



Process of Municipal Bond Debt Issuance



The PFM Group

Public Financial Management, Inc.
PFM Asset Management LLC
PFM Advisors

Public Financial Management, Inc.
221 W. 6th St., Suite 1900
Austin, TX 78701
512.614.5325
512.472.0932 fax
www.pfm.com

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Presenter

- John E. Crumrine – Austin, TX
Senior Managing Consultant – Public Financial Management, Inc.



Municipal Advisor Rule

Regulatory Landscape for Municipal Advisors

- Since October 1, 2010 both the SEC and MSRB have regulated the activities of municipal advisors
 - Established a statutory definition of municipal advisor
 - Required municipal advisors to register with the SEC and MSRB
 - Made explicit a fiduciary responsibility to issuer clients
- The SEC's new Municipal Advisor Rule (the "Rule") was to become effective on January 13, 2014 but became effective July 1, 2014
- The new Rule aims to further define who or what entity is acting as a municipal advisor
 - Under the rule, only a municipal advisor may provide advice regarding municipal financial products or the issuance of municipal securities with limited exceptions
 - General information is not considered advice as long as it cannot be construed as providing a recommendation regarding municipal financial products or the issuance of municipal securities

Municipal Advisor Rule Exemptions

- The potential implications of the Rule on underwriters and non-registered municipal advisors are significant as the SEC has made it clear that only municipal advisors may provide advice except under certain limited exemptions to the Rule
- These exemptions generally fall into the following three categories and are the subject of ongoing regulatory interpretation:
 1. *Request for Proposal (“RFP”) Exemption.* Responses to formal RFPs are generally excluded from the definition of municipal advisors, as long as they meet certain ongoing parameters regarding process and content
 2. *Underwriter Exemption.* An underwriter that has been engaged for a particular issuance of municipal securities and has provided full disclosure about the role of the underwriter as required by MSRB Rule G-17 is exempt from the Rule. The SEC has indicated that an open-ended engagement or participation in a pool of underwriters does not qualify on its own for the exemption
 3. *Independent Registered Municipal Advisor Exemption.* An underwriter may provide advice if the municipal entity or obligated person has engaged an IRMA to provide advice with respect to the same aspects of the municipal financial product or issuance of municipal securities. In order for this exemption to apply, the municipal entity or obligated person must make a representation in a reasonable manner, including written disclosure that an IRMA has been engaged



Type of Bond Sales

Types of Bond Sales

- There are two types of public municipal bond sales:
 - **Competitive Sale** – This sale process includes the advertising of the bonds with the sale date, time and place where bids will be taken. The bids are then evaluated and the bonds are awarded to the underwriter providing a bid resulting in the lowest true interest cost.
 - **Negotiated Sale** – In negotiated sale process, the issuer, prior to the public sale date, selects a qualified underwriter. The issuer often selects a pool of underwriters to act as co-managers. The co-managers, acting together, make an offer to purchase the bonds from the issuer at a price that will both produce the lowest interest cost to the issuer and sell the bonds to investors.

Attributes of a Competitive and Negotiated Bond Sale

Attributes	Competitive Sale	Negotiated Sale
Issuer		
<i>Type of Organization</i>	Broad-based, general-purpose government	Special-purpose, independent authority
<i>Frequency of Issuance</i>	Regular borrower in public market	New or infrequent issuer of debt
<i>Market Awareness</i>	Active secondary market with wide investor base	Little or no institutional base, but growing dealer interest
Credit Quality		
<i>Rating</i>	"A" or better	Below single "A"
<i>Pledged Revenues</i>	General obligation	Project supported revenues
<i>Security Structure</i>	Conventional resolution and cashflow; rate covenant and coverage	Unusual or weak covenants; subordinated debt
<i>Trend</i>	Stable	Improving or under stress
Market Conditions		
<i>Interest Rates</i>	Stable, predictable market	Volatile or declining market
<i>Demand</i>	Strong investor demand, good liquidity, light forward calendar	Oversold market, heavy supply
Debt Structure		
<i>Tax Status</i>	Tax-exempt, no concerns	Taxable
<i>Debt Instrument</i>	Traditional serial and term, full-coupon bonds	Aggressive use of innovative bond structuring, derivative products, swaps, or variable-rate debt instruments

