STEP 6: PREPARING FOR A BOND SALE

Planning

Each bond sale needs a plan of finance. The key considerations, which your finance team can help you with, are:

- **Size** – How much does the Issuer[1] need or can afford to borrow? This involves an analysis of project costs, a schedule of expected expenditures, and the costs of selling bonds that will be capitalized as part of the bond sale.
- **Timing** – When does the Issuer need the money? This involves the spending schedule but focuses on how long the Issuer might take to spend the proceeds. The IRS limits the earnings on bond proceeds and the Issuer will need to work with Tax Counsel to ensure compliance with federal rules. Further, from a policy standpoint, trying to time the market is not generally considered the best approach to project funding but rather to time the sale of bonds in accordance with when the funds are needed.
- **Security** – What will be pledged to repay the bonds? The bonds, unless they are supported by a new property tax levy, will need a repayment source from existing and future revenues. In addition, some bond issues have one source of intended payment but are secured by additional sources to improve the credit worthiness and marketability of the bonds.
- **Repayment Structure** – How long will it take to repay the bonds? Municipal bonds are most often structured to pay interest twice a year and principal once a year. The Issuer needs to examine the timing of the revenue source that will be used to repay the bonds to match up the repayment structure with the revenue structure.
- **Method of Sale** – How will the bonds be sold? See "Method of Sale" for a discussion of the various considerations and methods for selling bonds.

Developing Bond Documents

A bond is a special type of loan and as such, a set of legal documents must be developed to formalize the details of the loan between the investors and the Issuer. The major legal documents are prepared by Bond Counsel. These take various forms: bond declarations, loan agreements, trust indentures, and bond resolutions are all forms of basic bond documents. The specific type of document depends on the type of bond the Issuer is selling and the types of promises (pledges) being made. Since these documents form the agreement between the investors and the Issuer, and since the details of these documents establish legal underpinnings of the bonds, it is important that the Issuer seek outside

[1] The term "Issuer" is a general reference to issuing districts, municipalities, and local governments.

counsel in determining the best options. The documents are a balance between giving adequate security to bond investors while preserving operating flexibility on the part of the Issuer. Bond documents should be developed in conjunction with the Issuer's Bond Counsel and Municipal Advisor. If the sale is Negotiated, the Underwriter should be involved as well, but it is important to remember that Underwriters are tasked with selling bonds to investors and therefore may have a bias towards increased investor security.

Official Statements

Prior to the sale, it is referred to as the Preliminary Official Statement (POS) and is the primary source of information for Underwriters, investors, and rating agencies in evaluating the value and creditworthiness of the bonds and the Issuer. The POS is used to introduce and develop primary purchase commitments prior to the sale or marketing of the bonds. The POS is regulated per Securities and Exchange Commission (SEC) Rule §240.15c2-12 Municipal Securities Disclosure and must be deemed final prior to distributing to investors. After the sale, the POS is updated with pricing information, including: the sale price, bond rating, final maturity schedule, and interest rates determined at the sale closing. This updated document is then published as the Final OS, or prospectus, for the bond issue.

The various sections of the Preliminary and Final Official Statements are prepared by the Issuer, Bond Counsel, Municipal Advisor, and Underwriter. These documents typically include general sections concerning the municipality or local government, its economy, fiscal condition, financial structure, revenue sources, revenue data, debt authority, and any outstanding litigation. The OS also includes sections which describe:

- The issuing entity,
- The project to be financed,
- Financial information concerning the Issuer,
- Specific details of the issue (including term and interest payment structure, as well as revenue sources which may be used to repay bonds), and
- The Bond Counsel's opinion as to the tax-exempt status of the bonds.

While several organizations may contribute to the preparation of the OS, the Issuer needs to recognize that the OS is the Issuer's document and therefore it is the Issuer's responsibility to ensure that the OS contains all material information needed to comply with federal and state requirements.

Official Statements (OS) from bond sales are available at no cost at the Municipal Securities Rulemaking Board's EMMA website. Also, MDAC staff is available for any questions at the Debt Management Division of the Office of the State Treasurer.

Credit Ratings

One of the most important factors determining the interest rate paid on bonds is the perceived quality of the Issuer's credit. This perception is most often based on its rating by one or more of the national ratings firms. The significance of bond ratings on the cost of borrowing is substantial. Consequently, Issuers that improve their ratings can reduce their borrowing costs.

