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Libor Replacement Carries Risk for States and Cities, Group Says.

- **Muni finance officers group issues bulletin on benchmark shift**
- **'There's a whole world of costs here,' says GFOA official**

The end of the London interbank offered rate after 2021 could have costly consequences for states and cities and managers need to start preparing, the Government Finance Officers Association said Thursday.

About $44 billion of floating-rate municipal bonds and an unknown amount of loans and interest-rate swaps entered into by states and cites are tied to the U.S. dollar Libor. Many of these securities and contracts will continue long after 2021, when Libor is phased out.

Municipalities will need to take inventory of debt and investments tied to Libor and hire lawyers and advisers to review contracts and renegotiate them before 2022, according to the GFOA. States and cities should also develop mechanisms to transfer Libor-based products to the Secured Overnight Financing Rate, Libor's replacement.

"There's a whole world of costs involved here that we haven't quite explored," said Emily Brock, federal liaison for the GFOA, which represents local government officials. "We don't understand the magnitude of it."

About $350 trillion of derivatives, loans, mortgages, commercial paper and other debt is tied to Libor, which was used for decades as a global floating-rate borrowing benchmark until rate-rigging scandals ruined the index's credibility. The Federal Reserve Bank of New York selected the Secured Overnight Financing Rate as Libor's recommended replacement.

Instead of a daily survey of about 20 large banks that estimate how much it would cost to borrow from each other without putting up collateral, SOFR is calculated using trades in the U.S. Treasury repurchase agreement market. S&P Global Ratings expects the SOFR rate to be lower than Libor because SOFR is secured by collateral.

It may not be feasible for banks and counterparties to amend trillions of dollars of derivative contracts before 2022, Loop Capital Markets said in March. Municipalities may be forced to terminate swap contracts, triggering millions of dollars in payments to banks or endure expensive and drawn-out legal battles.

In addition, switching outstanding tax-exempt floating-rate debt from Libor to a different index may cause them to be considered "reissued" under Internal Revenue Service guidelines, resulting in the debt becoming taxable, Loop said.

City managers that are well-versed in the transition to SOFR from Libor and actively preparing to amend documents will be viewed more favorable than those ignoring the issue or waiting until 2021 to deal with it, S&P Global Ratings said in a June comment.

“The often-restrictive procedures U.S. public finance issuers must follow to amend documents will make the three years go by very quickly,” the rating company said.

Bloomberg Markets

By Martin Z Braun

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— *With assistance by Danielle Moran*

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