By Mike Sudsina and Greg Van Wagnen

Is It Finally Time to Sell My Debt Competitively?

Best practices for public sector procurement typically require some sort of competitive bidding process for basic goods and services. So why is it that one of the largest expenditures a school district makes other than payroll, namely interest on debt, is typically acquired with little or no competition? Interest rates are one of the most simplistic commodities out there, yet schools usually sell their debt (aka buy interest rates) through negotiated arrangements with bankers with little or no competition added to the process.

This practice probably finds its origins in the debt limitations that Ohio schools must comply with that require unique structuring methods to raise the necessary capital to pay all the professionals enlisted to aid in the process. Under certain market conditions these unique structures are required, but not always. Since interest rates have been at historically low levels for nearly a decade, the table has been set for schools to sell their debt competitively.

A competitive sale is a method of selling bonds where the Issuer offers a debt issue for sale at a specific date and time and awards the bonds to the bidder with the lowest True Interest Cost (TIC).

The prime benefit of this method of sale is that it results in the best interest rate available from the entire market by allowing all eligible underwriters the opportunity to bid on the bonds. Because different bond underwriters have varying and evolving views of future interest rates and economic conditions, a competitive sale typically results in bids that can be as close as 0.01 percent from the winner to second-place, and often with spreads of over 1.00 percent to the last place bids.

Using a simplified hypothetical example, under current market conditions, a $10,000,000 bond with a 37-year maturity would cost the Issuer an additional $275,000 in interest expense over the life of the bond with just a 0.10 percent increase in TIC. To further illustrate interest rate sensitivity with a real-world example; recently two bonds were sold with matching ratings, final maturities, and bank qualified status. One sale was negotiated through a pre-selected underwriter with a 10-year call feature and the other was sold competitively with a 5-year call, which is usually considered more costly due to the added flexibility provided to the issuer. The reduced interest rates assigned to the competitive sale saved the issuer $374,010 in nominal interest expense which equated to $296,913 in present value terms.

Pre-selected underwriter with a 10-year call

Competitive sale with a 5-year call

How do you decide whether your bond sale could benefit from a competitive sale? You will need to start with the help of an unbiased municipal advisor (MA) to do the analysis to help decide whether your bond issue structure could successfully sell competitively. This will provide the opportunity to decide on the method of sale without the input of parties (bankers) who stand to gain from the outcome of the decision. If it is decided to proceed with a competitive sale, the MA will aid in the structuring, marketing, and verification of the bond sale.

Over the past 3 years several Ohio school districts have sold $168,648,000 of bonds and notes competitively, namely, Amherst EVSD, Bay Village CSD, Dublin CSD, Kenston LSD, Revere LSD, Richmond Heights LSD, Riverside LSD, Rossford EVSD, Tallmadge CSD, and Westlake CSD.

Bottom line—a competitive sale can result in the best interest rates available in the market and produce substantial interest savings to a school district over the life of the debt under the right conditions. The competitive sale method should be discussed with a municipal advisor early in the debt planning process.

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