There are three main firms that rate municipal bonds: *Fitch Ratings*, *Moody's Investors Service*, *S&P Global Corporation* Other organizations (i.e., *Kroll Bond Rating Agency*) rate municipal bonds but have not gained the widespread acceptance of these firms. Bonds are rated for a fee that is charged when the bonds are sold. There is generally no charge to maintain a rating over the life of an issue; however, industry standards may change. The Issuer should keep the agency apprised of financial circumstances. The rating is a measure of quality and credit risk and is reviewed periodically by the rating agency as long as bonds are outstanding.

A rating agency generally requires about three weeks between receipt of documents and issuing a rating. The Municipal Advisor or Underwriter will initiate contact with the rating agency and provide analysts with the necessary documentation.

The need for a rating or multiple ratings on an issue depends on a variety of factors, including:

- The size of the offering.
- Whether or not the Issue has outstanding rated issues of the same security.
- The perceived market for the bonds.
- The likelihood that an investment grade rating can be obtained. The Issuer may consider the potential purchasers in making a determination to obtain a rating.
- Whether the issue will carry credit enhancement.

The rating agency may contact the Issuer for updated information to issue a surveillance rating and the Issuer is required to provide the annual audit to the agency. When an issuer applies for and uses the rating assigned to a bond issue by a rating agency, the Issuer effectively contracts to provide the agency with the information (e.g. annual financial statements) necessary to maintain or keep the rating up to date. The rating agency has the option of confirming the existing rating, upgrading the rating, or downgrading the rating - depending on the changing financial status of the Issuer. The bond rating is an assessment of credit quality that remains important throughout the life of the issue. It is shortsighted to pay attention to the rating only at the time of a bond sale because the interest of traders and bondholders in credit quality remains as long as bonds are outstanding.

Many investors will only buy rated bonds because such securities carry an independent evaluation of credit quality. Others are required by law to hold only rated bonds. If the municipality fails to provide the rating agencies with the information required to keep this quality assessment current, the rating is withdrawn and the bondholder is left with an investment of indeterminate quality. A rating withdrawal can have a negative impact on the resale or trade value of a bond. For this reason, investors and traders have a strong interest in the maintenance of ratings. When ratings are withdrawn due to inadequate information, Underwriters will note this as a lack of sound debt management practices when the Issuer next enters the market, which often results in higher interest costs in the future. Accordingly, Issuers should give careful thought to the matter of whether or not a rating should be requested for the current bond issue.

Even if a new offering is rated, bidders are likely to view this rating with some skepticism if the Issuer has demonstrated a lack of concern regarding the maintenance of previous ratings. Management of municipal finance is an ongoing process and each decision or policy affects investors' overall view of management quality.

Many segments of the market are trying to standardize municipal financial reporting. It is recommended that reports be consistent with Generally Accepted Accounting Principles (GAAP) for governmental units.

Rating Criteria Overview

The rating agency is primarily interested in the strength of the security pledged to the repayment of debt. The lower the amount of debt in relation to the resources pledged to repayment normally results in a higher rating. Many factors that enter into the rating may be beyond the Issuer's immediate control, such as the state of the local economy. However, Issuers can influence factors that may enhance credit quality.

General Obligation Bonds

Four principal factors are evaluated in order to rate a GO bond:

1. **Debt**
   - Debt burden
   - Debt history and trends
   - Debt policy
   - Debt as a percentage of current budget revenues
   - Future borrowing plans

   Burden is expressed as net direct and overall (or overlapping) debt per capita and net direct and overall debt as a percent of estimated full value of property within the municipality's boundaries.

2. **Financial**
    - Fiscal performance
    - Budgetary control
    - Revenue adequacy and diversity
    - Financial administration
    - Historical trends

3. **Economy**
    - Natural resources and population
    - Income
    - Employment
    - Industrial diversification
    - Economic structure and amount of capital
    - Economic performance and prospects

4. **Administration or Management**
    - Organization
    - Services
    - Performance
    - Policies

Revenue or Limited-Liability Bonds

Rating analysis for Revenue or Revenue-supported Bonds is similar to that of GO bonds. The focus shifts from the taxing power of the entity to the earning power of the project. The following principal factors are evaluated to rate a Revenue Bond:

1. **Legal Protection**
   Legal protection for the bondholders and the governmental entity is outlined in the bond indenture. The bond indenture authorizes the bond issuance, defines the bondholder's security, the Issuer's responsibilities, and provides the rate covenant.

