COUNTY OF MILWAUKEE
INTEROFFICE COMMUNICATION

DATE: July 6, 2011

TO: Supervisor Lee Holloway, Chairman, County Board of Supervisors

FROM: Pamela Bryant, Interim Fiscal and Budget Administrator, Department of Administrative Services
Mark Grady, Principal Attorney, Corporation Counsel
Jerome Heer, Director of Audits, Audit
Stephen Cady, Fiscal and Budget Analyst, County Board
Dave Anderson, Public Financial Management
Chuck Jarik, Chapman and Cutler LLP

SUBJECT: Comparison of Negotiated and Competitive Bond Sale Methods (Informational Report)

BACKGROUND

At the Finance and Audit Committee meeting of May 19, 2011, Supervisor De Bruin requested that a report be provided for the July cycle that describes the bond sale methods used by the City of Milwaukee and the State of Wisconsin including the reasoning for selecting the specific sale method. In response to this request, the workgroup has investigated the practices of the City and the State. As the attached exhibit and the following discussion indicate, the rationale utilized by the City and the State in determining the appropriate method of bond sales is consistent with the County's practice.

As indicated in the May report (included at the end of this report) from the Department of Administrative Services (DAS), State Statutes require that General Obligation Bonds issued to fund new projects must be sold by a competitive sale. This requirement applies to the County, City and State. All other debt obligations (such as general obligation notes, revenue bonds, and refunding bonds) may be sold on either a competitive or negotiated basis. The practice utilized in determining the method of sale by the City and State is as follows:

CITY OF MILWAUKEE

The City of Milwaukee's practice is to sell its bonds on a competitive basis unless there is a compelling reason to use a negotiated sale. The reasons for this practice include the fact that the City's strong ratings attract favorable bids from a number of different firms; the City will obtain the lowest interest rate available on the day the bonds are sold; and, since the underwriter is determined by the best bid, the selection of the underwriter is transparent to both the market and the public.

A listing of all of the City's recent debt issuances and methods of sale is attached. Since 2009 there have been two instances when the City has negotiated the sale of its debt. The rationale for utilizing a negotiated sale was as follows:

Market conditions. During late 2008 the country faced the worst financial crisis since the great depression. Large underwriting firms and banks were failing and the credit markets were extremely tight. Many underwriting firms were either unwilling or unable to competitively bid on municipal bonds. As a result of this environment, the City determined that it would negotiate its early 2009 bond issues.

Sewer Revenue Bonds. During June of 2011 the City issued its Sewer Revenue Bonds on a negotiated basis. The City chose to sell the bonds on a negotiated basis due to the fact that the bonds 1) contained an advanced refunding component 2) are supported totally by sewer revenues and 3) are not supported by the City's general obligation pledge. A previous competitive sale of its sewer revenue debt resulted in fewer bids than the City normally receives on its general obligation debt. The City would, however, consider issuing this debt on a competitive basis in the future.

Historically the City has always sold its debt on a negotiated basis when it has issued variable rate debt and sometimes when it has refunded debt. The rationale for utilizing a negotiated sale for these financings is as follows:

Variable Rate Debt. The nature of variable rate debt requires that the interest rate be re-set on a regular (often weekly) basis. Bondholders have the right to sell their bonds each time the rate is reset. As a result, it is necessary to select an underwriter who can remarket the bonds as often as necessary. It is not practical to competitively bid variable rate debt.

Refunding Bonds. Whenever a municipality issues bonds it establishes a call date for the bonds. A call date is the first date that the municipality can prepay bondholders. If a municipality chooses to refinance its debt 90 days prior to this date or anytime thereafter, the refinancing is considered to be a current refunding. The City will sell bonds used for current refunding on a competitive basis, often combining it with a bond issue financing capital projects.

If a municipality chooses to refinance its debt more than 90 days prior to this date, it must refinance utilizing an advanced refunding. During an advanced refunding the proceeds of a new bond issue are placed in an escrow account until the call date. The escrow pays the debt associated with the old bonds and the municipality pays the debt associated with the new bonds. The amount of savings from an advanced refunding, the size of the debt issue, and the final debt structure can be impacted by maturities of the bonds being refunded, the terms of the new bonds, and the interest earned on the escrow account.

If the advance refunding has an escrow that will exist for a short period of time, such as the County's 2011 advanced refunding, the City will sell the bonds on a competitive basis just as it does its current refundings. If the escrow is to remain in existence for a longer period of time, the City will sell the bonds on a negotiated basis. By selling these bonds on a negotiated basis, the City is able to maintain flexibility in determining which maturities of the outstanding bond issue to refund and in timing the sale to insure that the City is able to meet its savings objectives.

