WCCUSD CBOC 9/11/2015 7:35 PM

Cost Savings Measures Subcommittee

For Measures D (2002), J (2006), D (2010) and E (2012)

Agenda, Thursday, September 17, 2015 at 5:00 PM, Meeting No. 5

Facilities Operation Center, 1400 Marina Way South, Richmond, CA

Mission: Understanding and reviewing "soft-costs." Reviewing efforts by the school district to maximize bond revenues by implementing cost-saving measures, including, but not limited to, all of the following: (A) Mechanisms designed to reduce the costs of professional fees, (B) Mechanisms designed to reduce the costs of site preparation, (C) Recommendations regarding the joint use of core facilities, (D) Mechanisms designed to reduce costs by incorporating efficiencies in school site design, (E) Recommendations regarding the use of cost-effective and efficient reusable facility plans. [1] Also to monitor progress on master facilities plan development and to provide feedback on the format and substance of the plan. [2] On August 31, 2015, the Change Order Subcommittee was merged with this Subcommittee. [3]

Meeting Number: 5

Call to Order by Chair Tashia Flucas

Pledge of Allegiance – Chair Tashia Flucas

Roll Call Members – Anton Jungherr

- Tashia Flucas, Chair
- Tom Waller, Vice Chair
- Charlene Harlan-Ogbeide
- Anton Jungherr

Staff

- Lisa LeBlanc
- Juan L Garrahan, SGI
- Luis Freese

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[1] The CBOC approved the formation of the Cost Savings Measurers Subcommittee on December 10, 2014 with this scope. This is an ad-hoc committee not subject to the Brown Open Meeting Act.

[2] CBOC Resolution 14-1, adopted December 10, 2014, Comprehensive Planning for the WCCUSD School Construction Program Using Different Resource Scenarios/ "The End Game." The Chair's report dated March 18, 2015 assigned monitoring of the master facilities plan development to this CBOC Subcommittee.

[3] Ivette Ricco August 31, 2015 email to Change Order Subcommittee and Cost Savings Measurers Subcommittee.

Agenda Review and Adoption – Tashia Flucas

Public Comments – Tashia Flucas

Approval of Minutes, August 20, 2015 (meeting # 4) *[4] - Anton Jungherr

Review SGI Reports - Juan L. Garrahan, SGI

- Monthly Schedule Status Report August 2015
- Review One Copy of Each Report Received by the District during the Period January to July 2015

Request CBOC to Authorize CBOC Independent Legal Counsel Adam Ferber to Review the District Providing the CBOC Online View Only Access to Construction Databases - Anton Jungherr

- Primavera Project Management
- Primavera Contract Management
- Central Program Reports Data Base (CPRDB)

Request to be on CBOC September 23, 2015 agenda.

Request CBOC to Authorize CBOC Independent Legal Counsel Adam Ferber to Review SGI Agreement End Date– Anton Jungherr

Request to be on CBOC September 23, 2015 agenda.

Long Range Facilities Master Plan Status Report

The intent is for the Subcommittee to be briefed at each meeting during the facilities master planning process.

Request Jack Schrader and Associates Enrollment Estimate – Anton Jungherr

Lisa LeBlanc stated at the July 16, 2015 and August 20, 2015 Subcommittee meetings that this "draft" report was not available.

[4] *= backup document attached to agenda.

Owner Controlled Insurance Program (OCIP) Status Report – Tom Waller

Staff recommended, at September 15, 2015 Facilities Subcommittee meeting, OCIP insurance alternate on PVHS project

Change Order(s) Exceeding 5% of the Original Contract– Tom Waller

The intent is for the Subcommittee to review the *CBOC Change Order Information – Sub Project Summary* for projects where change order(s) exceed 5% of the original contract. The report reviewed by the Subcommittee would be the same report submitted to the CBOC at their regular monthly meeting.

Cost of Bond Sales and Best Practice – Negotiated or Competitive *– Anton Jungherr

The intent is to review the cost of prior bond sales and obtain an understanding of the costs/benefits of negotiated bond sales vs. competitive bond sales.

Meeting Schedule 2015– (all meetings are held on third Thursdays of the month at the Facilities Operation Center at 5:00 PM) – Tashia Flucas

- October 15, 2015
- November 19, 2015

Next Meeting – Thursday, October 15, 2015 at 5:00 PM – Tashia Flucas

Good for the Order – Tashia Flucas

Adjournment - Tashia Flucas

Documents Attached to Agenda

- Minutes (draft), August 20, 2015
- *Competitive Versus Negotiated Sale of Debt*, California Debt and Investment Advisory Commission, September 1992

Approved by: Tashia Flucas, Chair
Tom Waller, Vice Chair
Cost Savings Measures Subcommittee

*Backup document attached.

