

Bond Case Briefs

Municipal Finance Law Since 1971

A \$180 Billion Program to Spur Government Spending Is Backfiring.

States and cities are refinancing bonds and causing investor ire because of federal budget cuts more than a decade ago.

In March the University of California system decided to save itself some money. Just like a homeowner with a mortgage when better rates are available, it set out to refinance some of its debt. But then things got complicated. Current bondholders [staged a revolt](#) to stop the \$1 billion deal, hiring a big-name law firm that threatened a lawsuit.

The drama surrounding UC's bond offering is part of a bigger story: the messy demise of a financing program once hailed as a way to use markets to save the US economy. The university system had issued a Build America Bond, part of a federally subsidized program to get the economy moving again in the wake of the 2008 financial crisis. Lenders had pulled back from markets, and Congress and the administration of then-President Barack Obama were looking for creative ways to finance public spending that could generate jobs while upgrading the country's infrastructure.

They came up with BABs as an alternative to traditional municipal bonds. Munis are a cheap way for states, cities and colleges to borrow because the interest they pay is usually exempt from federal and state income taxes. That means the borrower can offer investors a lower rate than a comparable taxable issuer can. The catch is that munis aren't as attractive to a big investor outside the US, such as a Canadian pension plan or a Japanese insurer, because the foreign buyer doesn't benefit from the tax break. BABs would come without the tax break but pay a higher rate, making them appealing to a broader group of global investors. To keep the loans affordable for borrowers, the federal government would pay them back in cash 35% of the interest cost each year.

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