Attributes	Competitive Sale	Negotiated Sale
Marketing		
<i>Use of Underwriters</i>	Broad market participation	Ability to select "best qualified" banker and direct business to local or regional firms
<i>Investors</i>	Process blind to ultimate investors	Sale can be managed to achieve wide distribution or targeted allotments
<i>Pre-marketing</i>	Limited need for pre-marketing – commodity, market pricing	Specific pre-sale activity to generate demand
<i>Flexibility in Timing</i>	Limited flexibility	Greatest flexibility in timing
<i>Fine Tuning Structure</i>	Limited options given to bidders	Unlimited ability to fine tune
Cost		
<i>Interest Rate</i>	Highest market price for commodity offered on day of sale	Best match of product with specific investor demand
Preparation		
<i>Resolution/ Structure</i>	Issuer determines own preference for managing	Professional banking support and more direct marketing input in balancing security for investor vs. flexibility for issuer
<i>Disclosure</i>	Issuer relies on own program disclosure	Underwriters' counsel assists in the preparation of official statement

Competitive vs. Negotiated – Ideas to Consider

Mixing the use of competitive and negotiated sales may provide an optimal approach to an issuer's financings:

Empirical data suggest competitive sales produce lower TICs

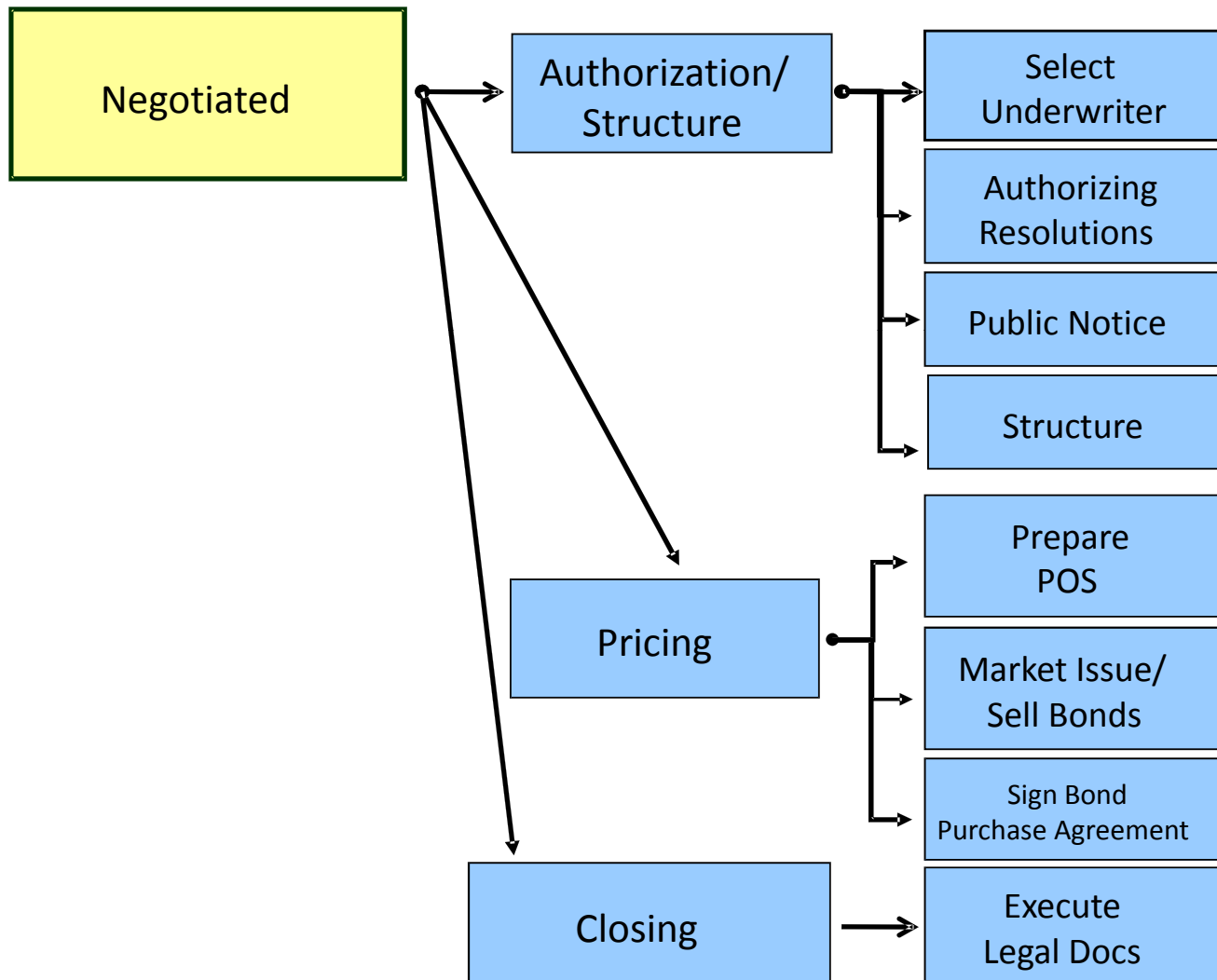
Competitive sales provide benchmarks for negotiated sales