Distribution: Subcommittee Members, Ricco, LeBlanc, Bonnett, Freese, Garrahan, Hanson (post to CBOC Website)

WCCUSD CBOC

Cost Savings Measures Subcommittee

Agenda, Thursday, September 17, 2015

Draft Minutes

August 20, 2015

Line 31

WCCUSD CBOC 9/11/2015 6:21 PM

Cost Savings Measures Subcommittee
For Measures D (2002), J (2006), D (2010) and E (2012)
Minutes, August 20, 2015 at 5:00 PM, Meeting No. 4
Facilities Operation Center, 1400 Marina Way South, Richmond, CA

Mission: Understanding and reviewing "soft-costs." Reviewing efforts by the school district to maximize bond revenues by implementing cost-saving measures, including, but not limited to, all of the following: (A) Mechanisms designed to reduce the costs of professional fees, (B) Mechanisms designed to reduce the costs of site preparation, (C) Recommendations regarding the joint use of core facilities, (D) Mechanisms designed to reduce costs by incorporating efficiencies in school site design, (E) Recommendations regarding the use of cost-effective and efficient reusable facility plans. [1] Also to monitor progress on master facilities plan development and to provide feedback on the format and substance of the plan. [2]

Meeting Number: 4

Call to Order by Anton Jungherr at 5:05 PM

Roll Call Members –
- Tashia Flucas, Chair – present (arrived 5:10 PM)
- Kelvin Love - absent
- Charlene Harlan-Ogbeide - present
- Anton Jungherr - present

Staff Present
- Lisa LeBlanc
- Luis Freese
- Melissa Payne (new Director, Contracts Administration)
- Catherine Boskoff, Attorney, Orbach Huff Suarez + Henderson LLP (left at about 5:20 PM)

DRAFT

[1] The CBOC approved the formation of the Cost Savings Measurers Subcommittee on December 10, 2014 with this scope. This is an ad-hoc committee not subject to the Brown Open Meeting Act.

[2] CBOC Resolution 14-1, adopted December 10, 2014, Comprehensive Planning for the WCCUSD School Construction Program Using Different Resource Scenarios/ "The End Game." The Chair's report dated March 18, 2015 assigned monitoring of the master facilities plan development to this CBOC Subcommittee.

Owner Controlled Insurance Program (OCIP) Status Report – Catherine Boskoff presented her report, <u>*Pinole Velley High School Potential Project Savings.*</u> (See attached report)

M/S/C Jungherr/Flucas approved 3-0-0-1 [3] to recommend that WCCUS request PVHS bidders to disclose the cost of insurance included in their bid and that the District solicits cost for OCIP insurance including third party administration. This process would allow the District to perform a cost/benefit analysis on OCIP insurance for the PVHS project.

Yes: Flucas, Harlan, Jungherr, Absent: Love

Agenda Review and Adoption – approved

Public Comments – none

Approval of Minutes, July 16, 2015 (meeting # 3) - approved

Review SGI Reports - tabled to September 17, 2015 Subcommittee meeting.

- Monthly Schedule Status Report July 2015
- Monthly Cost Control Reports July 2015 (need agreement on reports to be provided to the Subcommittee)

Request CBOC to Authorize CBOC Independent Legal Counsel Adam Ferber to Review the District Providing the CBOC Online View Only Access to Construction Databases -

- Primavera Project Management
- Primavera Contract Management
- Central Program Reports Data Base (CPRDB)

M/S/C Jungherr/Flucas to approve request 3-0-0-1.

Yes: Flucas, Harlan, Jungherr, Absent: Love

DRAFT

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[3] Vote order: yes-no-abstain-absent

DRAFT

Request CBOC to Authorize CBOC Independent Legal Counsel Adam Ferber to Review SGI Agreement End Date

M/S/C Jungherr/Flucas to approve request 3-0-0-1.

Yes: Flucas, Harlan, Jungherr, Absent: Love

Long Range Facilities Master Plan Status Report

Lisa LeBlanc briefed the Subcommittee on this matter.

Request Pinole Valley High School Three Cost Estimates – Luis Freese briefed Subcommittee (See attached report)

- Mercurial Cost Estimating - $118,927,706
- Harris Construction Company - $118,465,404
- Silva Cost Consulting, Inc./WLC - $110,495,762
- Original Board approved budget was $104,000,000

Request Jack Schrader and Associates Enrollment Estimate

Lisa LeBlanc said that this report was still in "draft" form and that the final version would be released "in the next several weeks."

Ms. LeBlanc at the Subcommittee meeting of July 16, 2015 stated that she had this draft report, which she did not provide to the Subcommittee.

