

## Bonds Briefing Paper: Modification of SLGs Program

### Present Law

State and local governments at one time complied with the arbitrage yield restrictions by diverting the arbitrage to an underwriter or some other person (e.g., they would purchase securities from the underwriter with proceeds of an advance refunding at a price in excess of fair market value in order to reduce the yield of the securities to the maximum permitted yield). In response to this, the Treasury Department regulations were amended to prohibit State and local governments from acquiring yield restricted obligations for an amount in excess of fair market value, and the Treasury Department instituted the SLGs program to make available securities (U.S. Treasury Obligations -- State and Local Government Series) that would enable State and local governments to comply with arbitrage yield restrictions.

The SLGs regulations issued by the Bureau of Public Debt provide that:

1. A SLGs subscription setting forth the issue date, maturities, and interest rates must be submitted at least 20 days before the issue date (and not earlier than 60 days before the issue date);
2. The minimum maturity of a SLG is 45 days, and the minimum denomination is \$1,000;
3. If a SLG has a maturity of one year or less, it may be redeemed after 45 days from the issue date on 20 days' notice. If a SLG has a maturity of more than one year, it may be redeemed after 1 year on 20 days' notice. If a SLG is redeemed prior to maturity, the interest is recalculated for the period the SLG was outstanding so that it does not exceed the maximum interest rate that was available for the shorter maturity, and a penalty is assessed for the additional borrowing costs the Treasury will incur by reason of the redemption (the difference between the Treasury's current borrowing cost to the original maturity of the SLG and the original rate of interest payable on the SLG);
4. The issuer must certify that the total to be invested in SLGs is not more nor less than the proceeds of the issue that are subject to arbitrage yield restrictions, and that none of the proceeds were derived from the redemption of SLGs prior to maturity;
5. An issuer who fails to make timely payment for a subscription is ineligible to subscribe for SLGs for at least six months (unless the failure is established to have been taxable. (This is a clarification of the proposed modification offered on April 15.)

5. The following are added to the category of tax-exempt IDB's subject to a volume cap:
  - a. District heating and cooling facilities
  - b. Hazardous waste facilities.
6. Clarify that the "safe harbor rules" for purposes of airports, docks and wharves electing outside the volume cap is as follows: "leases not more than 80% of the facility's useful life with no option in the lease to buy the facility at less than fair market value."
7. Require that the Treasury SLGS program, as modified by the Chairman's proposal, be in place as of January 1, 1987.
8. As under current law, each state's volume limitation is allocated one-half to State issuers and one-half to local governments within the state on the basis of relative populations unless the state adopts a statute providing a different allocation. Clarify that the Governor of each State is permitted to issue a proclamation overriding the Federal rules prior to State legislation allocating the volume limitation.
9. Minimum size requirement for designed blighted area would be reduced from 15 to 10 contiguous acres.
10. Hazardous waste facilities and solid waste facilities issued under the IDB volume cap would be eligible to claim depreciation over a recovery period of 8 years.\*

11. There will be an exception from the rule restricting the term of the bonds to no more than 120 percent of the economic life of the property financed for bonds issued in equipment “pooled” financing arrangements, but it will be limited to loans made to individual organizations by the pool to 120 percent of the economic life of the property financed.
12. The Chairman’s proposal continues the present-law rule allowing costs of bond insurance to be recovered from arbitrage profits if the costs do not exceed interest rate savings resulting from the insurance. The proposed modification would expand this exception to letters of credit, provided the letters of credit were purchased pursuant to competitive bidding.

All other provisions in the Chairman’s proposal are adopted without change. Those provisions include:

1. the present law volume caps, and
2. the Chairman’s arbitrage and advance refunding rules.

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\* Depreciation for IDB financed multifamily housing will be deferred until the Committee considers the proposed credit for low income rental housing.

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