Possible Elimination Of Libor Could Impact Senior Living Communities

Regulators Look To Possibly Replace Key Financial Benchmark

LIBOR, the London Interbank Offered Rate, may be retired. A new standard is set to replace the 50 year-old benchmark underlying more than $350 trillion in securities worldwide, including $3.8 trillion in the tax-exempt municipal markets. LIBOR is the basis for many financial products, including direct tax-exempt bank loans for senior living communities. Replacing LIBOR will not only impact non-profit senior living communities that have direct bank loans, but will impact millions of organizations around the world. The following provides a brief history of LIBOR, why regulators are phasing it out, and its possible on impact non-profit senior living communities.

HOW LIBOR CAME TO BE

By the mid-1980s, international banks were rapidly expanding into new financial instruments. Introduced in 1969, and formalized in 1986, LIBOR allowed lending to proliferate by making loans from different banks uniform. Uniformity allows financial institutions to buy and sell loans more easily, spreading risk as opposed to concentrating it, thus promoting additional lending. Today, LIBOR is calculated in five currencies for seven different maturities.

NEED FOR REPLACEMENT

Historically, LIBOR was determined by taking the average of daily estimates provided by a group of twenty international banks, based on what those banks will charge (or pay) to borrow money from each other. As a result, LIBOR was not determined by compiling data from actual transactions, rather banks self-reported the numbers. Because banks had the ability to report arbitrary numbers, LIBOR was vulnerable to corruption and collusion by manipulating LIBOR to their advantage. LIBOR rigging has resulted in industry-wide fines, convictions, and the firing of high-profile executives.

Further, it appears LIBOR may have run its course. There is not enough meaningful data to support the benchmark (one market used to determine LIBOR experienced just 15 transactions in 2016); and a number of banks have pulled out of the committee that sets the rate to avoid the opportunity to manipulate, further reducing the amount of data. Each of these items, plus the tainted history, destabilizes the capital markets, which participants and regulators are seeking to address.

Interested parties have proposed numerous replacements and it is much too early to determine what financial instrument(s) may serve as a replacement. Switzerland has decided to switch to its own index by December 29, 2017 and the European Central Bank has indicated it wants the financial industry to take responsibility for finding a replacement.

It is possible that more than one benchmark will replace LIBOR. Different countries may select different benchmarks and there may be multiple metrics to measure multiple data points, such as borrowing costs and bank risk. Voluntary use of the new rate, whichever it is, is expected to begin in 2018, with LIBOR fully phased-out by 2021. This transition will be time-consuming and difficult, so it is possible the timeline could change, and other benchmarks may gain favor. Some are even hypothesizing LIBOR will retain its place as the lending benchmark of record.

POSSIBLE IMPACT ON BORROWERS

Non-profit health care organizations have been using LIBOR-based financial instruments since its inception. Loan documents typically include provisions regarding what occurs if a benchmark rate cannot be calculated, or is no longer available. Generally, these provisions provide for the use of a different benchmark, until borrower and lender can agree on a long-term replacement. For borrowers, the change could have wide-ranging effects.

The upshot: There is not much borrowers need to do right now, and apart from reviewing loan documents, there is not much borrowers can do other than begin a dialogue with their lenders. This situation is fluid and we will provide updates as more becomes known. BB&T Capital Markets stands ready to assist our healthcare and senior living clients nationwide as more information becomes available.