Pinole Valley High School Design Capacity

- Design capacity 1,600 students v. 950 projected enrollment

Subcommittee needs status of cost/benefit analysis at design capacity of 1,000, 1,200, and 1,400

Lisa LeBlanc briefed the Subcommittee on WLC, Inc. response to the above three student enrollment options. (See attached report) For each option, the cost would increase:

- Reducing the classroom space to 1400 would increase cost $9,806,859
- Reducing the classroom space to 1200 would increase cost $6,673,599
- Reducing the classroom space to 1000 would increase cost $3,388,239

Meeting Schedule 2015– (all meetings are held on Thursdays at the Facilities Operation Center at 5:00 PM)

- September 17, 2015
- October 15, 2015
- November 19, 2015

Next Meeting – Thursday, September 17, 2015 at 5:00 PM

Good for the Order – none

Adjournment – at 6:00 PM

Prepared by: Anton Jungherr, Secretary
Cost Savings Measurers Subcommittee

Approved by: Tashia Flucas, Chair
Cost Savings Measurers Subcommittee

DRAFT

Distribution: Subcommittee Members, CBOC Chairperson Ricco, LeBlanc, Bonnett, Freese, Hanson, Payne (post to CBOC Website)

Attachments to Minutes

- Pinole Valley High School Potential Project Savings (OCIP)
- Tom Waller Email to Mark Bonnett, July 16, 2015, WCCUSD and OCIP
- Summary of Construction Cost Estimates for Pinole Valley High School – New Campus
- Rough Order of Magnitude Cost Options for Student Enrollment Reductions (PVHS), WLC Architects, Inc., 8/19/15

DRAFT

8/20/15

Catherine G.
Beskid6

Owner **C**ontrolled **I**nsurance **P**rogram

PINOLE VALLEY HIGH SCHOOL

POTENTIAL PROJECT SAVINGS

- ***AUTHORITY***:
  Under section 4420.5 of the Government Code, school districts can participate in OCIP programs if, "[p]rospective bidders, including contractors and subcontractors, meet minimum occupational safety and health [OSH] qualifications established to bid on the project." (Gov. Code, § 4420.5, subd. (b)(1).)
  - Pre-qualification:
    WCCUSD requires Contractors to complete a prequalification questionnaire and a financial statement in accordance with Public Contract Code 20111.5(e) – occupational safety is a current component for prequalifying.

- ***OCIP ADVANTAGES***:
  - Potential cost reduction through:
    - Elimination of redundant costs and contractor mark-ups
    - Minimized cross-litigation/subrogation
    - Coordinated claims and loss control
    - Simplicity:
      - Two to three insurers
      - Consistent coverage

Economies of Scale Analysis: By implementing an OCIP on major projects like PVHS, there is a potential for significant cost savings over traditional insurance approaches because the District can purchase insurance for the entire project at a lower rate than what individual policies would cost the contractor and its subcontractors. Insurance costs included in contractor bids can range from 1.5% to as high as 4% of the overall cost of construction. By removing these costs, in addition to other loss prevention and safety management advantages, OCIP's could save between .5% and 1.2% of the overall construction costs.

Since the additional administrative burden attendant with an OCIP is typically outsourced to a third party administrator, the costs associated with running the OCIP program will need to be weighed against the potential construction cost savings.

One approach for assuring that an OCIP is cost beneficial would be to require alternate pricing on the bid form that *includes* and *excludes* insurance costs from the contractor's base bid for (at least) the following coverages:

- Commercial General Liability (CGL)
- Workers' Compensation
- Excess Liability
- Builder's Risk

<u>For example</u>: on a $120mil project, OCIP administration costs greater than $600k begin to overcome the anticipated cost effectiveness. By knowing up front how much can be saved, the District could exercise the option of implementing the OCIP or following traditional insurance protocols.

Separate insurance amount on bid → PVHS

· Base bid w/o insurance
· Alt. - insurance

Alternate Construction Manager

3rd party Admin –

DJ/TF . OK

Subj: **FW: WCCUSD and OCIP**
Date: 7/16/2015 2:35:07 P.M. Pacific Daylight Time
From: tomjwaller@earthlink.net
To: ivettericco@gmail.com, AJungherr@aol.com, msflucas@yahoo.com, Kellov@msn.com, tmpanas@yahoo.com, dkcbshicks@aol.com, maureen.toms@comcast.net

For info.

Tom

From: Tom Waller [mailto:tomjwaller@earthlink.net]
Sent: Thursday, July 16, 2015 2:28 PM
To: Mark Bonnett (mark.bonnett@wccusd.net); Sal Mendoza (sal@salmendoza.net)
Subject: WCCUSD and OCIP

Let me introduce the two of you.

Mark Bonnett is the Executive Director of Business Services for the West Contra Costa Unified School District (WCCUSD).

Sal Mendoza is the principal of Mendoza Insurance Brokers, Inc., a member of the Alliance of Schools for Cooperative Insurance Programs (ASCIP), which provides Owner Controlled Insurance Program (OCIP) coverage to risk-sharing pool participants.