Negotiated sales motivate firms to bring innovative ideas to the table

Negotiated sales provide maximum flexibility to optimize the structure & execution of refundings

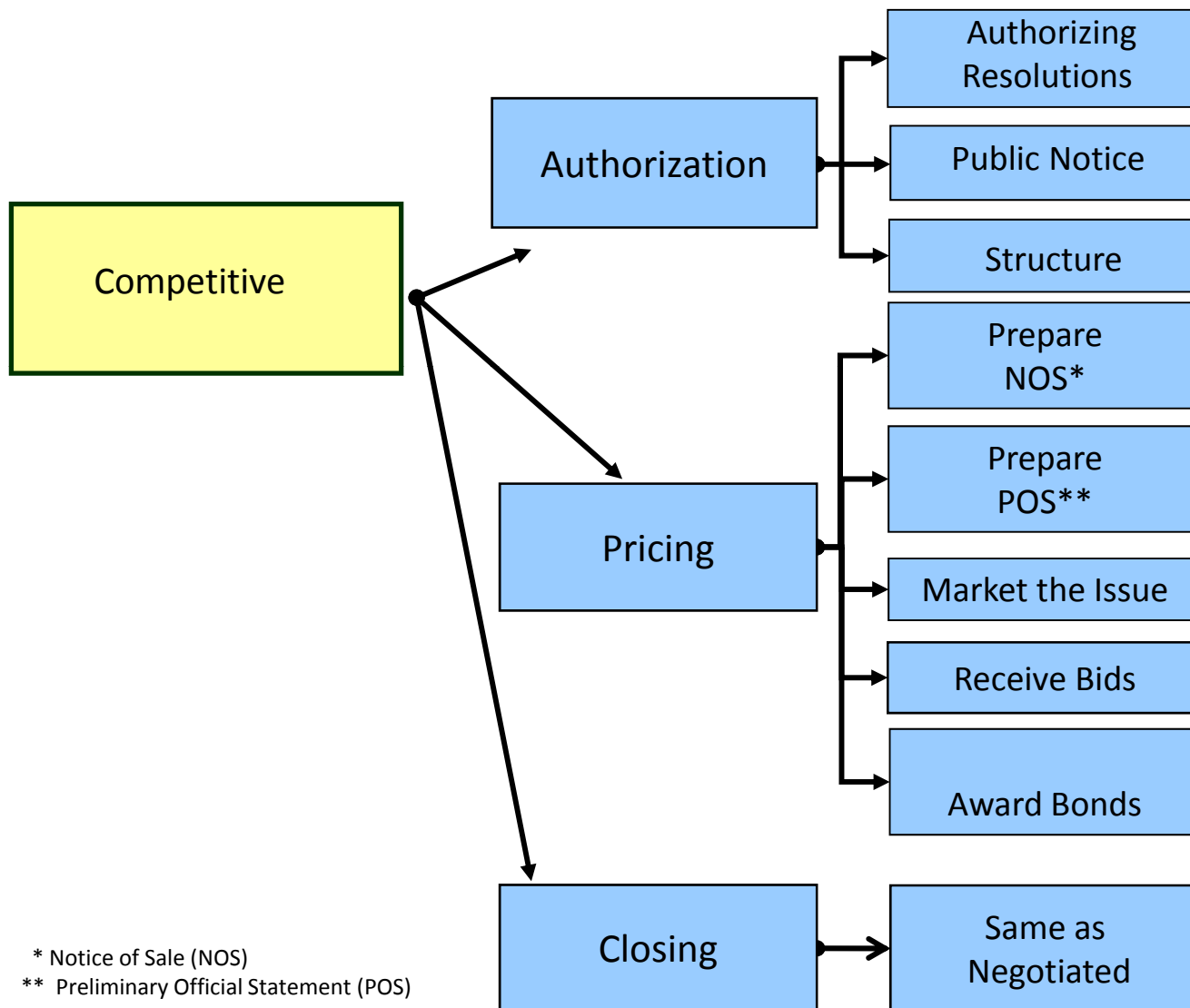
Rewarding firms that support the issuer's competitive sales by including them in future negotiated sale syndicates results in better pricing

