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Risky Business: Bank Loans to Local Governments.

The authors recently graduated with Master in Public Policy degrees from Stanford. They conducted research in conjunction with the Volcker Alliance, a nonprofit, nonpartisan organization that was launched in 2013 to address the challenge of effective execution of public policy and rebuild trust in government. Their advisors were Joe Nation, a SIEPR researcher, and Christine Pal Chee, a lecturer in the Public Policy Program.

Local governments across California — and the U.S. — are increasingly borrowing from commercial banks instead of issuing public bonds. These loans can be problematic for financial markets and for local governments themselves, risking a lack of transparency and poor terms including accelerated or immediate repayments for events such as a ratings agency downgrade.

Our research, based on California Debt and Investment Advisory Commission (CDIAC) data from 2010 to 2016, found that more than half of California municipalities that borrowed directly from banks are at such financial risk.

Historically, local governments have raised funds through issuing public bonds, a process regulated by the Municipal Securities Rulemaking Board (MSRB), a regulatory agency focused on municipal financing and subject to oversight of the Securities Exchange Commission (SEC). The process is highly transparent, informing citizens and financial market participants alike.

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