At last night's WCCUSD Citizens Bond Oversight Committee (CBOC) meeting, there was an OCIP item on the agenda. At that time during the meeting, it was revealed that Mark is already looking into OCIP as a possibility for WCCUSD.

Mark, I'm sure Sal and the ASCIP/OCIP team stand ready to provide any assistance that would help WCCUSD fully consider and evaluate the OCIP construction insurance option, why ASCIP, etc.

Will the two of you please communicate to explore possible timing and content of any desired information exchange and/or interaction?

Thank you,

Tom Waller
CBOC Member
Cell phone 510.334.2277

Summary of Construction Cost Estimates
for
Pinole Valley High School - New Campus

No.	Estimator/Consultant	Date of Estimate	Total Construction Cost Estimate
1	Mercurial Cost Estimating	May 14, 2015	$118,927,706.00
2	Harris Construction Company	June 5, 2015	$118,465,404.02
3	Silva Cost Consulting, Inc. / WLC	June 19, 2015	$110,495,762.00

Budget Approved
181,900,000

104,000,000

West Contra Costa Unified School District

New Pinole Valley High School

Rough Order of Magnitude Cost Opinion for Student Enrollment Reductions **DRAFT**

WLC Architects, Inc.
8/19/2015

Assumptions:

1. Provide a ROM Cost Opinion for redesigning PVHS for projected student enrollments of 1000, 1200 and 1400 students

2. High School core facilities such as the administration area, library, multipurpose room, gymnasium, theater and specialty lab spaces are not directly governed by the anticipated student enrollment. These spaces are programmed, designed and allocated square footage based on their function and therefore have not been reduced in square footage for these calculations. Only academic classrooms and associated circulation space have been removed.

3. The current design is for a projected student enrollment of 1600. Each reduction of 200 students removes six (6) 960 sf classrooms plus circulation space for a total of 9000 square feet.

4. The majority of academic classrooms are located in the three story classroom building. Any removal of square footage in that building will necessitate a redesign of the entire building structural, electrical, fire and mechanical systems with associated design fees.

5. Redesign of the three story classroom building will likely trigger a resubmittal of the project to DSA with associated review fees.

6. The current project was designed to meet the 2010 building code. Because of this significant redesign, DSA may require the classroom building and the entire campus be resubmitted under the new 2013 code triggering additional design fees and DSA review fees.

7. The additional time required for redesign and DSA review and approval would likely delay the construction and the opening of the school one year until 2019.

8. The delay of the project would extend the need for the temporary campus an additional year.

9. The delay of the project by one year would incur a construction cost escalation factor of approximately 10%-15%.

10. Any project delay also impacts the cost of the future temp campus removal and field replacement project phases due to escalation.

11. Additional criteria may significantly increase or decrease these cost assumptions.

West Contra Costa Unified School District

New Pinole Valley High School

Rough Order of Magnitude Cost Opinion for Student Enrollment Reductions **DRAFT**

WLC Architects, Inc.
8/19/2015

Original Design		
Three Story Classroom Bld SF		135,146
Estimated Classroom Bld Construction Cost	$	48,066,275
Estimated Classroom Construction Cost/SF	$	338

Option No. 1	Student Enrollment	SF Reduction	$/SF	Savings/Costs
Student Enrollment	1,400	9,000	$ 338	$ (3,042,000)
Redesign Fees				$ 273,780
DSA Review Fees for complete resubmittal				$ 740,389
Escalation of entire project for one year	$ 116,388,902	$ 113,346,902	10%	$ 11,334,690
Temporary Campus Costs				$ 500,000
Net ~~Saving~~s/Cost				**$ 9,806,859**

Option No. 2	Student Enrollment	SF	$/SF	Costs
Student Enrollment	1,200	18,000	$ 338	$ (6,084,000)
Redesign Fees				$ 486,720
DSA Review Fees for complete resubmittal				$ 740,389
Escalation of entire project for one year	$ 116,388,902	$ 110,304,902	10%	$ 11,030,490
Temporary Campus Costs				$ 500,000
Net ~~Saving~~s/Cost				**$ 6,673,599**

Option No. 3	Student Enrollment	SF	$/SF	Costs
Student Enrollment	1,000	27,000	$ 338	$ (9,126,000)
Redesign Fees				$ 547,560
DSA Review Fees for complete resubmittal				$ 740,389
Escalation of entire project for one year	$ 116,388,902	$ 107,262,902	10%	$ 10,726,290
Temporary Campus Costs				$ 500,000
Net ~~Saving~~s/Cost				**$ 3,388,239**