2. **Project Essentiality.** A key factor in rating Revenue Bonds is the essentiality of the project for the which the bonds are being sold. Water and sewer Revenue Bonds, for example, are considered highly essential since most property owners cannot easily avoid incurring and paying for utility services. In contrast, the use of enterprises such as parking garages, entertainment venues, golf system and other enterprises are largely at the discretion of the public and the demand for such services is often uncertain.

3. **Demand-Creating Potential**
   Demand-creating potential includes basic economic trends and trends relating to the specific revenues pledged. Providing feasibility studies or management projections are helpful in the evaluation process.

3. **Administration or Management**
   Administrative or management of a municipality is evaluated on the basis of organization, services, performance, and policies.

4. **Finances**
   Key factors analyzed for the finances of an entity are: debt service coverage, stability, balance sheets, liquidity, future financing needs, and projected operations.

Information Requirements

To perform a rating review, historically the rating agencies require the following general information. To establish what information is required for your specific bond issue, contact the rating agencies and/or enlist the help of your bond professionals.

General Obligation Bond Issues

- Preliminary Official Statement
- Audit reports/audits from the past three years
- Latest operating budget
- Capital budget or planning document
- Authorizing resolution or ordinance
- All legal documents relative to security debt

May also request:

- Description of the economy
- Last five years' assessed valuation
- Building permit activity
- List of ten largest taxpayers
- Current population estimate
- Last five years' tax rates, levies, current and total collections
- Pending litigation

Revenue or Limited-Liability Bonds

- Bond security covenants
- Ten-year trend of receipts
- Any engineering report on feasibility and construction
- Economic data related to specific purpose of financing

- Nature and term of lease obligations
- Trust indenture or bond resolution
- Nature and term of lease obligations
- Any engineering report on feasibility and construction
- Any lease agreement applicable

Credit Evaluation

Credit evaluation is both an objective and subjective exercise. Because of this, rating recommendations undergo an internal rating committee review process. A consensus is required before the proposed rating is assigned.

Ratings and the Bond Market

Moody's ratings, beginning with the highest, are: Aaa, Aa, A, Baa, Ba, B, Caa, Ca, C and, CON for a conditional rating. Bonds in the Aa, A, Baa, Ba and B groups are further broken down into sub-ratings of 1, 2 or 3. For example: Aa1, Aa2 or Aa3, with Aa1 representing the rating that Moody's believes possesses the strongest investment attributes within that group.

S&P Global ratings, beginning with the highest, are: AAA, AA, A, BBB, BB, B, CCC, CC, C and D for bonds in default. Ratings from AA to BB may be modified by the addition of a (+) plus or (-) minus sign to show relative standing within the major rating categories.

Fitch Ratings are: AAA, AA, A, BBB, BB, B, CCC, CC, C. DDD, DD and D are used for bonds in default. Ratings from AA to BB may be modified by the addition of a (+) plus or (-) minus sign to show relative standing within the major rating categories.

The ratings of the three main agencies are roughly comparable, from Aaa/AAA to C/C. Ratings of Baa and BBB are the lowest acceptable rating for bonds to be considered of investment grade and therefore of interest to institutional buyers.

Investors use bond ratings for various purposes. Large institutional investors may do their own credit research to supplement the rating agency evaluations. Ratings may be used as a screening mechanism to narrow a list of potential investment choices.

A municipality may want to follow the secondary market trends of bonds to compare the performance of their own bonds to others of similar credit quality. The bond rating, in addition to a variety of other factors, has a direct bearing on the interest rate paid by an Issuer.

As a matter of policy, some Issuers also limit the sales of bonds that do not carry an investment grade rating to special classes of investors, known as Qualified Institutional Buyers or Accredited Investors.