Negotiated Sale Process



During the pricing process, the issuer, financial advisor and underwriter work closely together. Structural details are negotiated with the underwriter throughout the process.

Competitive Sale Process



The Notice of Sale (NOS) is the legally governing document for the competitive bid process. It details the terms of the bonds, bidding parameters, and award process.

* Notice of Sale (NOS)

** Preliminary Official Statement (POS)

Private Placement vs. Public Issuance

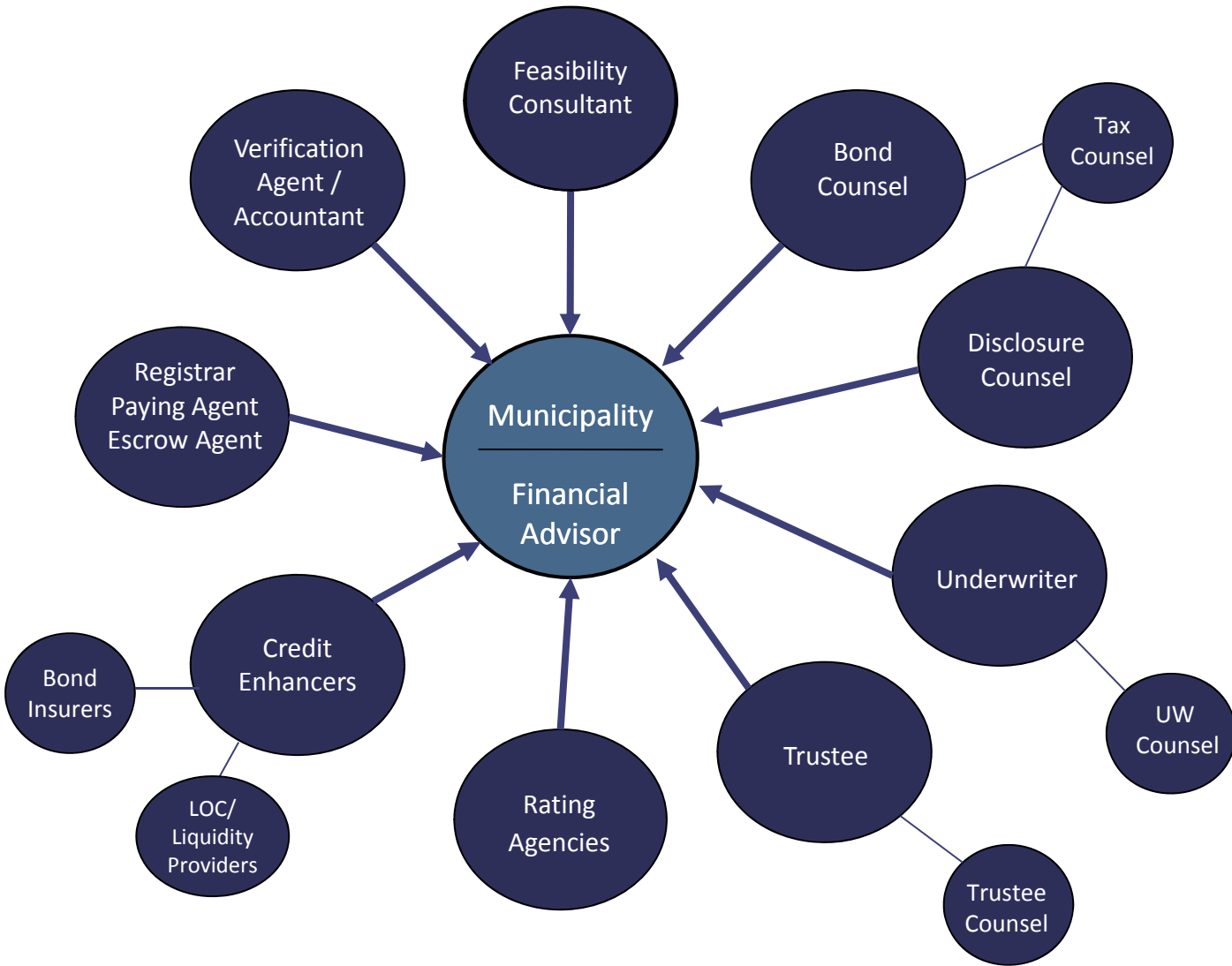
- Advantages
 - There is no need to pursue a public rating, bond insurance, or a letter of credit
 - Private loans reduce the number of parties to the transaction (no underwriter, no rating fee, etc.)
 - Limited on-going disclosure (small-issuers)