WCCUSD CBOC

Cost Savings Measures Subcommittee

Agenda, Thursday, September 17, 2015

Competitive Versus Negotiated Sale of Debt

Line 63

ISSUE BRIEFS

California Debt and Investment Advisory Commission

SEPTEMBER 1992

COMPETITIVE VERSUS NEGOTIATED SALE OF DEBT

Deciding whether to go negotiated or competitive is the most important decision an issuer can make.
The Bond Buyer, April 8, 1991

INTRODUCTION

While one may quibble with the notion that the decision to sell debt through the negotiated or competitive process is "the most important decision an issuer can make," this issue clearly represents one of the most controversial topics in public finance today. The controversy extends back to the mid-1970s, when more and more issuers began to select the negotiated method as the preferred way of selling bonds. This shift has been attributed to several factors, including the increasing utilization of revenue bonds instead of general obligation bonds; the volatile interest rate environment of the late 1970s and early 1980s; and the emergence of innovative financing options and products. The last factor is particularly relevant to California, where the restrictions imposed by Proposition 13 in 1978 led to the development of new financing techniques.

Most bond industry professionals would agree that neither the competitive sale nor the negotiated method of sale is ideal for *all* bond issues. The appropriate method of sale should be determined on a case-by-case basis after evaluating a number of factors related to the proposed financing, the issuer, and the bond market. The challenge for public issuers, then, is to properly identify how the relevant decision factors apply to their proposed bond issues. This *Issue Brief* on the two principal methods of selling public debt is designed to help issuers conduct such a systematic evaluation of their proposed bond issues. It is intended to provide general guidelines for public issuers, particularly those who are infrequent participants in the bond market.

COMPETITIVE UNDERWRITING

Competitive underwriting is the method of bond sale in which the issuer sells its bonds to the underwriter offering the lowest bid meeting the terms of the sale. In a competitive underwriting, the issuer, typically with a financial advisor or investment banker, conducts all the origination tasks necessary for the bond offering. These tasks include structuring the maturity schedule, preparing the official statement, verifying legal documents, obtaining a rating, securing credit enhancement, and timing the sale. The issuer then advertises the sale of the bonds in advance of the specified sale date through a Notice of Sale (NOS). The NOS contains relevant information on the proposed issue and the criteria by which the bonds will be awarded. At the specified date, time, and venue, the issuer opens all bids and awards the right to purchase the bonds to the underwriter with the best bid based on the criteria specified in the NOS.

Advantages

Competitive environment. The issuer's ultimate goal in a financing is to protect the public's interest by obtaining the lowest possible interest cost. Consequently, the most compelling argument in favor of a competitive sale is that the competition among underwriters provides the incentive for keeping the effective interest cost as low as possible. Under the competitive bid process, market forces determine the price.

Historically lower spreads. While the gross underwriting spreads (management fee, expenses, underwriting fee, and takedown) between competitive and negotiated bond sales have been narrowing over the past decade, competitive underwriting is still generally viewed as the best means of reducing underwriting costs. While one may argue that equating spreads is an *apples versus oranges* comparison and that any advantage in spread should be weighed against other costs of the financing, data since 1982 indicate that competitive issues hold an edge in terms of lower underwriter fees paid on general obligation and revenue bond issues.

Open process. The other positive feature of competitive sale is that the issuer generally avoids allegations of unfairness or impropriety in the selection of the underwriter because the bonds are sold through a public auction.

Disadvantages

Risk premium. Underwriters bidding on a competitive sale have no guarantee of being awarded the bonds. Thus, underwriters cannot be expected to conduct the same level of pre-sale marketing (canvassing prospective investors before the sale) as in a negotiated sale. To compensate for uncertainty about market demand, underwriters may include a hedge or a risk premium in their bids, which can show up either in the spread or the reoffering scale. The amount of the risk premium, however, should also be weighed against the total cost of the financing.

Limited timing and structural flexibility. An issuer's ability to make last-minute changes is limited by the competitive sale process. With regard to timing, competitive bidding entails a 15-day lag between the time documents are completed and the actual sale date, due to legal notice requirements. Hence, the issuer's ability to speed up the sale process, if necessary, is restricted. While a NOS can be structured to allow for postponement of a competitive sale and subsequent reoffering with a minimum of two days prior notice, the competitive sale process remains less flexible than its negotiated counterpart.

In addition, the competitive sale restricts the issuer's ability to adjust major structural features, such as final maturity and call provisions, to match the demand realized in the actual sale process. Again, while a properly structured NOS can increase the flexibility of a competitive sale by allowing for changes in the size of the issue (within certain parameters), principal maturity amounts, and the composition of serial versus term bonds, a negotiated sale still holds the advantage if flexibility in structuring is of paramount consideration.