With regard to market timing, there is an important distinction between the City's practice and the County's current practice. The determination by the City as to whether to use a negotiated or a competitive sale as well as all steps in the bond sale process (timing of the sale, underwriter selection, award of bids, etc.) has been delegated to an appointed public debt commission. The debt commission is able to meet to authorize the final terms and conditions of a negotiated sale (or to further delegate the authorization to the Comptroller) on any day of the year. This provides the City with approximately 200 days each year when the City can approve the final terms and conditions of a negotiated sale. Under current County practice, the County Board approves final terms and conditions on a regularly scheduled Board meeting date thereby limiting the number of sale days and greatly decreasing the opportunity to utilize a negotiated sale as a method of timing the market.

STATE OF WISCONSIN

The State of Wisconsin selects the method of selling its bond based upon the type of debt issued, the complexity of the debt issuance, and market conditions. For straightforward transactions where the amount and structure of the debt is known and market conditions are normal, the State will issue its debt obligations on a competitive basis. If the issue has a high degree of complexity, needs flexibility as to timing or structure or if there are particularly challenging market conditions, the State will issue its debt on a negotiated basis.

Examples of State debt sold through competitive sales are:

General Obligation Debt. The State sells general obligation debt used to finance capital projects on a competitive basis as a result of the same statutory requirements and utilizing the same rationale as used by the City.

Operating Notes. The State issues notes annually to fund its cash flow. Even though the debt is not general obligation debt, the short term of the notes (less than one year) combined with the State's strong credit results in favorable competitive bids.

Transportation Revenue Bonds. The State issues bonds to finance transportation projects. The repayment of the debt comes from vehicle registration fees. Even though the bonds are not general obligation debt, the vehicle registration fees are considered to be a strong credit and the state will normally issue the debt on a competitive basis.

Examples of State debt sold on a negotiated basis:

Refunding Bonds. Like the City, the State will sell refunding bonds on a negotiated basis. Also, like the City, the State utilizes a negotiated sale in order to have greater flexibility in timing the sale to insure that market conditions will allow the State to meet savings targets. The State can agree to the final terms and conditions of a negotiated sale on any day due to the fact that the bond sale process has been delegated to the capital finance office in the state Department of Administration.

Appropriation Bonds. In 2009 the State issued approximately $1.5 billion in appropriation bonds. A number of factors led to a determination that a negotiated sale would be the best method for selling the bonds: 1) the bonds are considered to be "story bonds" due to the complexity of the credit features associated with this issue; 2) the size of the issue was very large for the state; 3) the issue was a refunding issue; and 4) the State did not provide its general obligation pledge as security.

cc: County Executive, Chris Abele
Johnny Thomas, Vice Chairman, Committee on Finance and Audits
George Aldrich, Chief of Staff, County Executive's Office
E. Marie Broussard, Deputy Chief of Staff, County Executive's Office
Terrence Cooley, Chief of Staff, County Board
Pamela Bryant, Interim Fiscal and Budget Administrator, DAS
Steve Cady, Fiscal and Budget Analyst, County Board
Jerry Heer, Director of Audits, County Board
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City of Milwaukee

Date of Issue, Issue Name, Lead Underwriter

General Obligation - Competitive Sale

6/9/2011	$100,000,000 Cash Flow Notes, 2011 R2	BAML
6/9/2011	$93,625,000 Notes, 2011 N3	Wells Fargo
6/9/2011	$28,890,000 Bonds, 2011 B4	Wells Fargo
6/9/2011	$33,930,000 Taxable Bonds, 2011 T5	Baird
4/15/2010	$147,000,000 Cash Flow Notes, 2010 R4	JP Morgan
4/15/2010	$49,420,000 Bonds, 2010 B5	PNC
2/19/2010	$129,295,000 Notes, 2010 N1	Bardays
2/19/2010	$8,270,000 Taxable Notes, 2010 T2	Baird
2/19/2010	$7,970,000 Taxable Bonds, 2010 T3	Baird

General Obligation - Negotiated Sale

2/20/2009	$93,180,000 Notes, 2009 N1	Morgan Stanley
2/20/2009	$17,450,000 Refunding Bonds, 2009 B2	Morgan Stanley

Non-General Obligation - Negotiated Sale

6/9/2011	$52,565,000 Sewer Revenue Bonds, 2011 S1	Cabrera

State of Wisconsin

Date of Issue, Issue Name, Lead Underwriter

General Obligation - Competitive Sale

2/2/2011	$428,740,000 Bonds, 2011 Series A	JP Morgan
9/2/2010	$465,420,000 Bonds, Series C and D	JP Morgan/Bardays
4/7/2010	$322,630,000 Bonds, Series A and B	Citi
9/3/2009	$423,090,000 Bonds, Series C and D	BAML/Wachovia
6/18/2009	$101,975,000 Bonds, A and B	BAML/Bardays

Non-General Obligation - Competitive Sale

12/9/2010	$200,000,000 Transportation Rev Bonds, 2010 Series A and B	JP Morgan
8/31/2010	$21,205,000 Master Lease Certif of Participation, 2010B	JP Morgan
7/1/2010	$800,000,000 Operating Notes, 2010	JP Morgan
7/1/2009	$800,000,000 Operating Notes, 2009	Bardays