- Disadvantages
 - Shorter amortization with potential roll-over risk
 - Could potentially require higher interest rates and more restrictive covenants, especially regarding additional debt



Participants in a Bond Sale

Participants and Their Roles



Roles and Responsibilities of the Issuer

- Before issuance:
 - Select financing team: Bond Counsel, Financial Advisor and Underwriter
 - Understand the financing plan and choose the financing structure

- After issuance:
 - Supervising, investing and administering the expenditure of bond proceeds
 - Collecting, or monitoring the collection of revenues (taxes)
 - Use of revenues to pay operating expenses and debt service
 - Compliance with all undertakings, covenants and agreements
 - Management of any enterprise funded by the debt
 - Filing of any required reports with various governmental regulators, a bond insurer or other credit enhancement provider, if any, and credit rating agencies
 - Addressing any problem that may arise with respect to the bonds, such as a shortfall in revenues, a tax audit or a regulatory issue
 - Preparing, reviewing, and filing Annual Reports and Listed Event Notices under SEC Rule 15c2-12

- The Financial Advisor is a professional consultant retained to advise and assist the issuer :
 - Review the financial feasibility of the capital projects
 - Assess the available sources /nature of revenues
 - Formulating and/or executing a debt financing plan to accomplish the public purposes chosen by the issuer
 - Surveying the issuer's existing debt structure and capital financing program and designing and assisting in the execution of a total financing plan for the issuer
 - Assessing bond market conditions at the time of sale of the bonds to determine the appropriateness of the interest rate and other terms of the underwriter's offer to buy the bonds

Financial Advisor during a Bond Issuance

- Recommend a financing structure (including the nature of the security for the bonds, excess revenue coverage requirements, debt service reserve fund requirements, facilities insurance requirements, liability insurance requirements and the need for credit enhancement)
- Recommend a maturity schedule, redemption terms and other terms of the notice of sale
- Review Official Statement and other documents, for distribution to potential underwriters, investors, credit enhancement providers and rating agencies
- Be the primary spokesperson on behalf of the issuer with the credit rating agencies
- Recommend the timing of sale of the bonds
- Arrange for and direct the mailing of the Official Statement and the official notice of sale to potential underwriters and investors
- Contact and answer the questions of potential underwriters and investors
- Analyze bids received at the competitive sale
- Recommend whether to accept or reject such bids
- Assist bond counsel in organizing the closing (i.e. the delivery of the bonds in return for payment for the bonds)

Bond Counsel

- Bond Counsel has the responsibility of giving the legal opinion delivered with the bonds:
 - Confirming that the bonds are valid and binding obligations of the issuer
 - Interest of the bonds is exempt from federal and state income taxes

- Bond counsel also prepares and reviews the legal proceedings for the issuance of the bonds, which includes:
 - Including election proceedings if an election is required
 - Resolutions of the governing body of the issuer authorizing the issuance of the bonds and otherwise relating to the bond issue
 - Documents under which the bonds will be issued and secured.

- The bond opinion does not make financial recommendations or represent a financial judgment as to the acceptability of the bond for the investor

- Bond Counsel May NOT be Underwriter's Counsel

Rating Agencies

- Credit rating agencies are firms that analyze the probability of the debt instrument returning all of the principal to the investor
- Municipal credit ratings are opinions of the investment quality of issuers and issues in the municipal markets
 - Underwriters and investors rely upon the credit quality judgment made by the rating agencies
- Municipal debt ratings are viewed:
 - In relation to the general state of the economy
 - Debt levels and mix /type of debt
 - Revenue and expense cash flows
 - Issuer's management strategies

What is a Rating?