Minimum issuer control over underwriter selection and bond distribution. In competitive underwriting, the bonds are sold to the underwriter submitting the best bid, based on the NOS criteria. The issuer exerts little influence over which underwriting firms actually purchase the bonds and how these bonds are ultimately distributed. For example, the issuer's ability to ensure that regional firms are included in the underwriting syndicate of a large issue, or that a portion of the bonds are sold to certain types of investors (e.g., retail or regional investors) is limited. In a competitive sale, market forces determine the distribution of the bonds. This lack of control, however, should only be disadvantageous to the extent that the issuer is interested in influencing the composition of the underwriting team or the distribution of the bonds.

NEGOTIATED UNDERWRITING

In a negotiated sale, the terms of the purchase are subject to negotiation between the issuer and the underwriter. Whereas the issuer accepts or rejects the underwriter bids in a competitive sale, the issuer can and is expected to negotiate with the underwriter over the price of the bonds and the spread in a negotiated sale.

In a negotiated sale, underwriter selection is one of the first steps taken by the issuer. Because the issuer selects an underwriter without fully knowing the terms under which that underwriter is willing to purchase the bonds, the issuer's selection is based on other criteria, which generally include the underwriter's expertise, financial resources, compatibility, and experience. Once the underwriter is selected, both the underwriter and the issuer participate in the origination and the pricing of the issue. A financial advisor or another investment banking firm will often represent the issuer's interest in a negotiated sale.

Advantages

Assistance in originating the issue. While the underwriter's primary role in a negotiated sale is as the purchaser of the issue, the underwriter can also assist the issuer in performing origination tasks such as preparing the official statement, making presentations to rating agencies, and obtaining credit enhancement – in essence, "one-stop shopping." Some issuers, however, prefer to engage a financial advisor or another investment banking firm for assistance in a negotiated sale. In a competitive sale, the issuer performs the origination tasks or pays for these services separately.

Effective pre-sale marketing. Because the underwriter in a negotiated offering is assured the right to purchase the bonds, the underwriter can conduct more effective pre-sale marketing than in a competitive sale. By developing information about market demand for the bonds, the underwriter can reduce inventory risk, presumably leading to a lower risk premium in the pricing. Pre-sale marketing is especially important for issuers who have not developed a reputation among investors or whose securities are not widely held among investors.

Timely and structural flexibility. Another advantage of negotiated underwriting is flexibility – the ability to sell the bonds at any time and to change the structure of the issue in response to changing conditions. Although the issuer may announce a negotiated sale date, this date is considered a target and can be changed if deemed necessary (because of a large supply of similar securities or unfavorable interest rate movements, for example). Similarly, negotiated underwriting allows the issuer the flexibility to adjust the structure of the issue up until the time of sale to meet either the issuer's or the investor's needs.

Influence over underwriter selection and bond distribution. In a negotiated sale, the issuer exercises more influence over underwriter selection and bond distribution. The choice of the underwriter in a negotiated sale is based on a variety of criteria which may target certain types of underwriting firms and establish distribution goals. Issuers trying to reach certain market sectors may be able to negotiate with the underwriter to allocate the bonds accordingly. Again, this type of control should only be relevant to issuers wishing to include certain firms in the underwriting syndicate or wanting to make sure that certain types of customers receive a portion of the bonds.

Disadvantages

Lack of competition in the pricing. In a negotiated sale, the bond pricing is less subject to the rigors of competition, as the underwriter obtains the exclusive right to purchase the bonds in advance of the pricing. Unless the issuer is vigilant during the pricing, the interest rates may be structured to protect the profit margin of the underwriter, not to keep the issuer's borrowing costs as low as possible. Although some underwriters may exercise restraint in the pricing to protect their reputation and promote future business, issuers should take the responsibility to obtain market information on comparable transactions at the time of the pricing.

Elements of spread open to wide fluctuation. While underwriters in a negotiated sale can provide an array of financial services which are in addition to the actual underwriting of the bonds, issuers should not lose sight of the fact that these services come at a price. Insofar as the cost of these services will be paid for as part of the underwriting spread (versus a flat fee), some issuers may not be fully aware of the compensation that is being provided for such services, or whether they actually need all the services being provided. Thus, the chance for wide fluctuations in spread between comparable deals is greater in a negotiated environment. The negotiated sale process demands increased scrutiny on the part of the issuer to keep spreads reasonable.

Appearance of favoritism. Because underwriter selection is based on quantitative *and* qualitative factors, negotiated sales can be subject to allegations of impropriety. Issuers must be prepared to defend their underwriter selection criteria, as well as their ultimate cost of borrowing, to avoid the appearance of impropriety.

