# GFOA Best Practice

## Selecting and Managing the Method of Sale of Municipal Bonds

**Background.** Note: This Best Practice (BP) is one of a group of five relating to the sale of bonds. These five BPs should be read and considered in conjunction with each other because of the interaction of the processes to which they apply. The five BPs are:

- Selecting and Managing the Method of Sale of Municipal Bonds
- Selecting and Managing of Municipal Advisors
- Selecting Bond Counsel
- Selecting Underwriters for Negotiated Bond Sales
- Pricing Bonds in a Negotiated Sale

State and local government bond issuers should sell their debt using the method of sale that is most likely to achieve the lowest cost of borrowing while taking into account both short-range and long-range implications for taxpayers and ratepayers. Differing views exist among issuers and other bond market participants with respect to the relative merits of the competitive and negotiated methods of sale. Moreover, research into the subject has not led to universally accepted findings as to which method of sale is preferable when taking into account differences in bond structure, security, size, and credit ratings for the wide array of bonds issued by state and local governments.

Concerns have been raised about the lack of a competitive process through the use of Request for Proposals (RFPs) in the selection of underwriters in a negotiated sale and the possibility of higher borrowing costs when underwriters are appointed based on factors other than merit. As a result, issuers have been forced to defend their selection of underwriters for negotiated sales in the absence of a documented, open selection process.

The appropriate duties, roles and responsibilities of municipal advisors and underwriters are often not well understood. Municipal advisors are the only parties with a federal fiduciary duty to state and local government issuers. In contrast, the relationship between the issuer and underwriter is one where the relationship has a common purpose but also some competing objectives, especially at the time of bond pricing. It is important for issuers to become familiar with the Securities and Exchange Commission's (SEC) Municipal Advisor Rule, and understand its implications on underwriter responsibilities as discussed in the materials related to the Municipal Advisor Rule. Resources to help issuers become familiar with the Rule are included in the References section of this document.

**Recommendation.** When state and local laws do not prescribe the method of sale of municipal bonds, the Government Finance Officers Association (GFOA) recommends that issuers select a method of sale based on a thorough analysis of the relevant rating, security, structure and other factors pertaining to the proposed bond issue. If the issuer has in-house expertise, defined as dedicated debt management staff whose responsibilities include daily management of a debt portfolio, this analysis and selection could be made by the issuer's staff. However, in the more common situation where an issuer does not have sufficient in-house expertise, this analysis and selection should be undertaken with the advice of a municipal advisor. Due to the inherent conflict of interest, issuers should not use a broker-dealer or potential underwriter to assist in the method of sale selection unless that firm has agreed not to underwrite that transaction. Additionally, Municipal Securities Rulemaking Board (MSRB) Rule G-23 states that a broker-dealer firm may not serve as municipal advisor and underwriter on the same transaction.

The GFOA believes that the presence of the following factors may favor the use of a competitive sale:

1. The rating of the bonds, either credit-enhanced or unenhanced, is at least in the single-A category.
2. The bonds are general obligation bonds or full faith and credit obligations of the issuer or are secured by a strong, known and long-standing revenue stream.
3. The structure of the bonds does not include innovative or new financing features that require extensive explanation to the bond market.
4. The issuer is well known and frequently in the market.

Similarly, GFOA believes that the presence of the following factors may favor the use of a negotiated sale:

1. The rating of the bonds, either credit-enhanced or unenhanced, is lower than single-A category.
2. Bond insurance or other credit enhancement is unavailable or not cost-effective.
3. The structure of the bonds has features such as a pooled bond program, variable rate debt, deferred interest bonds, or other bonds that may be better suited to negotiation.
4. The issuer desires to target underwriting participation to include disadvantaged business enterprises (DBEs) or local firms.
5. Other factors that the issuer, in consultation with its financial advisor, believes favor the use of a negotiated sale process.

If an issuer, in consultation with its financial advisor, determines that a negotiated sale is more likely to result in the lowest cost of borrowing, the issuer should undertake the following steps and policies to increase the likelihood of a successful and fully documented negotiated sale process:

1. There should be a written contractual relationship with a municipal advisor (a firm unrelated to the underwriter(s)), to advise the issuer on all aspects of the

sale, including selection of the underwriter, structuring, disclosure preparation and bond pricing.

2. Select the underwriter(s) through a formal request for proposals (RFP) process. The issuer should document and make publicly available the criteria and process for underwriter selection so that the decision can be explained, if necessary.
3. Due to potential conflicts of interest, the issuer should also enact a policy regarding whether and under what, if any, circumstances it will permit the use of a single firm to serve as an underwriter on one transaction and a municipal advisor on another transaction.
4. Issuers with sufficient in-house expertise and access to market information may not need to retain a municipal advisor. Such issuers should have at least the following skills and information: (i) access to real-time market information (e.g. Bloomberg) to assess market conditions and proposed bond prices; (ii) experience in the pricing and sale of bonds, including historical pricing data for their own bonds and/or a set of comparable bonds of other issuers in order to assist in determining a fair price for their bonds; and (iii) dedicated full-time staff to manage the bond issuance process, with the training, expertise and access to debt management tools necessary to successfully negotiate the pricing of their bonds.
5. Remain actively involved in each step of the negotiation and sale processes in accordance with the GFOA's Best Practice, Pricing Bonds in a Negotiated Sale.
6. Require that financial professionals make disclosures pursuant to MSRB Rule G-17 and disclose any conflicts of interest that may exist, as well as the name(s) of any person or firm compensated to promote the selection of the underwriter; any existing or planned arrangements between outside professionals to share tasks, responsibilities and fees; the name(s) of any person or firm with whom the sharing is proposed; and the method used to calculate the fees to be earned.
7. Review the "Bond Purchase Agreement" and "Agreement Among Underwriters" and ensure that the terms and conditions are acceptable to the issuer and identify issues that need to be negotiated with the underwriters.
8. Openly disclose public-policy issues such as the desire for Minority, Women and Disadvantaged Business Enterprises (MWDBEs) and regional firm participation in the syndicate and the allocation of bonds to such firms as reason for negotiated sale; measure and record results at the conclusion of the sale.
9. Prepare a post-sale summary and analysis that documents the pricing of the bonds relative to other similar transactions priced at or near the time of the issuer's bond sale, and record the true interest cost of the sale and the date and hour of the verbal award.

Finally, as noted above, it is important for issuers to become familiar with and understand the Municipal Advisor Rule's implications on underwriter responsibilities as discussed in the materials related to the Municipal Advisor Rule.

*Approved by the GFOA's Executive Board, February, 2014.*