To BAB Or Not To BAB – That Is The Question

In recent months issuers are beginning to question whether or not they are interested in issuing bonds through the Build America Bond (BABs) program. Although the economics are favorable for BABs with the 35% interest rebate and Recovery Zone Economic Development Bonds (RZEDBs) with the 45% interest rebate other issues are being considered.

Issuers have been informed they will **all** be required to complete a questionnaire. The questionnaire asks whether or not certain written policies have been implemented. No one wants to answer incorrectly.

The Internal Revenue Service has indicated that it plans to audit a significant number of BAB issuers, perhaps as high as half of all issuers. This is a much higher level than the random audits on traditional tax exempt issues.

Pricing of BABs is more restrictive than traditional tax exempt bonds and it appears that the IRS may be monitoring sale prices for compliance during the period between bond pricing and bond closing. Issuers are thus subject to compliance requirements that are the result of actions of a third party, the underwriter, not through their own actions.

Amounts of money owed by an issuer to the Federal Government can be deducted from the Treasury rebate.

Failing to fully comply with the regulations by an issuer's actions, or by an underwriter, can conceivably result in denial of interest rebates.

It is for the above reasons that some issuers of all sizes have made the decision to forgo the financial benefit of BABs or RZEDBs in favor of issuing traditional tax exempt bonds.

Please contact your bond counsel to discuss all of the requirements affiliated with issuing BABs or RZEDBs so that you are fully informed.

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The Bond Insurance Industry

How valuable is it today? Who are the remaining players? With the recent changes in the bond insurance industry, from the downgrades of all insurers to the more recent upward recalibration of ratings by agencies such as Moody's Investors Service and Fitch, no wonder the demand for bond insurance has declined. Underwriters are not looking to insure bond deals today that are rated Aa and above. Bond insurance is not being purchased directly by the issuer nor on a bidder's option basis by the underwriters.

About 10% of the current market is using bond insurance down from 50% a couple years ago. With the recent recalibration of ratings, this will probably go down since many issuers with Baa1 ratings have now moved up to A1 and Baa2 to A2. This has allowed these issuers to sell bonds that would have previously needed bond insurance. The recalibration of ratings has to be quite challenging for the bond insurance industry. In addition, with the economic and financial stress that issuers are experiencing, the insurance industry risk of paying claims is financially challenging as well.

As the changes took place with the bond insurance industry, so did the selection or the preference of a particular insurer by the underwriters. As a result, the remaining bond insurance companies have changed their strategies. Insurance companies that were taking only issues $5M or more several years ago are now impartial to the size and pricing their insurance accordingly.