COMPETITIVE VERSUS NEGOTIATED: DECISION FACTORS

While it is impossible to develop a fail-safe formula to follow for making a decision on the appropriate method of sale, issuers can make informed decisions by conduction a systematic review of certain factors on a case-by-case basis. These factors can be classified under **issuer characteristics**, including *market familiarity, credit strength, and policy goals*; and **financing characteristics**, including *type of debt instrument, issue size, complexity of the issue, market conditions,* and *story bonds.*

Issuer Characteristics

Market familiarity. Attracting sufficient investor and underwriter interest is critical to the success of any bond issue. The frequent issuer is at an advantage in terms of attracting market interest insofar as the market is already familiar with its credit quality. Although the trend is toward greater disclosure for all issuers, generally, the market does not require as much information from frequent issuers as it does from infrequent market participants. Consequently, the infrequent issuer should consider the extent to which pre-sale marketing – which may be more effective under the negotiated sale – is necessary for the success of its bond sale.

Credit strength. Everything else being equal, the higher the credit quality of the issue and the issuer, the less likely there will be a need for negotiation. Because of the steady demand for high quality municipal bonds, issuers with a strong credit position can fare well in competitive bidding. Consequently, issuers should consider the competitive sale for issues rated A and above. Weak issuers may not attract sufficient market interest or induce competition and, consequently, may benefit from the more effective education process offered by the negotiated sale.

Policy goals. As noted earlier, issuers will find that the competitive bid process does not provide them much influence over the composition of the underwriting syndicate or the distribution of bonds. Moreover, some have argued that the competitive sale process screens out minority-owned, women-owned, or other small firms that do not have the resources to compete with more established underwriters.

In a negotiated sale, smaller firms will often have a better chance of being included in an underwriting syndicate, though there is no guarantee that smaller firms will be allocated bonds. To the extent that issuers believe that influencing the composition of the underwriting syndicate and the distribution of bonds are worthwhile policy objectives, they may be better served by the negotiated sale. When issuers choose a negotiated sale for these reasons, however, they should clearly specify the rationale and criteria for the selection of underwriters and the allocation of bonds to avoid any appearance of impropriety.

Financing Characteristics

Type of debt instrument. The market responds to familiar or well-known debt instruments and, likewise, tends to be apprehensive about innovations. An issuer using a relatively new debt instrument may have to familiarize the market with the security features of the instrument. The negotiated sale is invariably more conducive to this education process. However, insofar as the market has the ability to rapidly absorb information regarding new debt instruments, "innovative" instruments can quickly become mainstream. Thus, as the market becomes more familiar with a particular debt instrument, the need to educate market participants on the nuances of the instrument will diminish. Everything else being equal, more familiar instruments will be better suited to competitive sale.

Issue size. The size of the bond issue influences both the level of investor interest and the market's ability to absorb the issue. The general rule is that if the issue is either too small or too large, the issuer should consider negotiating the sale. A very small issue will probably not attract any attention in the market without a concerted sales effort. A very large issue, on the other hand, may not easily be absorbed by the market. Therefore, effective pre-sale marketing activity – offered by the negotiated sale – becomes necessary.

Complexity of the issue. It is convention in the public finance industry that "plain vanilla" issues (i.e., those that are readily accepted and understood by underwriters and investors) lend themselves to the competitive bid process. Consequently, bonds which are structured to include features such as variable rates, put features, or interest rate swaps, may be more appropriate for negotiated sale.

Market conditions. During periods of interest rate stability, the need for flexibility in the timing of the sale is not particularly critical. Conversely, the timing of the sale is very critical in an unstable or volatile market, especially when there is a need to bring an issue to the market in a few days. In such cases, the flexibility inherent in a negotiated sale can be indispensable. For example, refunding issues which are motivated by the desire to capture the savings offered by lower interest rates, and which may be susceptible to even minor fluctuations in market rates, may be better served by the timing flexibility offered by the negotiated sale.

Story bonds. In some cases, an issue faces market difficulties because it is associated with unusual events or conditions. For instance, issues linked to a previous default, litigation, or other adverse circumstances may be difficult to place. By the same token, issues or structures that are not familiar to the market may require added explanation. These issues are sometimes referred to as "story bonds," because in order to develop sufficient market interest, the issuer has to "tell a story," or explain why the bonds are actually sound investments. Issuers of story bonds, such as Mello-Roos bonds can benefit from the more effective pre-sale marketing opportunities offered by the negotiated sale. Nevertheless, bonds that may require an explanation, such as the bonds sold by the City of Los Angeles to finance a court-ordered judgement against the City, can be sold successfully in a competitive sale if the market is familiar with the issuer and the credit security is particularly strong.

ALTERNATIVE APPROACHES

Issuers who find that the traditional approaches outlined in earlier sections do not completely meet their financing needs, may want to consider one or more of the alternative approaches described below.

