



Build America Bonds

An update May 2014

In light of recent events, a review and explanation of some of the unique traits of Build America Bonds (BABs) is in order. BABs are taxable municipal investments. They possess characteristics that distinguish them apart from other bonds. Many UASI clients hold these bonds in their tax deferred portfolios.

Like many taxable municipal bonds, a large number of BABs were issued with 'extraordinary redemption' options. In these cases, the issuers reserved the right to call bonds in the case of certain events or conditions. When coming to market with bonds, many BAB issuers stipulated that a reduction or elimination of the Federal Government's subsidy would serve as one such condition. At the time, this was a new and often overlooked condition. This is due to the fact that taxable municipal bonds were not subsidized by the federal government in this fashion before the BABs program began. In 2013, it was decided that along with other Federal budget cuts, subsidy payments to BAB issuers would be cut by 7.2% (beginning in FY 2014). As a result, many issuers now have the option to redeem their BABs.

Considering this, holders of BABs may now be at risk of seeing their bonds called away. In fact, several issuers have already taken this opportunity to call their outstanding bonds and refinance at lower interest rates via tax exempt issuance. This has resulted in loss for some BAB investors that paid premiums for their bonds.

While this seems like negative news for BAB investors, it's important not to panic. Many of these bonds were issued with 'make whole call' provisions. This means that in the case of an extraordinary event, the issuer's option is to redeem bonds at the **greater** of par or a treasury spread. The 'make whole' safeguard protects investors from having their bonds called away at an otherwise below market price.

UASI has focused only on purchasing BABs with make whole calls for our clients. Therefore, we're comfortable holding them. If panic selling of BABs happens to arise due to recent events, we stand ready to take advantage of the opportunity via informed purchases.

Matt DeLorenzo
Fixed Income Strategist