Credit Enhancements

Enhancing the creditworthiness of a bond issue by shifting credit-related risks to a third party through the use of bond insurance can be a means of lowering borrowing costs. There are several nationwide firms that offer bond insurance. Bond insurance is used to guarantee payment of the entire principal and interest of the issue or, in some cases, specific maturities within an issue. Such insurance may not be necessary and may not reduce overall borrowing costs after the insurance premiums are factored in. Bond insurance is not always desirable or available, but may be suitable and may lower borrowing costs in some cases. Prior to 2008, common beliefs were that bond insurers would keep their AAA ratings forever. In 2008, that perception changed as all bond insurers suffered significant downgrades. As of 2017, two AA rated bond insurers are writing new insurance policies and may be a viable option for lower rated bond issues.

Structuring

When determining the maturity schedule for a bond issue, it is important to match bond and interest payment dates to the available cash flow. If the bonds are self-supporting, the bond principal repayment dates should be scheduled to coincide with revenue collections. If the bonds are dependent on tax collections, payment dates should be matched to the timing of the receipt of property taxes by the issuer. Municipalities that fail to make this match have had to issue short-term debt repeatedly to meet temporary cash flow deficits that could have been avoided by selection of the appropriate maturity schedule. In Oregon, many general obligations bonds are structured with December 15 (interest only) and June 15 (principal and interest) payment dates to coincide with the large annual tax turnover in late November.

After matching bond issue debt service to available cash flow, a second factor to consider in designing a maturity schedule is overall cash flow. Decide how the new debt service schedule will impact the existing maturity schedules. Project future borrowing needs as defined in the capital improvement plan. Make sure the new maturity schedule has been optimally designed for the issuer's cash flow capacity.

Maturity schedules can be designed either to result in roughly equal annual debt payments, to "wrap around" existing debt service to result in a combined level debt schedule, or to otherwise fit an issuer's desired repayment structure. Issuers should be aware that ascending debt service schedule (achieved by deferring principal repayment) may be viewed negatively by the rating agencies and investors.

Most municipal bonds are structured with serial bonds – bonds that mature each year and are structured with different coupons and yield related to the length of the maturity. Generally, bond yields rise as maturities lengthen due to the increased risk in a concept known as the "yield curve". Bond issues may also be structured as term bonds. In the instance of term bonds, the entire principal of the term bond is paid at a single coupon and yield and priced to the final maturity date. With term bonds, Issuers are usually required to make annual mandatory redemptions to smooth out payments.

In general, longer bonds will pay a higher yield because of greater risk to the investor (positive yield curve). Most GO bonds are structured with final maturities of one to twenty years.

Debt instruments may be issued using any of the following interest payment formats or combination of formats:

- Be paid at regular intervals at a defined coupon rate.
- Be deferred until the principal matures (zero coupon bond).
- Be set at a fixed interest rate for the term of the obligation.
- Vary with a specified market interest rate (variable/floating rate).

Call options allow bond Issuers to redeem or refund securities prior to their stated maturity. Most government Issuers choose to issue long-term, fixed coupon debt knowing that a ceiling has been placed on future debt service outlays. However, Issuers also prefer to have the ability to refinance their debt if interest rates fall. The call option permits Issuers this flexibility. Bonds issued without a call option may not be refinanced for the purpose of realizing debt service savings.

Credit factors may also contribute to the decision to sell callable bonds. If an Issuer's credit position improves; a call provision would allow refunding at a later date in a more favorable environment. On the other hand, if conditions worsen, the Issuer is not compelled to call bonds at the optional date.

Issuing refunding bonds incurs additional cost, but the savings quoted will be net of all issuance costs. Current Oregon laws do not require a vote on a refunding issue, though other normal bond issuing and administrative costs remain. A need or desire for financial flexibility should provide the principal justification in determining whether a call feature is to be included. The technical aspects of a call feature include:

- The amount of premium (if any), to be paid.
- The number of years before the call.
- The order in which the bonds are to be called.

A typical call option for municipal bonds provides that the bonds may be called after approximately ten years at a price of par (100% of face value). It is unusual for Issuers to have pay a redemption premium unless they are seeking to redeem the bonds sooner than ten years from the date issuance.

Regardless of the fact that coupon bonds are no longer issued, the interest rate on any bond is still referred to as its coupon rate. Issuers may set the conditions for coupon rates bid by purchasers. Typical restrictions include:

- Requiring the same coupon rate for all bonds in a single maturity.
- Requiring coupon rates in multiples of one thousandth of one percent (0.001%).
- Requiring that coupon rates on maturities after the call date to be in increasing (non-descending) order.