Conducting competitive bidding within the legal framework of a negotiated sale. Issuers who prefer the competitive pricing environment offered by the competitive sale but, for one reason or another, can ill afford the 15-day notice requirement, may want to consider an approach that offers both the flexibility of the negotiated sale and the competition in the pricing of the competitive sale. Under this approach, the issuer utilizes the legal framework of the negotiated sale, allowing the acceleration of the sale process. However, instead of negotiating the price and interest rate of the issue with just one underwriter, the issuer solicits bids from all interested underwriters and awards the right to purchase the bonds to the lowest bidder, thereby maintaining a competitive environment in the pricing. A disadvantage with this approach is that it does not provide the flexibility to make last minute or unanticipated changes in the structure of the issue.

Infusing competition in the negotiated sale process. More often than not, competition among underwriters produces lower costs and higher levels of service. Thus, it is important that issuers who plan to use the negotiated sale consider employing a competitive process for the selection of their underwriter. The use of a request for qualifications (RFQ) or request for proposals (RFP) to solicit interest requires potential underwriters to compete against one another on the basis of cost and services offered.

There are at least two ways the issuer can infuse competition into the underwriter selection process. One way is to establish an underwriting pool, similar to the one developed by the State Treasurer's Office, from which underwriters for all negotiated issues will be chosen. The issuer should select pool underwriters based on responses to an RFQ in order to determine those who are qualified to take the issuer's bond offerings to the market. Another method is to issue an RFP requiring interested underwriters to outline their proposals for taking specific bond offering to the market. Either way, issuers should consider the quality and level of service offered, not just costs, when selecting the underwriter.

"Unbundling" financial services. Issuers who do not need the full range of services offered by a financial advisor or investment banker, and who are concerned about costs, may want to consider "unbundling" financial advisory services – hiring a financial advisor or investment banker only for certain portions of the sale. For example, in a negotiated sale, the issuer can hire a financial advisor or another investment banking firm to assist in the bond pricing, but not in preparing the bond documents. By splitting the services in this way, the issuer can lower the costs of financial advisory services, while receiving needed assistance on a particular element of the bond sale process.

RECOMMENDATIONS

The following recommendations are intended to assist issuers not only in choosing an appropriate method of sale, but also in reducing issuance costs.

Participate in all aspects of the bond issuance. Issuers should never forget that it is their responsibility to protect the public trust by selling their bond issues at the lowest possible interest cost. The members of the financing team are merely agents of the issuer. Therefore, issuers should take an active part in all the decisions related to the sale of their bonds: the selection of the underwriting method; the selection of the financing team; the marketing of the bonds; and the investment of the bond proceeds. While not all issuers are experts in municipal finance, they should not be shy about asking their financing team members critical questions.

Moreover, it is important that issuers who choose the negotiated sale do not relegate the responsibility to obtain the best pricing for the issue to the underwriter. Personal and trustworthy relationships, notwithstanding, the underwriter's fiduciary responsibility ultimately lies with its investors. And because the investors' and the issuer's interests are not necessarily complementary, the responsibility for looking out for the issuer's interests during the pricing should remain with the issuer.

Assess the level of demand for the issue. Naturally, a competitive sale will not be successful if it does not produce real competition. While as a technical matter, two bids are necessary to generate competition, three or more bids will generally ensure the issuer that the bid price of the bonds approximates the price of comparable securities being issued at the same time. (A notable exception is the State of California, which customarily receives only two bids on its general obligation bond sales and is still able to secure competitive prices for its bonds.) If the issuer determines that a competitive sale will generate only one bid, a negotiated sale may be preferable.

Focus on the total cost of the financing. The spread is but one component of the total cost of the financing. While it is an important cost factor, concentrating negotiations on the spread at the expense of the interest rate pricing can prove counterproductive to the issuer's goal of keeping the total financing cost as low as possible. Conversely, focusing on the interest rates without considering other costs of borrowing, such as underwriter spread and financial advisory fees, can be equally deceiving. The key is to consider the total cost of financing when evaluating a particular debt issue.

When in doubt, hire a financial advisor. Negotiated bond sales customarily require a greater deal of skill on the part of the issuer than competitive sales. In order to evaluate the financial terms offered by the underwriting syndicate, the issuer must be able to identify how the market is pricing similar transactions. An issuer lacking the expertise to undertake such an analysis negotiates from a position of weakness. In such cases, the issuer should consider hiring a financial advisor or another investment banking firm to assist in some or all aspects of the financing. Similarly, an issuer lacking the expertise to perform the origination tasks necessary to prepare an issue for competitive sale or to evaluate the bids once they are submitted, may also benefit from the services of a financial advisor or an investment banker.

Evaluate the method of sale for every issue. It is very important that issuers evaluate the method of sale for each bond issue. Issuers should avoid becoming too comfortable with a particular approach. Each time an issuer comes to market, it should be with the knowledge that the method of sale has been thoroughly evaluated.