- An alphabetic and/or numeric symbol used to give relative indications of credit quality
- Measure the risk to the investor that issuer will default, both the willingness and ability to pay
- Independent, objective & relative assessments of both qualitative & quantitative factors

Long-Term Municipal Ratings

	<u>Moody's</u>	<u>S&P</u>	<u>Fitch</u>
Investment Grade	Aaa	AAA	AAA
	Aa1	AA+	AA+
	Aa2	AA	AA
	Aa3	AA-	AA-
	A1	A+	A+
	A2	A	A
	A3	A-	A-
	Baa1	BBB+	BBB+
	Baa2	BBB	BBB
	Baa3	BBB-	BBB-

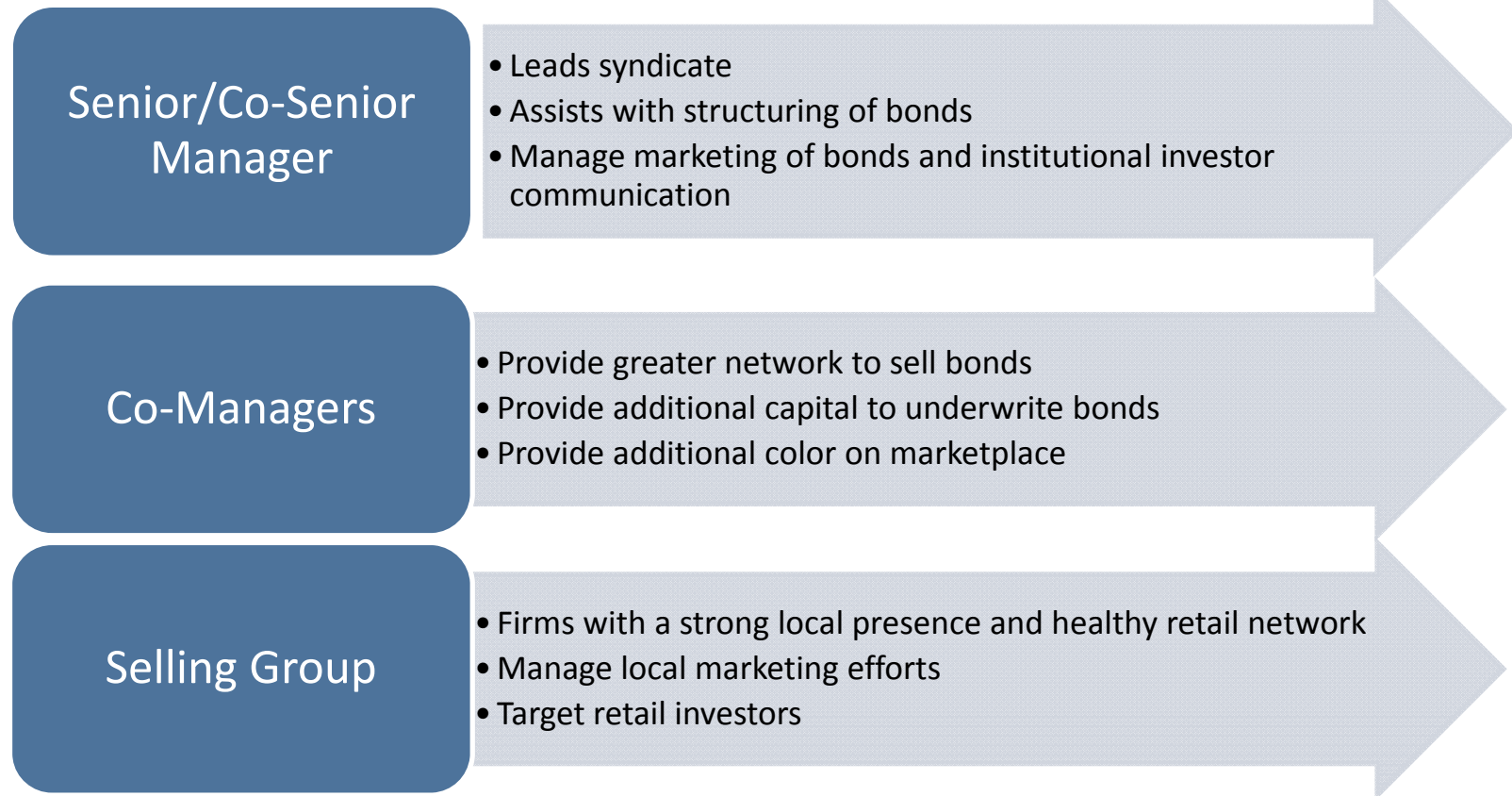
Note: Moody's ratings within certain categories are modified by number (1, 2, and 3) while S&P and Fitch are modified by "+" and "-" symbols.

