STEP 5: METHOD OF SALE

The three main methods of a bond sale are competitive, negotiated, and private placement. Prior to 1991, ORS Chapter 287A provided that most GO bonds issued by municipalities be awarded through public advertising and competitive bid. However, the 1991 legislature changed this law to allow the negotiated sale of GO issues. Revenue bonds and most other types of obligations continue to have the flexibility to be issued through competitive or negotiated sales.

The lack of definitive empirical evidence that would favor one method of bond sale over the other (i.e. negotiated vs. competitive) has resulted in a divergence of views as to the relative merits of each of the two methods. It is recommended that the issuer carefully consider the merits of each kind of sale and make an independent decision as to which type of sale best suits the needs of the issuer for each bond sale. It is optimal for the issuer to have policies in place which ensure that:

- The most appropriate method of sale is selected in light of financial, market, transaction-specific, and issuer-related conditions.
- The method of sale is evaluated for each bond issue, including an assessment of the different risks associated with each method.
- The governmental entity should be able to explain the rationale for its decision.

Competitive Sales

Competitively bid sales are a frequent method of choice for well-rated issuers selling reasonably sized bonds because competition drives the cost of the issue to the lowest possible level. Consequently, underwriters bid for these bonds with the comfort of knowing that investors understand and buy them without an extensive educational process. Conditions that generally favor a competitive sale include:

- The issuer has significant public borrowing experience with a positive reputation in the financial debt markets.
- There is an active secondary market for the issuer's securities.
- The debt structure is backed by the issuer's full-faith-and-credit or a strong, historically performing revenue source backs the debt structure.
- The issue is not viewed by the market as carrying complex or innovative features or requires explanation as to the bonds' security.

- Interest rates are stable, market demand is strong, and the financial debt market is able to absorb a reasonable amount of buying or selling at reasonable price changes.
- Policy considerations can be reasonably addressed through specifications of the Notice of Sale. An example of a policy consideration would be a disadvantaged business enterprise (DBE) and regional firm participation that relate to syndicate membership and bond allocations.

A general outline to a competitive bond sale is as follows:

1. The issuer hires outside professionals (usually a Bond Counsel and Financial Advisor) to review the nature of the project and help them determine the financing requirements.

2. The issuer, with the assistance of the Bond Counsel and Financial Advisor, prepares a preliminary official statement (POS) which describes the issuer, the credit structure, the finances, and other items that would be important to potential bond investors.

3. The Bond Counsel and Financial Advisor prepare legal documents related to the sale including a Notice of Sale (NOS) describing the process for bidders (usually investment banking firms) to submit bids for the bonds.

4. The issuer's governing body passes the needed authorizations to sell the bonds.

5. The Bond Counsel and Financial Advisor arrange for the dissemination of the POS and NOS.

6. On the date and time specified in the NOS, the issuer receives bids for the bonds. The bidders provide bids based on their review of the bond credit worthiness and their perception of investor interest in the bonds. Bids are received via online bidding programs. The issuer awards the bonds to the lowest cost bidder. Once the bids are awarded, the winning bidder owns the bonds and can then resell the bonds to investors. The amount of profit the winning bidder receives is based on the price at which they resell the bonds to investors.

Official Bid Form

For competitively issued bonds, issuers should include a Notice of Sale (NOS) in the preliminary official statement (POS). Most commonly, competitive issues use an electronic platform to accept bids. Two nationally recognized platforms are Grant Street Group and i-Deal. Issuers submit the NOS to the electronic bidding service and the details of the sale are posted on a website. Bidders sign up and submit bids using a standardized format which does not allow submittal of bids that do not meet the requirements of the NOS. The issuer may view the sale results, confirm the bid calculations, and award the bid electronically after the sale has closed.

Awarding the Bid on Competitive Sales

Acceptable bids must strictly adhere to the terms and conditions of the NOS; any conditional and qualified bids must be discarded. The issuer, Bond Counsel, and Financial Advisor should be in close contact during the sale. One bid should be identified as the apparent winner, subject to later verification. The winning bid should be awarded based on the lowest True Interest Cost (TIC). Generally the Financial Advisor or Bond Counsel will verify the computation provided by the electronic bidding platform for the winning and cover bids.

Issuers commonly require a good faith deposit at the time of the bid. This can be arranged by the bidder providing a surety at the time of the bid and later sending the deposit if they win the bid. The nature and amount of the good faith deposit should be included in the NOS. Not all issuers require a good faith deposit in advance of the bid, as some issuers allow the winning bidder to make a good faith deposit shortly after the award of the bid. Historically, cashiers' checks for the good faith deposit were required as part of the bid. Given the logistical difficulties of getting an actual check to the issuer from the money centers that bid on bonds, checks are no longer standard. Frequently, underwriters use Sure-Bid which offers a surety bond in lieu of a check.

Negotiated Sale

In a negotiated bond sale, after preliminary discussions and interviews, a single firm or syndicate of firms is selected to purchase and resell the issue. The price is negotiated at the time at which the bond purchase agreement is signed. This allows discussion of the specifics of the issue and its merits and facilitates an exchange of information between issuer and underwriter. Negotiated bond issues allow the underwriter to know several weeks in advance that it will have a specific product to sell. The underwriter's sales and marketing force can then determine how receptive the market is to the bond issue. There is time for the issuer to change some aspects of the bond, such as the bond's size, terms, security, conditions, yields, maturities, or call provisions to make it more appealing (if necessary).

