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A Surge in Build America Bonds Calls: Navigating the Waters of Extraordinary Redemption.

Discover the impact of issuers activating ERP clauses on Build America Bonds (BABs) and its ripple effects on the municipal financing landscape. Gain insights into the strategic implications for investors and issuers in navigating this evolving trend.

Amid the echoes of bustling Wall Street and the undercurrents of a shifting financial landscape, a notable trend has emerged, capturing the attention of investors and municipal entities alike. The spotlight has turned towards the Build America Bonds (BABs), a relic of the post-2008 economic recovery era, as issuers increasingly exercise their right to call these bonds early under an 'extraordinary redemption provision' (ERP). This maneuver, spurred by recent court rulings and the prevailing interest rate environment, marks a pivotal moment that could reshape the terrain of municipal financing.

Understanding the Surge in ERP Calls

The genesis of this trend can be traced back to the inception of BABs during the fiscal stimulus efforts of 2009 and 2010. Designed to invigorate infrastructure projects and local economies, BABs offered a 35% subsidy on interest payments from the federal government to issuers, a lifeline that has since been repeatedly undercut by sequestration. However, the interpretation of sequestration as an 'extraordinary event' has been a subject of debate, leaving issuers in a limbo over their right to seek extraordinary optional redemption. The tide turned with a favorable court decision that clarified sequestration's adverse impact on subsidy payments, emboldening issuers to activate their ERP clauses. With around \$110 billion of BABs harboring embedded ERP calls, and only a fraction deemed economical to call thus far, the stage is set for a significant uptick in activity. This year alone, the anticipation of \$20 billion to \$30 billion in ERP exercises presents a watershed moment, with potential reverberations across the taxable municipal bond market.

The Ripple Effects

The unfolding scenario presents a dichotomy of impacts. On one hand, the proactive redemption of BABs could signal a more assertive stance by issuers against the backdrop of fiscal challenges, offering a pathway to refinance at potentially lower interest rates. This strategic recalibration could enhance fiscal sustainability for municipalities, nurturing an environment ripe for fresh investments. On the flip side, the surge in ERP calls injects a dose of uncertainty into the market, potentially rattling investor confidence. The specter of premature redemptions may deter participation in future deals, casting a long shadow over the attractiveness of similar taxable municipal offerings. Furthermore, this trend underscores the intricate dance between fiscal policy decisions and market dynamics, a balancing act that demands meticulous navigation by all stakeholders involved.

Looking Ahead

As we stand at the crossroads of this significant shift, the broader implications for the municipal bond market loom large. The increasing exercise of ERP rights by BAB issuers not only reshapes the

immediate landscape but also sets a precedent for how extraordinary events are navigated in municipal finance. Investors and issuers alike are keenly watching how this wave of ERP calls unfolds, gauging its impact on market sentiment and future issuance strategies. Amidst this flux, the resilience and adaptability of the municipal bond market are put to the test, offering a compelling narrative on the interplay between policy, finance, and market dynamics. As the story of BABs continues to evolve, the lessons learned may well chart the course for the next chapter in municipal financing.

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