Fewer restrictions on coupon rates may encourage more bidders. The advantages of rate restrictions to an Issuer must be balanced against the potential consequences of such restrictions. Consequences could include higher interest costs, but this is not normally the case if the restrictions are familiar to the bond community. The restrictions cited above rarely demand a premium for their imposition. Issuers should work closely with their Municipal Advisor to determine the couponing restrictions most likely to achieve the Issuer's financing goals.

Oregon municipalities may establish their own maximum interest rate which is generally calculated using the True Interest Cost (TIC) computation for determining an overall average interest rate. The TIC method is that TIC considers the time value of money involving a present value calculation and gives a true picture of the cost involved.

Sale Date

Although market conditions are difficult to predict, timing of a bond sale is very important. In periods of high interest rates, Issuers may postpone construction of a project or use interim financing arrangements. When rates are lower, Issuers with bond issues outstanding which have call provisions may issue Advance Refunding or Current Refunding bonds to refinance higher interest rate debt.

In addition, short-term considerations, such as the day-to-day schedule of other bond sales, are important. In general, bond sales are most successfully scheduled mid-week rather than on Mondays or Fridays. Interest rates are most unpredictable (most volatile) just before and after holiday periods and long weekends. Furthermore, when an issue is sold to a bank or syndicate, the bonds are usually re-offered the same day or the next.

Issuers should try to avoid periods of unsettled monetary or bond market conditions and should avoid large competitors (other bond sales of similar security, tax status, credit and structure), which will weaken the demand for bonds. Issuers can use the Oregon Bond Calendar to assist in scheduling their bond sale.

Choosing a sale time involves planning. When choosing the time of day for accepting bids on Competitive sales of bonds, Issuers should make sure that they are in a position to award the bonds to the winning bidder shortly after the winning bid has been established. The time at which bids are to be awarded may also need to be coordinated with a special board or council meeting. Alternatively, the governing body may choose to delegate the award of the bonds to its finance director or other senior finance official, eliminating the need for a special board meeting.

Required Filings

State and municipality bond sales are reported to the Municipal Debt Advisory Commission (MDAC). Sales not reported to the MDAC consistent with ORS 287A.640 and OAR 170-61-0000 will be in non-compliance with the law. Bond professionals in Oregon are aware of this provision of the statute and should assist their client municipalities in meeting this requirement. Issuers should also forward a copy of their final official statement for the bond issue within seven (7) days of a bond sale**.** (See OAR 170-61-0000, Notice and Reporting Requirements by Public Bodies When Issuing Bonds.)

MDAC Form 1 (Bond Sale Notice)

In accordance with OAR 170-61-0000, all local governments, municipalities and agencies are required to notify the Commission of all bond sales. Official notice is accomplished by filing a Bond Sale Notice (MDAC Form 1) with the Commission. This is usually submitted by bond professionals through the use of the Bond Tracker system managed by the Debt Management Division Municipal Debt Advisory Commission services of the Office of the State Treasurer.

The notice of the bond sale must be submitted not less than 10 days preceding the bond marketing date (ORS 287A.640 and OAR 170-61-0000). It must include preliminary bond sale information such as:

- The issuing entity and address
- Type of bond
- Anticipated bond marketing (sale) date
- Bond par amount
- Project or purpose of the bond issue
- Source of revenues used to repay the bonds
- Anticipated closing date
- Bond Counsel

- Municipal advisor (if applicable)
- Underwriter (if sale is Negotiated)
- Bond issuance costs (if available)
- Other summary information identified on MDAC Form 1

The Commission will provide the public body and appropriate Bond Counsel a letter verifying receipt. The letter will indicate whether the bond sale is in compliance or non-compliance with OAR 170-61-0000v. Postponed or changed bond sales require submission of an updated MDAC Form 1 to the Commission as soon as the new information is available. Postponed or changed bond sales do not require another copy of the preliminary official statement unless a new printing occurs.