General Obligation Refunding Issues - Negotiated Sale

6/2/2011	$275,375,000 Refunding Bonds, 2011 Series 1	Citi
4/14/2011	$225,510,000 Refunding Notes, 2011 Series 1	Citi
3/3/2010	$201,165,000 Refunding Bonds, Series 1	BAML
9/15/2009	$54,355,000 Refunding Bonds, Series 1	Samuel Ramirez

Non-General Obligation - Negotiated Sale

11/18/2010	$153,050,000 Clean Water Rev, 2010 Series 4 and 5	JP Morgan
2/25/2010	$131,175,000 Clean Water Rev, 2010 Series 1, 2, 3	Morgan Stanley
10/1/2009	$165,000,000 Transportation Rev Bonds, 2009 Series A and B	Morgan Stanley
4/8/2009	$1,529,065,000 Gen Fund Appropriation Bonds, 2009 Series A	Bardays

COUNTY OF MILWAUKEE
INTER-OFFICE COMMUNICATION

DATE: May 10, 2011

TO: Chris Abele, County Executive
Supervisor John Thomas, Chairman, Committee on Finance and Audit

FROM: Pamela Bryant, Capital Finance Manager

SUBJECT: **Comparison of Negotiated and Competitive Bond Sale Methods**

On March 10, 2011, the Finance and Audit Committee directed the Department of Administrative Services, County Board Staff, Audit, along with the County's Bond Counsel and Financial Advisor to study the merits of a negotiated sale instead of a competitive bid process and provide the findings at the May 2011 meeting.

DEFINITIONS

The two methods of selling municipal bonds are through competitive sale (public sale) and negotiated sale (private sale).

Competitive Bond Sale Method

In a competitive sale, bonds are advertised for sale in trade publications and web sites. A notice of sale that includes the terms of the sale and a Preliminary Official Statement providing additional details about the County are made available to all interested underwriting firms. Based upon this information, any underwriting firm may bid on the bonds at the designated date and time. The bonds are awarded to the bidder with the lowest true interest rate.

Negotiate Bond Sale Method

In a negotiated sale, an underwriter is selected through a request for proposal process to purchase the bonds. Upon selection, the underwriter sells the bonds to its clients based on negotiated terms to meet the needs of its clients and the issuer. There is also a pre-sale process that provides an opportunity to determine client's interest in the sale prior to establishing final terms and bond pricing.

SALE METHOD COMPARISON

Wisconsin State Statute 67.08(2), states that, with some exceptions, bonds are to be sold publicly. A public sale is a competitively sold bond sale. A private sale is a negotiated bond sale. Refunding bonds and revenue bonds can be sold through either a competitive or negotiated bond sale method. Wisconsin State Statutes does not specifically state that promissory notes are to be sold competitively; therefore, they are sold through both the competitive and negotiated bond sale method.

Competitive bond sales offer several advantages over negotiated sales. For general obligation debt, the competitive sale typically assures the lowest interest rates available on the day in which the bonds are bid. While underwriting firms may attempt to secure the best interest rates for the issuer, different firms have different perceptions of the market and cater to various investing clients. This results in different preferences for maturities and yields, which contribute to the variety of the bids received competitively and increases the likelihood that the winning bidder will be the lowest possibly bid for the sale. The bids are received electronically and the bidders are unable to view each others bids until the bidding time has expired. This process ensures the objectivity of a competitive sale.

In accordance with Wisconsin State Statutes, Milwaukee County utilizes the competitive bond sale method for its general obligation bond sales. Airport Revenue Bond sales, which are more complicated, are sold on a negotiated basis. Underwriters would be unwilling to purchase the bonds without a thorough understanding of the revenue sources, bond covenants, lease arrangements and feasibility analysis associated with the bonds. In addition, the underwriter's clients tend to respond best to negotiated sales for revenue bond issues knowing that the underwriting firm has undertaken the due diligence necessary to understand the bonds.

Some of the industry reasons for using the negotiated bond sale method are the poor credit quality, unusually large issue size, new issuer to the bond market, unusual financing terms, innovative structure or security, and market volatility. The County has followed this logic for deciding when to use the negotiated bond sale method. In addition to the County's Airport Revenue Bond issues, the County sold the pension obligation bonds on a negotiated basis because the financing was an exceptionally large size issue for the County ($400 million), there was an unusual structure and there was market volatility. Therefore, the County, as has every other large issuer of pension obligation bonds, decided to use the negotiated bond sale method to sell these bonds.

RECOMMENDATION

This is an informational report.

Pamela Bryant

Pamela Bryant, Capital Finance Manager

cc: County Executive Chris Abele
Chairman Lee Holloway, Milwaukee County Board of Supervisors
George Aldrich, Chief of Staff, County Executive's Office
E. Marie Broussard, Deputy Chief of Staff, County Executive's Office
Terrence Cooley, Chief of Staff, County Board
Steve Cady, County Board Fiscal and Budget Analyst