offset increased discretionary spending caps is not fiscally responsible because it's just switching from indiscriminate cuts today to indiscriminate cuts years from now.

Some members of Congress have proposed reviving the BAB program, and the Obama administration is proposing the creation of a similar direct-pay bond program. But the budget agreement "undermines the chance of using this tool in the future" and highlights the need to make no changes to traditional tax-exempt bonds, Godfrey said.

Bond Dealers of America is disappointed to see that Congress may hurt direct-pay bonds but is pleased with the outline of the budget agreement overall, said Mike Nicholas, the group's CEO. He said that the agreement "will reduce the risks associated with federal budget and debt limit uncertainty for an extended period of time, which would be a positive development for state and local governments and the overall economy."

While experts expect the Bipartisan Budget Act to be approved by Congress, there may be both Republicans and Democrats that vote against it. Some Republicans will find fault with the fact that the deal is an agreement with the White House and raises the discretionary spending caps, while some Democrats may find the cuts to Medicare and Social Security spending in the deal to be problematic. There could be adjustments made to the measure to ensure it passes the House, Daly said.

THE BOND BUYER

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