MDAC Form 2 (Bond Sale Result)

Public entities issuing bonds will also report all bond sale results to the Commission by filing a Bond Sale Result document (MDAC Form 2). The form must be submitted not later than seven days after the bond marketing date. The form is usually submitted by bond professionals through the use of the Bond Tracker system managed by the Debt Management Division Municipal Debt Advisory Commission services. The public body and its Bond Counsel will receive written notice of non-compliance if sale results are not reported.

Distribution of NOS & POS

In order to ensure compliance with the legal requirements, Bond Counsel normally prepares the Notice of Sale. New bond sales are now advertised nationally using a variety of means. Some jurisdictions still require advertising in local press while state law now allows for bypassing local printed press and using national electronic media services. Most advisors believe this second method reaches all prospective bidders in a Competitive sale.

The Notice of Sale (NOS) is the official offer to sell the bonds and provides the official description of the security and the bidding process. It also directs the interested bidders to the POS for a full discussion of the security and information provided by the Issuer related to the bond sale.

Most Issuers now use one or more electronic media networks to provide the notice of the bond sale to potential investors and to distribute the Preliminary Official Statement (POS). Additionally, Issuers may publicize sales by distributing POSs directly to banks and investment banking firms.

Bond Registration

In the past, municipal bonds could be issued in either coupon or registered form. However, federal legislation passed by Congress on August 20, 1982 -- the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) requires all bonds of one year or longer duration sold after June 30, 1983 be issued in registered form. Accordingly, it is no longer legal to issue bearer bonds for issues of one year or longer duration.

Registered Bonds

Registered bonds have a recorded ownership and must be re-registered to the new owner each time they are sold or transferred. Such bonds do not have coupons and may be registered in denominations substantially larger than $5,000. A Paying Agent, which is usually a financial institution, automatically sends interest payments to the owners.

Book-Entry Only Registered Bonds

Book-Entry Only registered bonds are recorded ownership bonds which are not available in physical form. Such bonds are held by a securities depository and recorded by computer or other permanent means for the benefit of the bond owner. No individual certificates are issued, but all other features of a Registered Bond cited above remain. The main advantage of this type of bond is reduced issuance expense for the issuer. Book-Entry Bonds are generally registered through DTC.

Responsibilities of the Registrar

Responsibilities of the Registrar include registration of bonds at the time of issuance (i.e. following a sale) and transfer of bonds during the life of the issue. The Registrar is usually a bank or other financial institution; however, the Issuer, in some cases, may choose to assume the responsibility. Selection of a Registrar should be based upon an assessment of the market of an Issuer's bonds. The Registrar should be located as close as possible to the primary market for an Issuer's bonds and should guarantee prompt transfer of ownership.

Performance standards must be met by transfer agents (Registrars) in order to comply with the Securities and Exchange Commission rulings.

Issuers may, from time to time, solicit proposals for Paying Agents. The MDAC maintains a list of qualified banks that provide these services.

The following costs and fees may be borne by the Issuer issuing bonds:

- Underwriter's fee/discount/spread
- Bond Counsel fee
- Municipal Advisor fee

- Rating fees
- Credit enhancement fees
- Official Statement cost
- Bond printing cost
- Out-of-pocket costs such as travel, financial data preparation, etc.
- Other costs such as Blue-Sky search fees (i.e. state securities law), Paying Agent/Registrar, Underwriter's Counsel fee, and Trustee fee
- MDAC fee

For Refundings:
- State advance refunding fees
- Escrow verification
- Escrow Trustee

Closing

The closing date is the date on which the bonds (in electronic form) are exchanged for payment from the bond Underwriter.

The amount due at closing is equal to the principal amount, plus the original issue premium or less the original issue discount, if any, less the Underwriter's discount, less the amount of the good faith deposit. The bonds are delivered to the purchaser on receipt of the closing amount, usually in federal funds or other guaranteed funds. The bond issue does not become a debt of the Issuer until the completion of the bond closing.

Often, proceeds from the bond sale are not spent immediately and are held until needed for the project. The Internal Revenue Code strictly regulates the investment of bond proceeds. Subject to ORS 294.040 and 294.135-294.155, the bond proceeds custodial officer may, after having obtained a written order from the governing body which is in the governing body's minutes or journal, invest any sinking fund, bond fund or surplus of funds in his/her custody in any approved investments. (Reference ORS 294.035.)