Underwriter

- An underwriter is a securities dealer who helps government entities bring bond issues to market
- During the bond issuance:
 - In a negotiated sale, leading up to the bond sale the underwriter is a critical member of the finance team, opining on how various legal and structural decisions will impact the marketability of the eventual bond issue
 - The key role it plays is to buy the bonds from the issuer and then resell them to investors
 - First, the Underwriter assesses bond market conditions to recommend timing and pricing of the bond sale
 - Forms an underwriting syndicate in the case of large issues
 - Obtains agreement from the underwriting syndicate to the interest rates and terms of sale for the bonds
 - Signs a bond purchase agreement on behalf of itself or the underwriting syndicate
 - Ensures that appropriate continuing disclosure undertakings are entered into by the issuer to show compliance with SEC Rule 15c2-12
 - Mails the Official Statement to potential bond buyers and underwriting syndicate members

Syndicate of Underwriters

- Using a syndicate of underwriters can greatly improve the sale of bonds
 - Multiple firms can be strategically organized to garner broader retail interest



Underwriter Compensation

- **Management fee:** a fee paid to the managing underwriter for handling the affairs of the syndicate, including, in the case of a negotiated sale, structuring the issue and negotiating with the issuer
- **Expenses:** any advertising and printing costs to the underwriter, fees and expenses of underwriter's counsel, Blue Sky fees and expenses, computer expenses, travel expenses, MSRB fees, and other expenses
- **Takedown:** normally the largest component of the spread, similar to a commission, which represents the income derived by the selling broker or dealer from the sale of the bonds
- **Risk:** the amount of compensation for risks incurred by the underwriter in underwriting the bond issue, relating to the difficulty of marketing the issue, bond market conditions and the amount of bonds remaining to be resold after the execution of the bond purchase agreement
 - It is rare for there to be any risk component in the spread

Underwriter's Counsel

- Underwriter's counsel is customarily selected by the underwriter to represent the underwriter and its interests in a negotiated sale
 - Competitive sales generally do not require the retention of underwriter's counsel

- Underwriter's counsel customarily review, from the underwriter's perspective, the documents prepared by bond counsel and negotiate matters relating to those documents on behalf of the underwriter

Credit Enhancement Provider

- Entities that guarantee or insure in one form or another the sufficiency of revenues to pay the bonds

- In each case the purpose of the credit enhancement is to provide:
 - Additional security for the bonds that improves the credit rating of the bonds
 - Lower borrowing cost to the issuer

- Credit enhancement only makes sense where the savings from the credit enhancement exceed the cost of the credit enhancement
 - Or where the credit enhancement facilitates the sale of a bond issue that would not otherwise be possible

- Normally, the credit enhancement provider is selected by the issuer with advice from the underwriter and/or financial advisor

- The Trustee (when required):
 - Establishes and holds the funds and accounts relating to the bond issue
 - Accounts for bond proceeds and revenues
 - Determines that the conditions for disbursement of proceeds and revenues have been met
 - May also collect revenues and execute investments
 - Also protects the interests of bondholders by monitoring compliance with covenants and acting on behalf of bondholders in the event of default

- The trustee generally acts as the liaison to the bondholders, particularly when a decision needs to be made about restructuring the debt or making only a partial repayment

Other Participants

- Bond registrar- maintains a list of the names and addresses of all registered owners of the bonds and records transfers and exchanges of the bonds
- Authenticating agent - authenticates bonds upon initial issuance or upon transfer or exchange
- Paying agent - pays interest on the bonds by check or wire to the respective registered owners, and pays principal of the bonds to the registered owners upon surrender of the bonds at maturity or upon earlier redemption
- Escrow agent - holds the investments acquired with the proceeds of an advance refunding and uses payments on those investments to pay debt service on the refunded bonds
- Dissemination agent - acts on behalf of the issuer or other obligated person to disseminate annual reports and event notices to repositories under SEC Rule 15c2-12