Conditions that favor a negotiated sale include:

- The issuer has limited public borrowing experience and no reputation in the financial debt markets.
- The issue has a non-enhanced credit rating of below A and can obtain a credit enhancement prior to the sale.
- The revenue stream backing the debt is weak, uncertain, or has no history.
- The issue is too large to be easily absorbed by the market or too small to attract investors without a concerted sales effort.
- The issue is viewed by the market as carrying complex or innovative features or requiring explanation as to the bonds' soundness.
- Last minute changes in disclosure are likely due to legal or legislative issues.
- Policy considerations, such as disadvantaged business enterprise (DBE) participation and regional firm participation that relate to syndicate membership and bond allocations, or targeting specific investors.

If a negotiated sale is to be used, issuers should make sure that the process is equitable and defensible and keep thorough records throughout the selection process. Issuers must be aware that the negotiated method of sale does not always promote the "appearance" of an open and fair process that is inherent to the competitive bid method of sale. The underwriter selection process can be susceptible to allegations of partiality and unseemliness, political favoritism, and "pay-to-play" abuses. It is imperative that issuers guard against any appearance of impropriety or abuse of the public trust and select underwriters and other municipal finance players based on the merit of their qualifications and cost to the taxpayer.

To potentially lower costs and to provide market and negotiated sale process knowledge, issuers (especially small municipalities) hire a Financial Advisor (FA) to assist in the sale. See Step 2 for more information on the FA's role and functions.

The negotiated method of sale may be appropriate when certain conditions (previously described) do not allow for a competitive bond sale. In such cases, it is recommended that finance officers adhere to the following practices before entering into a negotiated sale and throughout the negotiated sale process:

- Ensure fairness by using a competitive underwriter selection process through a Request for Proposals (RFP), a Request for Qualifications (RFQ), or another form of solicitation that ensures that multiple proposals are considered.

- Remain actively involved in each step of the negotiation and sale processes to uphold the public trust.
- Ensure that either an employee of the issuer or an outside professional (other than the underwriter), is familiar with, and abreast of, the conditions of the municipal market and is available to assist in structuring the issue, and pricing/monitoring of sales activity.
- Avoid potential conflicts of interest that may occur if the services of a professional financial advisor are used for a particular bond issue and that financial advisor also acts as underwriter of the same bond issue.
- Request that financial professionals disclose the name or names of any person or firm (e.g. attorneys, lobbyists, and public relations professionals), compensated to promote the selection of the particular financial entities.
- Request all financial professionals submitting joint proposals or intending to enter into joint accounts or any fee-splitting arrangements in connection with a bond issue to fully disclose to the issuer. This disclosure would include any plan or arrangements to share tasks, responsibilities, and fees earned as well as disclosing the financing professionals with whom the sharing is proposed, the method used to calculate the fees to be earned, and any changes thereto.
- Review the "Agreement Among Underwriters" (AAU), and ensure that it is given to the issuer and that it governs all transactions during the underwriting period.

A general outline to a negotiated bond sale is as follows:

1. The issuer's governing body passes the needed authorizations to sell the bonds.

2. The issuer hires outside professionals (usually a Bond Counsel and Financial Advisor) to review the nature of the project and determine the financing requirements.

3. The Financial Advisor and issuer prepare a solicitation for Underwriters and distribute the solicitation to qualified firms. A selection should be made based on a review of received proposals, and those proposals should include both the firm's experience and the fees they would charge.

4. The Underwriter prepares a preliminary official statement (POS) which describes the issuer, the credit structure, the finances, and other items that could be important to potential bond investors.

5. The Underwriter, Bond Counsel, and Financial Advisor work with the issuer to prepare legal documents related to the transaction.

6. The Underwriter arranges for the dissemination of the POS to potential investors.

7. On the day of the sale, the Underwriter discusses the bonds with investors and determines, in consultation with investors, the rates and structure that will result in sufficient investor interest to sell all of the bonds. The Underwriter takes orders for the bonds and adjusts the interest rates based on actual orders, to optimize the sale.

Private Placements

A private placement is a special type of negotiated sale in which the issuer sells bonds directly to the investor. The investor is most generally a bank. The issuer either directly contacts a bank or prepares a solicitation, which is circulated to a limited group of banks. The issuer generally specifies the preferred terms of the loan and the bank responds with conditions and terms that it would require. The transaction does not generally include disclosure documents (such as the official statement) and is generally limited to a loan document prepared by either the bank's counsel or Bond Counsel. The private placement can be a cost effective means of financing in that issuance costs are very low. Therefore, short transactions or small transactions can bear a slightly higher interest rate and still have an overall lower effective borrowing cost.

A private placement generally follows the following steps:

1. The issuer determines financing needs.

2. The issuer discusses financing options with a Financial Advisor to determine that a private placement is the most cost effective approach.

3. The Bond Counsel and Financial Advisor prepare authorizing documents for the financing which the issuers' governing body approves.

4. The issuer and Financial Advisor prepare a term sheet to describe the transaction.

5. The issuer contacts their bank or the financial advisor prepares a short RFP to solicit proposals from banks.

6. The issuer and Financial Advisor review proposals and select bank.

7. Bond Counsel (usually) or the bank's counsel prepares the loan documents.

8. Money transfers at closing.

Governmental Agency Direct Loans

There are a number of direct lending programs at State agencies. These include programs for clean water, wastewater, highways, and general governmental infrastructure. The availability of funds and the timing of funds vary greatly from program to program and from year to year. Issuers may contact DEQ, Business Oregon, or ODOT to inquire about these programs. These programs often make funds available at lower costs than market-based transactions.