LIBOR References in Bank Loan or Privately Placed Debt Contracts

Top considerations for governments and key dates

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LIBOR References in Loan Contracts

The US Dollar London Interbank Offered Rate (LIBOR) is a widely used index for floating rate financial contracts. State and local governments often see this index in bank loans, floating rate notes, direct placements, and swap/derivative products intertwined with municipal debt. LIBOR may also be found in lease contracts, lines of credit and other types of financings and credit enhancements.

The use of LIBOR is being phased out in __new__ loan contracts by the end of 2021 as certain tenors (time periods) of LIBOR will stop being published on December 31, 2021 and all tenors by June 30, 2023. For existing LIBOR contracts, state and local governments should review their contracts to ensure they have robust language that will enable the contract to perform as intended after LIBOR ceases to be published by referencing a new benchmark, such as SOFR.

The Government Finance Officers Association has distributed a suite of materials about LIBOR and replacement rates including:

- **LIBOR Resource Center for Governmental Issuers**
- **On the Hunt for LIBOR: Where to find your exposure and what to do about it**
- **LIBOR and the ISDA Protocol Top Ten**
- **GFOA Advisory on LIBOR Transition**

As a continuation of the LIBOR – Public Sector Industry Workgroup's efforts, this document will discuss the key considerations for governments about their bank loans and privately placed debt before the cessation of LIBOR.

I Have a Bank Loan That References LIBOR— What Should I Be Doing?

Timing is essential. For outstanding contracts that reference LIBOR, start talking NOW with your municipal advisor (MA), bond counsel (BC) and other professionals, about appropriate next steps. It may be the case that you will need to secure public board/council approval for the changes to these financial contracts, which will take TIME – getting started earlier is key.

Know the "Fallback Rate" discussed in the contract. The fallback rate is the index to which your loan will revert to in the event that the listed reference index (e.g., LIBOR) ceases to exist or upon a contractual provision that allows the contract to switch prior to a cessation date. Commercial banks may not have uniform solutions across products and such solutions may differ between institutions. Governments should discuss their options with their MA and/or BC. Governments should be especially concerned if there is no fallback index referenced or if prime rate is referenced, and consider whether amending that language to SOFR or another index is warranted.

Fallback Rate should be carefully considered for any NEW contract in 2021. For new contracts, be sure to work with your MA and BC. Consider using an alternative rate to LIBOR, especially if the term of the contract extends beyond June 30, 2023, when LIBOR will no longer be published on a representative basis. If you choose to continue using LIBOR, make sure that the contract contains fallback language that clearly states what index will be used. Discuss with your MA and BC to determine an appropriate fallback index.

Determine costs associated with changes. Changes to financial contracts where LIBOR is referenced could incur a financial penalty, and governments may also have charges associated with contract changes when using outside professionals. Contracts need to be negotiated with both parties in the transactions, and governments need to be well aware of what is in their contracts and what needs to happen to make changes. *Thus, preparation, timing and education are important.*

Be prepared for the execution of the change. When converting a loan from a LIBOR based index to another index (SOFR may be the industry 'norm'), governments need to be aware of the possible operational and cash flow impacts, and the turnaround time for this change may be challenging. Governments should discuss with their MA and/or BC about how the transition will best occur. Governments should also discuss the use of a lookback provision or payment delays, and when the financing may be a hedged loan, be aware that there could be additional risk involved. For example, fallback language in hedge agreements may not match the fallback language in the loan itself.

Other Considerations

There are numerous other items that governments should discuss with their MA, BC and auditors certifying your annual financial reports about your particular contracts to see if there are additional matters that you should address. These include:

- Accounting and GASB issues
- Federal tax liabilities with some contracts
- Consider other types of financial products instead of a loan where LIBOR is referenced (e.g., publicly issued Floating Rate Note, swaps)

Key Dates

December 31, 2021: No new contracts should reference any tenor of LIBOR. The one week and two month LIBOR rates will cease to be published.

June 30, 2023: All LIBOR tenors will no longer be published on a representative basis. Contracts should be updated as soon as practicable, <u>and well in advance of that date!</u>

In all cases: Issuers should consult with their MA and BC as soon as possible.

The entire LIBOR transition is a fluid matter within the financial sector, including for state and local governments. Governments should keep abreast of these developments through GFOA alerts, and discussions with their own financing team.