

## BUILD AMERICA BONDS GENERAL SUMMARY \* DIRECT PAYMENT TYPE

AUTHORIZED BY AMERICAN RECOVERY AND REINSTATEMENT ACT OF 2009



<b>PURPOSE:</b>	BABs allow state and local governments to issue taxable bonds for capital projects and to receive a direct subsidy payment from the U.S. Treasury for a portion of their borrowing costs.
<b>FEDERAL SUBSIDY:</b>	35% of total coupon interest.
<b>ISSUANCE DEADLINE:</b>	Prior to January 1, 2011.
<b>USE OF PROCEEDS:</b>	Only capital expenditures may be financed. No refundings, working capital or private activity bonds. Not more than 2% of proceeds to pay issuance costs.
<b>SUBSIDY FILING PROCESS/ FIXED RATE BONDS</b>	Submit IRS Form 8038-CP (1 page) not more than 90 days and not less than 45 days from relevant interest payment date.
<b>VALUE CAP:</b>	No volume cap or limit on number of BAB issues.
<b>TAX RULES:</b>	BABs must comply with existing tax regulations such as arbitrage and rebate
<b>A BRIEF HISTORY:</b>	Authorized February 17, 2009 with the first issues in early April 2009. Initially BABs were anticipated to have characteristics typically seen in taxable securities. This included "bullet" term maturities and absolute call protection. Most, not all, of initial BABs have been highly rated, large issues. As of May 15, 2009 approximately 30 Direct Pay BABs have closed. Proceeds range from \$2.0 million - \$5.0 billion. The median size of BABs issued is approximately \$56.0 million.
<b>EVOLUTION:</b>	BABs may be evolving to structures more typical of the tax-exempt market. Some issues are being structured with 10 year par calls and serial bonds. Smaller, lower rated BABs issues may become more commonplace.
<b>PRICING:</b>	Initially some BABs traded at premium on the secondary market within 24 hours of pricing, indicating that the initial interest rates may have been inefficient (higher than the market). Pundits have referred to an "early entry penalty" meaning that sometimes pioneers pay a price. Appropriate pricing levels are being sought.
<b>RATING AGENCY FEEDBACK:</b>	One rating agency considers 35% subsidy additional revenue, not an off set to debt service. For coverage, test must show ability to pay all debt, not just 65%. The same rating agency expressed concern that BAB structures with term maturities and non-callable bonds or make whole provisions may impact an issuer's financial flexibility.
<b>REASON FOR CONCERN?</b>	Fear about suspension of future cash subsidies has been expressed. Some have questioned if the on-going 35% federal cash subsidy could be terminated by future congressional action. Congressional staff state the risk of discontinuing the Direct Payment BAB subsidy is unlikely.
<b>IMPACT ON MARKET:</b>	BABs have brought buyers of taxable bonds into the municipal market and shifted some issuance from the tax-exempt to taxable market. This has decreased tax-exempt supply, thereby impacting interest rates. The total impact of BABs is yet to be determined. Likely that Direct Payment BABs will continue to evolve in structure and pricing.
<b>OTHER TYPES OF BABS:</b>	Other BAB provisions authorize tax credits where 35% of interest is provided to an investor in the form of a tax credit. To date a tax credit BAB has not been issued.

\* Summary is partially based on IRS Notice 2009-26. That notice solicits public comment on Direct Payment procedures and is subject to revision. This summary is general in nature and may not be applicable to specific issuer circumstances or timing. Call Tom Johnsen at (949) 660-7311 for inquiries about BABs.

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