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Barclays Has No Excuse for Private-Prison Drama.

The bank risked reputational harm by trying to thread the needle between lending and underwriting.

Barclays Plc probably should have seen this coming.

For more than two weeks, the London-based bank has been embroiled in controversy after Bloomberg News was first to report that the bank was serving as lead underwriter of a municipal-bond deal that would raise hundreds of millions of dollars for two Alabama prisons owned by CoreCivic Inc., a giant in the private-prison industry. The saga ultimately came to a close on Monday, with Barclays withdrawing from the offering after becoming the first company ever to be kicked out of the American Sustainable Business Council and its partner organization Social Venture Circle, which combined represent some 250,000 businesses.

Barclays doesn't have much of an excuse here. The bank pledged two years ago to no longer provide new financing to private-prison companies. Yet it certainly looks as if it saw the murky conduit-financing segment of the $3.9 trillion municipal market as something of a workaround to this commitment. After all, as lead underwriter, it technically wouldn't be funding the prisons itself. Rather, the debt would be issued by a Wisconsin agency called the Public Finance Authority on behalf of Government Real Estate Solutions of Alabama Holdings LLC, which is 100%-owned by Tennessee-based CoreCivic. The two new prisons would be leased and staffed by the Alabama Department of Corrections.

Barclays initially focused on Alabama's role in the deal. "At the direction of the State of Alabama, Barclays has worked alongside the state's representatives and advisors to finance the procurement of two new correction facilities that will be leased and operated by the Alabama Department of Corrections for the entire term of the financing," the bank said in a statement to Bloomberg News's Amanda Albright and Danielle Moran. "The commitment we made in 2019 not to finance private prison companies remains in place."

It's true that Governor Kay Ivey of Alabama, a Republican, favored the financing arrangement. "Leasing and operating new, modern correctional facilities without raising taxes or incurring debt is without question the most fiscally responsible decision for our state," she said in a February statement. "We are improving public safety, providing better living and working conditions, and accommodating inmate rehabilitation all while protecting the immediate and long-term interests of the taxpayers."

Still, the transaction was undoubtedly a boon for CoreCivic. Albright and Moran reported that as part of the offering, Alabama's corrections department agreed to prioritize lease payments above all other obligations to the extent allowed by law. That strong commitment, along with "a unique prepayment mechanism," led S&P Global Ratings to consider the $634 million deal investment grade, noting that the "insolvency risk during construction is shifted from the project to Alabama Department of Corrections." In other words, while the debt wouldn't sit on the state's balance sheet, Alabama was in some ways still putting its own creditworthiness on the line. And Barclays was helping to make that happen.

Then there’s the Public Finance Authority itself. My Bloomberg colleague Martin Z. Braun has written extensively about the agency, which has no employees yet has issued billions of dollars of municipal bonds for projects across the country. Sometimes, these deals get into trouble. “In Roach-Infested Slums, a Muni-Bond Default Spurs Big Questions,” read one headline about a company that used conduits including the PFA. “Las Vegas Charity Files Bankruptcy 20 Months After Debt Sale,” said another. A man who pleaded guilty in January to running a Ponzi scheme had previously raised $11 million through the PFA. Obviously this doesn’t represent all of its bond sales, but it happens enough that muni investors and reporters alike rightfully dig into the details of any project coming through the agency. Barclays shouldn’t have been blindsided by the scrutiny.

Yet the bank appeared willing to barrel through a revolt among some investors. On Thursday, the offering was delayed, the public portion of the sale was downsized by about $200 million and yield spreads widened from pre-marketing levels. But that kind of pressure can simply be written off as part of the job of underwriting a large muni-bond deal from an unfamiliar borrower.

The broader reputational hit from the American Sustainable Business Council on Friday was something else entirely. “We abhor the hypocrisy represented here and renounce the continued investment in the broken, unjust system of incarceration of this country,” MaryAnne Howland, the council’s board chair, said in a statement. Some choice comments from other advocates: “Profiting from human suffering is just about the antithesis of social business;” “The days of empty corporate platitudes are over;” “We urge banks like Barclays to rethink their investment strategies for a healthier and more equitable world.”

That kind of blowback just isn’t worth the underwriting fee. “We have advised our client that we are no longer participating in the transaction,” Barclays said Monday. “While our objective was to enable the State to improve its facilities, we recognize that this is a complex and important issue. In light of the feedback that we have heard, we will continue to review our policies.” KeyBanc Capital Markets also resigned as an underwriter.

Trying to explain the difference between lending and underwriting can be tough enough in ordinary circumstances. When a private-prison company is involved, it’s a position that’s pretty much doomed from the start, even if it’s true that the new facilities would replace those that are old and dilapidated. Add the PFA and its spotty history into the mix, and it has all the makings for a volatile situation. This likely won’t be the last controversial deal to try to slide through the muni market, but Barclays learned the hard way that associating with unsavory offerings has a greater stigma than ever in today’s markets.

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