By Mike Sudsina

Enlisting a Municipal Advisor Helps Ensure Solid Bond Rates

For those in the process of preparing bond issues—either for new projects or to refund prior bond issues for savings—once all the preparation is completed, there will undoubtedly be a big sigh of relief knowing all the work is done. Well, hold on. The most important part is yet to come.

The actual pricing of the bond issue—setting the interest rates—is clearly the most important step in the process since it has the largest cost impact. But most treasurers enter this phase of the financing without the proper support.

Bond counsel and bankers assist along the way in preparing the bond issue through the documentation, disclosure, and rating processes, and treasurer/CFOs are clearly relied upon for expertise and knowledge. But the mechanics of pricing the bonds are not typically in the treasurer's wheelhouse.

For this very reason, the Government Finance Officers Association (GFOA) recommends that independent, outside pricing assistance be engaged in these situations.

Naturally, the bankers are on top of current market conditions and interest rate trends, but an astute treasurer knows that the banking firm's first responsibility is to the purchasers of the bonds—the investors that you depend on to buy your bonds. So the underwriter is likely to give some deference to investors when setting interest rates on the bonds. In the interest of self-preservation, the bankers know that they cannot overly favor the investor, or their pricing of your issue will look out-of-line when compared to others in the market. But how do you know?

Some investment banking firms serving the Ohio market do a good job post-sale reporting by documenting your deal and comparing it to others that sold in a similar time frame. However, not all do, and others might be inclined to show sales that only make the one they did for you look good.

Regardless of the post-sale reporting, it is important to enlist the proper resource to assist you *while the bonds are being priced* so you have an active role in the process. Traditionally, the resource used to fill this role is the municipal advisor (MA), formerly know as the financial advisor (until renamed in the recent Dodd-Frank Wall Street Reform and Consumer Protection Act).

The Securities and Exchange Commission (SEC), as empowered by the Dodd-Frank legislation, now imposes a fiduciary duty on MAs, which means the advisor must put the school district's interests ahead of its own. This is a much more rigid threshold of protection for the school district than that required of the underwriter in the form of the "fair dealing" standard, which states that bankers must "deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice."

While including the setting of the interest rates on your bonds could be considered "fair," it is far from the higher fiduciary standard. For example, it might be considered "fair" to price a particular maturity of a bond issue 5 basis points higher than other deals in the market. While doing so, the underwriter meets their goal of satisfying their investor client, yet a 5 basis point difference could cost taxpayers nearly $150,000 over the life of a $10 million bond issue.

The fiduciary duty imposed on the MA requires the advisor to ensure that the treasurer is made aware of this situation, even if it puts the advisor at odds with the bankers. Having unbiased knowledge of the overall market conditions available to the treasurer could have a favorable impact on the rates achieved at the end of the pricing period.

In addition to the actual rates achieved, there are other factors impacting the effectiveness of a bond issue—including the structure of the issue, who the bonds are marketed to, and what types of buyers end up with your bonds. These are all areas where an outside advisor can add value. For example, the SEC appears to be looking for the MA to track trades made by the underwriter for a period after the sale date in order to identify unfair trades. Here again, the typical treasurer is not equipped to perform such reviews, but an independent registered municipal advisor is. You owe it to yourself and your constituents to add the proper resources to your financing team to ensure an effective all around result for your next bond issue.

Mike Sudsina is owner of Sudsina & Associates.
216.215.7753 | *mike@sudsina.com*