



Mode of Sale

... Negotiated or Sealed Bid?

In preparing for the sale of bonds, the issuer must decide which mode is likely to result in the lowest costs for its debt and to achieve other important policy objectives. This decision is based on:

- The characteristics of the issuer,
- Market conditions, and
- The type of the financing that is being contemplated.

It is important to note that an issue is not likely to meet all of the conditions that favor one mode of sale over the other. A primary objective in selecting the mode of sale is to choose the one that will generate the most interest for the issuers' bonds among underwriters and, more importantly, investors.

Sealed bid sales enjoy benefits achieved through competition, such as being able to justify that the bonds were sold at the lowest interest cost given the prevailing market conditions or demonstrating to the public that the public access to bonds was conducted fairly; which must be weighed against reduced opportunities to generate prior investor interest in the securities.

Conversely, issuers contemplating a *negotiated sale* know that they have greater flexibility in structuring their financing, determining their offering date or in developing a marketing plan to attract investors; yet, they also risk that the price negotiated for the bonds may be lower than would have been obtained in a sealed bid offering.

Regardless of the mode of sale that is chosen, the issuer needs to look for opportunities to achieve the most flexibility, the greatest competition, and the most knowledge in order to obtain the lowest overall cost of financing its debt. The table on the other side displays a summary of conditions favoring either mode of sale.

Perspective on Mode of Sale

It is arguable that a sealed bid sale forces the issuer to become hostage to the market as the time and sale date must be established well in advance. Thus, a penalty rate may be assigned to the issue if the inflexibility of this process forces the issuer into a temporarily weak market. However, the shrewd selection of an experienced Financial Advisor mitigates this infrequent occurrence as the experienced advisor is qualified to project the forward calendar with a measurable level of certainty.

The **Maine Municipal Bond Bank**, established in 1972, has served local Maine communities well by pooling debt into a common plan of financing. This allowed the enjoyment of economies of scale vis-à-vis costs of issuance; as well as permitting lower quality credits more attractive rates. The give-up, however, was that the local credits' "name" in the market lost familiarity. Interestingly, the Bond Bank uses the *negotiated sale* mode.

In the last few years more and more issuers have recognized the merits in access to debt financing via an "individual sale". Since 1990 over 60 local municipal entities in Maine have sought this financing alternative. However, due to the unseasoned nature of local Maine names in the market, many issued through a *negotiated sale*.

Times have now changed ... for the better! Due to a greater application of ratings to "individual sale" issuers; and the greater frequency of issuance of a variety of local Maine names, many local issuers may now easily enjoy access to the market via the *sealed bid* mode. Thus, local municipalities may again borrow long-term debt at competitive rates, on their time frame, while satisfying the concern of its taxpayers that they are receiving the lowest interest rate for their debt. *Convenience and value!*

COMPETITIVE vs. NEGOTIATED SALES:
Summary of Conditions Favoring Each Method of Sale

DEBT STRUCTURE	CONDITIONS FAVORING A COMPETITIVE SALE	CONDITIONS FAVORING A NEGOTIATED SALE
Pledged Revenues	General Obligation or Strong System Revenue	Project Supported Revenues
Security Structure (for Revenue Bonds)	Conventional Resolution and Cash Flow; Rate Covenant and Coverage	Unusual or Weak Covenants; Subordinated Debt
Debt Instrument	Traditional Serial and Term, Full Coupon Bonds	Use of Innovative Structuring, Derivative Products, Structure to Attract Particular Investors (e.g., Discount Bonds), etc.
CREDIT QUALITY		
Rating	'A' or better	Below Single 'A'
Outlook	Stable	Weak but Improving, or Under Stress
ISSUER CHARACTERISTICS		
Type of Organization	Broad-Based General Purpose Borrower	Special Purpose, Independent Authority
Frequency of Issuance	Regular Borrower in Public Market	New or Infrequent Issuer
Market Awareness	Active Secondary Market with Broad Investor Base	Little or No Institutional Awareness of Issuer; Historical Antipathy
Investor Comfort	Well-Known, Stable Issuer	Issuer Experiencing Significant Financial, Legal or Other Problems
MARKET CONDITIONS		
Interest Rates	Stable; Predictable Market	Volatile or Declining Market
Supply and Demand	Strong Investor Demand, Good Liquidity, Light Forward Calendar	Oversold Market, Heavy Supply
POLICY CONSIDERATIONS		
Participation in Sale of Bonds	Broad Market Participation Desired for Sale of Bonds	Desire to Direct Business to DBE or Local/Regional Firms
Stimulation of Investor Interest	Broad Market Participation Desired for Purchase of Bonds	Desire to Direct Business to Local/Regional Investors

Source: *A Practitioner's Guide to Effective Debt Management: Competitive v. Negotiated* (1994), Government Finance Officers Association, Chicago, Illinois.