

## **Build America Bonds Are Helping State and Local Governments Finance Infrastructure Projects and Create Jobs While Saving Taxpayers Billions**

### **Basics of the Build America Bonds Program**

- **New financing tool for state and local governments:** The Recovery Act of 2009 created an innovative new tool for municipal financing called Build America Bonds (BABs), which are taxable bonds for which the US Treasury Department pays a direct subsidy of 35 percent of the interest costs to the issuer. BABs have helped state and local governments finance public capital projects at lower borrowing costs.
- **BABs have attracted new investors:** The Build America Bonds program has broadened the market for municipal bonds to include investors that do not normally hold tax-exempt debt, such as pension funds and sovereign wealth funds. By attracting new investors to municipal bonds, BABs have helped to relieve the supply pressure in the municipal bond market and to lower borrowing costs.
- **Supporting infrastructure projects and job creation:** The BABs program supports local infrastructure projects and job creation by allowing states to move forward with capital investments in public buildings, schools, government hospitals, governmental housing projects, roads and transportation infrastructure, public safety facilities and equipment, water and sewer projects, environmental and energy projects, and public utilities.
- **Proposal to expand and make the BABs program permanent:** Given the demonstrated success of the BAB program, the President's FY 2011 Budget proposes making the program permanent with a subsidy rate that makes extension revenue-neutral. Additionally, the President's Budget proposes expanding the eligible uses of BABs, thereby allowing them to support financing for nonprofits and a wider range of municipal borrowing.

### **The BABs Program is widely successful and popular with state and local governments**

- **More than \$100 billion issued:** From the inception of the program in April 2009 through May 31, 2010, over \$106 billion of BABs have been issued by state and local governments in 49 states, the District of Columbia and two territories. Importantly, the pace of issuances remains steady today.
- **More than \$12 billion in savings:** A recent Treasury Department analysis showed that for the BABs issued in the first year of the program, state and local governments will save more than \$12 billion in present value borrowing costs compared with issuing traditional tax exempt municipal bonds, taking into account underwriting fees and net interest costs. These savings are considerably greater than the net cost to the federal government of the BABs program. [\[LINK\]](#)
- **States, cities hail BABs program:** From across the country, Governors, Mayors, State Treasurers and others have welcomed the BABs program. See attached.

### **Tax compliance measures**

- **Paying off delinquent taxes and other overdue federal debts:** Under federal law, the federal government reduces or "offsets" certain payments by the amount of outstanding taxes and non-tax debts owed to the federal government. In the overall context, the risk that payments under the BABs program could be reduced to pay off the overdue taxes or non-tax debts owed to the federal government remains relatively minor.
  - Few payments offset for overdue taxes: Based on available data, less than 2 percent of the total dollar amount of all BABs payments through March 2010 were offset to pay overdue taxes owed to the federal government.

- Not unique to BABs: Offsets for outstanding federal taxes and overdue federal debts are required by law and collected across the government. This program also assists states in collecting overdue state income taxes.
- Popularity remains high: Despite the possibility of the subsidy payments being reduced, BABs remain very popular for states and local governments looking to finance public infrastructure projects that are rebuilding communities and creating jobs.
- **Initial IRS compliance initiatives for BABs issuers**: Just like other municipal bond issuances, BABs issuances will receive appropriate scrutiny from the IRS, consistent with practices in tax-exempt bond programs.

**Ongoing compliance process**: BABs issuers must file an information return in connection with each separate bond issuance, which the IRS reviews to preliminarily determine if the issue qualifies. When issuers request interest payment, they send a separate return that the IRS matches with the original filing.

- New compliance questionnaires: The IRS began sending compliance questionnaires, which include questions about issue price and record keeping, to all issuers in February 2010.
- Audits as appropriate to protect taxpayers: The IRS will audit BAB issuances in an appropriate manner consistent with practices in tax-exempt bond programs. At this point, the IRS emphasizes it is too early to predict the specific audit rate. To date, less than 10 of the BABs issuers are currently being audited out of more than 1,300 total BABs issuances.

## **BABs underwriting fees are decreasing over time**

- **Significant decline in BABs underwriting fees in just the first year**: BABs underwriting fees have been declining since the program began, and have declined to a level comparable to that of tax-exempt bonds. The weighted average BABs underwriting fee was 6.25 in the second quarter of 2010, down from 7.88 in the second quarter of 2009, compared to an average of 6.2 for tax-exempt bonds, according to data from Thompson Reuters.
- **BABs underwriting fees have decreased over time for several reasons**:
  - BABs have gradually become better known and less risky from the underwriter's perspective, which likely lowered underwriting fees.
  - The initial launch of BABs required underwriters to incur some start-up costs, including developing the appropriate legal framework and writing placement documents, which likely raised the underwriting fees.
  - Institutional factors may have affected the cost of the initial BABs issues. As the program has matured, underwriting has migrated from corporate desks, which tend to charge higher fees, to the tax exempt desks, and underwriting fees have come down as a result.
  - There has been a shift away from negotiated sales to competitive sales, especially for small deals, which may have put downward pressure on underwriting fees.
- **Decline in BABs underwriting fees likely to continue**: Many of the factors that have contributed to the decrease in underwriting fees, such as improved certainty in the BABs market and increased investor familiarity could continue to lower underwriting fees in the coming months. And, a permanent extension of the BABs program would likely put further downward pressure on underwriting fees as certainty would be increased and underwriters would devote more resources to competing for BABs placements.
- Moreover, the underwriting fees paid by BABs issuers have been small relative to the significant savings on interest costs due to the program.

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