



Insurance Asset Management Basics of Build America Bonds

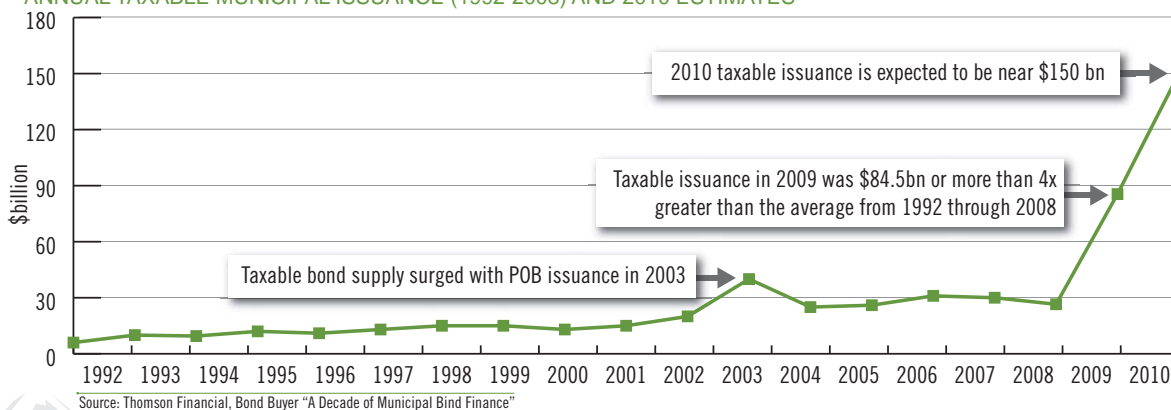


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Municipal Bonds

Build America Bonds (BABs) were created by the American Recovery and Reinvestment Act of 2009 (the “Recovery Act”), which was signed into law by President Barack Obama on February 17, 2009. The interest income on municipal bonds has traditionally been exempt from federal income tax. The Recovery Act authorizes state and local governments to issue Build America Bonds, which are municipal bonds whose interest is taxable on federal income tax basis. In return, the issuers receive a direct subsidy for 35% of their interest costs on the bonds. The program was implemented during the credit crisis, when municipal issuers were having trouble accessing the capital markets at reasonable rates. Currently, BABs can be issued by state or local governments for capital projects. Some examples of projects that would qualify for BAB financing include buildings for public schools, colleges and universities; power plants for publically owned utilities; transportation projects; and water and sewer facilities. There is no limitation on the volume of eligible BABs that can be issued.

In 2009, there was approximately \$85 billion in taxable municipal issuance and we expect between \$125 billion and \$150 billion in 2010. With approximately \$122.4 billion in issuance to date, the market for BABs is growing at an average rate of \$8.2 billion per month. Year-to-date, taxable municipal bonds account for 31% of total municipal issuance. This is significantly higher than the 16% of total municipal issuance BABs tallied in 2009.

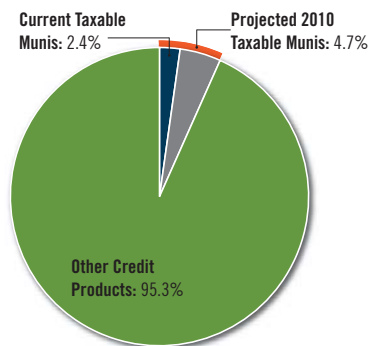
ANNUAL TAXABLE MUNICIPAL ISSUANCE (1992-2008) AND 2010 ESTIMATES



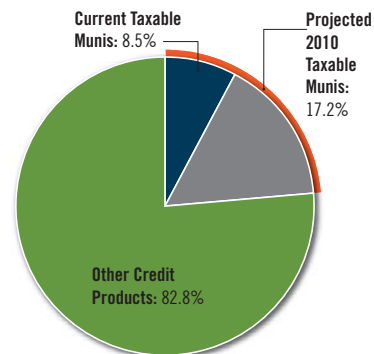
Structurally, BABs are quite similar to investment-grade corporate bonds. Historically, the municipal bond market has exhibited very low default rates in comparison to corporate credits. The majority of issuance has been long-dated, noncallable bonds, and over 50% of issuance has been made up of bonds with benchmark maturities of 250MM+.

At the time of this writing, legislation to extend the Build America Bond program for two years is awaiting approval. The decision is expected in September, and we believe the approval of the extension is likely. As had been expected, the subsidy payments will be reduced to 32% in 2011 and 30% in 2012.

TAXABLE MUNIS AS % OF CREDIT INDEX



TAXABLE MUNIS AS % OF LONG CREDIT



Source: Barclays Capital Municipal Strategies and Index Group

Barclays Capital expects the Build America Bond program to have a very material impact on the composition of its U.S. Credit Indices. Barclays Capital estimates that the BAB share of the U.S. Credit Index will increase from 2.4% to approximately 5%, and that its representation in the U.S. Long Credit Index will rise from about 8% to 17%. The Build America Bond program has given municipalities access to a much larger investor base, including pension funds, insurance companies, and foreign investors. With the rapid growth in this relatively new asset class, we believe that many investors benchmarked to Barclays Capital U.S. Credit Indices would benefit from including BABs in their portfolios. Otherwise, they risk significant tracking error as a result of their underweight positions in the sector. ■

For more information

How might Build America Bonds improve the efficiency of your portfolio?
For more information, please contact **Don Hill**, Head of Insurance Business Development, at **(802) 383-4062** or **dhill@dwight.com**.