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Investors Push Back on Washington State's $1.1 Billion Muni Bond Deal.

- **Two investors sent letters to deputy state treasurer**
- **$1.1 billion deal part of plans to refund using ERP call**

The state of Washington is getting pushback from investors on an upcoming mega deal to refinance debt that would cause holders of the old municipal bonds to face potential losses.

The sale is part of a wave of planned refundings that would replace taxable debt sold under the Build America Bonds program more than a decade ago with lower-yielding, tax-exempt securities. Washington is planning to sell about $1.1 billion of bonds later this month, according to preliminary bond documents dated March 18.

Two investors, Wedge Capital Management and Amica Mutual Insurance Co., sent emailed messages earlier this month to Washington's Deputy Treasurer Jason Richter voicing displeasure with the deal, according to copies provided to Bloomberg News by the treasurer's office.

"Although we are not the largest investors in the State of Washington, we are acutely exposed to the large book value losses these ERP calls, if enacted, would impose on all insurance and bank investors," wrote Brian Pacheco, a portfolio manager at Amica, in the message dated March 8. "We hope that you will reconsider your decision to call this via ERP."

There is a feud brewing between governments and investors over municipal borrowers exercising the call provision, which could save issuers like Washington money at the expense of investors. The transactions hinge on a provision in the bond documents that allows state and local governments to buy back their debt before it comes due if an extraordinary event occurs.

Build America Bonds Represent Chunk of Taxable Muni Debt

Outstanding taxable bonds by category, in billions

States and municipalities are seeking to call the bonds back under what's known as an extraordinary redemption provision because of the federal government's cut to the subsidies paid to municipalities that sold BABs. Through the program, the federal government was supposed to cover 35% of the interest paid to investors. That subsidy had been slightly reduced through sequestration.

Some investors, including Jonathan Souza, Wedge's director of credit research, argue the reduction isn't substantial enough to be considered an extraordinary event.

"Our interpretation of the BAB redemption provision is an extraordinary event will occur if there's a material change to Section 54AA or Section 6431, and the current sequestration rate of 5.7% wouldn't qualify," he wrote in an email dated March 7 to deputy Treasurer Richter.

Orrick, Herrington & Sutcliffe, LLP, a major law firm to municipalities, said in a February report that it believes the extraordinary redemption provision is available to issuers in most cases. In the last month, the refinancings have surged in popularity, with a bevy of issuers planning new deals.

A representative for Wedge Capital Management declined to comment and a spokesperson for Amica Mutual Insurance did not reply to requests for comment.

Earlier this month, a group of investors sent a letter challenging a $1 billion municipal bond refunding by the Regents of the University of California. That offering priced earlier this month and is slated to close next week.

Washington, at this time, still plans to move forward with the sale, which is scheduled for March 26, according to Adam Johnson, a spokesperson for the state treasurer's office.

Strategists at Barclays Plc have estimated that roughly $30 billion may be refinanced this year using the call. Still, they said in a March 8 report that some governments may scrap plans for the refinancings given the investor pushback.

"Concerns about validity of calling BABs through ERPs for most issuers could keep some of them on the sidelines," the strategists said in a report.

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