

What the Sequestration Means for Direct Pay Bond Issuers

March 6, 2013

Now that the federal sequestration has occurred, state and local governments that have issued certain direct pay bonds may see a reduction in refundable credits as long as the sequestration remains in effect. But exactly how much the credits will be reduced will not be known until the issuer submits its Form 8038-CP to request its credit payment or even until sequestration ends.

The sequestration is the result of Congress' attempt to compel itself to act on deficit reduction. In August 2011, as part of the Budget Control Act of 2011, Congress gave itself until March 1, 2013, to reduce the deficit by \$1.2 trillion. When it failed to meet its own deadline, the Balanced Budget and Emergency Deficit Control Act of 1985 required certain automatic reductions to take effect.

Unless Congress acts before September 30, 2013, these reductions will remain in place until that date. Among the cuts are reductions to refundable credits to "Direct Pay Bond" issuers who elected to receive a direct credit subsidy under Section 6431 of the Internal Revenue Code, including Build America Bonds, Recovery Zone Economic Development Bonds, Qualified School Construction Bonds, Qualified Zone Academy Bonds, New Clean Renewable Energy Bonds and Qualified Energy Conservation Bonds.

How much will the credits be reduced?

According to the Office of Management and Budget, the budgeted accounts intended to pay the refundable credits are subject to a 8.7 percent reduction under the sequestration order. At this time, it is not clear how much, if any, of each issuer's individual credits will be reduced. Issuers should continue to timely submit the Form 8038-CP claiming 100 percent of the allowable credit amount. At that time, the Internal Revenue Service may notify the issuer that a portion of the credit is subject to reduction by sequestration. The sequestration reduced rate will be applied until September 30, 2013 or intervening Congressional action, whichever is shorter.

Depending upon a number of factors, including the call provisions of a particular Direct Pay Bond issue, issuers may wish to evaluate whether there would be a benefit to refunding their Direct Pay Bonds on a current basis. If you have any questions regarding this alert or are an issuer of Direct Pay Bonds and would like to discuss refunding those bonds, please contact us.

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