



Expansion and Permanent Extension of BABs, Arbitrage Simplification Headline 2012 Budget Proposals

President Obama recently released his 2012 Budget Proposal (Budget). The Budget contains several provisions related to public finance including an expansion and permanent extension of the Build America Bonds (BABs) program. Political reception of the Budget has been mixed, but presidential budgets are an important starting point for legislative action.

The Budget Would Extend the Build America Bonds Program

Direct Payment Build America Bonds burst onto the municipal finance scene in 2009 but expired on December 31, 2010. The direct 35% federal interest subsidy that BABs provided made them very popular with issuers because the subsidy was much deeper than the implicit subsidy offered by tax-exempt bonds. Many in Congress decried the deep subsidy as too expensive, while many issuers objected to the requirement that BAB proceeds be used only for capital projects. The Budget tackles each of these objections. The Budget would extend BABs permanently but would reduce the subsidy to 28% of each interest payment, a rate described in the Budget as approximately revenue neutral relative to tax-exempt interest. In addition, the permitted uses of BABs proceeds would be expanded beyond "new money" capital projects to include (i) current refundings of prior public capital financings for interest savings; (ii) working capital financings of governmental operating expenses with a maximum 13-month maturity; and (iii) 501(c)(3)

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financings.

The Budget Would Simplify the Arbitrage Requirements

The Budget also proposes to simplify the confusing and highly overlapping yield restriction and rebate rules. The Budget proposes to repeal the yield restriction rules except for advance refunding escrows and other limited circumstances. In addition, while there are currently several complicated spending exceptions from the rebate requirement, the Budget would provide a more generous and simplified three-year spending exception. This new exception would apply to all tax-exempt bonds (other than advance refundings and working capital financings) that bear fixed-rate interest and have a weighted average maturity of at least five years, so long as the issuer spends 95% of the proceeds within three years and the issuer proceeds with due diligence to spend the bond proceeds. While not stated in the Budget, it can be anticipated that this exception would also apply to BABs meeting these requirements. The Budget would also increase the "small issuer" rebate exception from \$5 million to \$10 million and index the new limit for inflation.

The Budget Would Simplify Certain Private Business Use and Single-Family Housing Bond Requirements

Relating to the private activity bond tests, the Budget would repeal the 5% limit on "unrelated or disproportionate" private business use. In addition, two requirements applicable to single-family housing bonds would be eliminated: the requirement that the purchase price for the bond-financed houses not exceed a base amount and the requirement that, in general, only first-time homebuyers may purchase the bond-financed houses.

Summary

The Budget offers hope of a permanent, expanded BABs program, and some much needed simplification of the tax-exempt bond requirements. While the Budget is not itself a legislative proposal, it can serve as a framework for future action. As always, Squire Sanders will monitor the status of the Budget proposals and resulting legislation, and we will continue to provide you timely, accessible updates.

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