Should I 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, interest payments on debt, is typically acquired with little or no competition? Interest rates are one of the most simplistic commodities out there, yet debt is usually sold (aka investors buy interest rates) through negotiated underwriting arrangements with little or no competition added to the process.

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% from the winner to second-place, and often with spreads of over 1.00% to the last place bids.

Using a simplified hypothetical example, under recent 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% 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.

How do you decide whether your bond sale could benefit from a competitive sale? You will need to start with the assistance 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 year there have been 30 Ohio Cities, 4 Ohio Counties, 3 Ohio School Districts, and the State of Ohio that have competitively sold debt. Local governments alone account for over $500,000,000 of this competitively sold debt. This includes debt from small issuers like Wauseon selling a $500,000 one-year note up to Cincinnati selling a $99,905,000 twenty-year bond.

Bottom line – a competitive sale can result in the best interest rates available in the market and produce substantial interest savings 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.

For more information on deciding method of sale: www.gfoa.org/selecting-and-managing-method-sale-bonds