CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION

ISSUE BRIEFS

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PREPARING REQUESTS FOR PROPOSALS

The Anywhere Public Utility District (APUD) is a small enterprise special district located in rural California. The district has been able to pay for all capital improvements in the past on a pay-as-you-go basis, so the District has never issued debt. New facility demands, however, have forced the District to turn to long-term financing to find some of its new capital projects. A few months ago, the District's Board of Directors voted to issue bonds for water supply, storage, and distribution facilities. The bonds will be supported by the utility payments of the District's customers.

The District's Finance Officer must now assemble a team of finance professionals to assist in the planning and sale of the debt issue. What steps should the District's Finance Officer take to assemble the team?

Although this particular scenario is fictional, it does illustrate a situation faced by many public officials who must issue bonds to address their agency's capital needs. While many public agencies maintain staff who are well-versed in finance matters, even a relatively simple bond issue can pose technical challenges – sizing the issue, assessing debt service payment options, creating legal covenants, and complying with disclosure responsibilities – which may be better left to outside experts. Thus, the role of the government finance officer is not necessarily to master the intricacies and technical details of a bond issue, but rather to understand and to become proficient at selecting the best qualified professionals to do the job.

One recommended method of selecting outside professional help is the request for proposals (RFP). This *Issue Brief* is intended to acquaint public debt issuers with the RFP process and assist them in developing quality RFPs to procure outside municipal finance services.

THE REQUEST FOR PROPOSALS PROCESS

A *request for proposals* is a formalized method of soliciting information from candidate firms concerning their qualifications, experience, proposed compensation arrangements, and suggested approaches to the financing. Public agencies procure municipal finance services through the RFP process for several reasons. First, it provides a fair and objective means of selecting the best qualified municipal finance professional. In turn, this allows the agency to avoid any appearance of favoritism in the selection of the service providers. Second, it allows the issuer to compare qualifications, ideas, prices, and services of a wide pool of respondents. Finally, it forces the respondents to compete with each other, presumably resulting in a better price and/or higher level of service for the issuer.

Of course, the RFP process is not perfect. It is time-consuming, which can make it more cumbersome for financings that must be completed in a short time span. Moreover, information presented in RFP responses may be imperfect, incomplete, or misleading, as respondents naturally are inclined to highlight their strengths and gloss over their weaknesses. Public agencies usually can mitigate these deficiencies by (1) soliciting objective information which can minimize the need for interpretation and allow for meaningful comparisons, and (2) conducting an in-depth review of prospective candidates and their proposals.

DEVELOPING THE SCOPE OF WORK

Integral to RFP development is the formation of an internal team to make decisions related to the RFP, including the definition of the scope of work to be performed by the selected provider. The internal team helps the agency define its needs and address any problems with the RFP before it is released. It also provides guidance throughout the RFP process. To be effective, the internal team should include agency staff that have decision-making authority and are familiar with project financing and procurement issues. In addition to the agency's chief financial officer, the team often includes staff with public works, legal, and administrative/procurement expertise. When selecting internal team members, care should be taken to exclude any staff member who may have conflicts of interest.

The first task for the internal team is to define the scope of services to be provided. The more precise an agency can be about the services it expects from a provider, the more likely it is that the proposals received will address the agency's needs. A vague description of the scope of services to be provided may create confusion which, in turn, leads to numerous requests for clarification. The need to clarify RFP provisions not only takes up agency staff time, but may discourage potential providers from responding to the RFP.

How should the internal team go about developing the scope of work? The internal team may be able to refer to previous RFPs done by the agency to determine the types of professional services that have been required in the past. Prior lists of services can be refined to reflect the intricacies involved with the proposed transaction. If the issuer is new to the market, however, the internal team may have to draw from scope of service provisions of RFPs issued by similarly situated agencies, or develop its own list of services that the team believes will be necessary to carry out the financing. This may involve the development of more than one RFP to cover the range of services that will be needed to carry out the financing.

Services Commonly Sought in a Financing. What types of services are likely to be needed as part of the debt issuance process? While the list of services can vary dramatically, some of the more common types of services needed to carry out a debt financing include:

Financial Advisory Services. In many cases, the first financing team professional the issuer selects is the financial advisor. This professional advises and assists the issuer in developing and executing a financing plan. Specifically, financial advisors are routinely retained to provide the following types of services: review the financial feasibility of capital projects, assess available revenue sources, recommend a financing structure (coverage ratios, debt service reserve, credit enhancement, etc.), recommend maturity schedules and redemption terms, prepare and distribute the official statement, assist with rating agency presentations, recommend investment strategy for the proceeds, and analyze the bids in a competitive sale or assist in the selection of underwriters, and negotiating the terms of the offering in a negotiated sale.

Underwriting Services. If the bond is offered through a negotiated sale, the agency will need to retain the services of one or more investment banks to underwrite the debt issue. The investment bank(s) then reoffers the bonds to investors through the retail securities market. In a negotiated sale, the underwriter can also provide much of the financial structuring services listed above. (If the bond is sold through competitive sale, there is no need to solicit the services of an underwriter as the right to purchase the bond is awarded to the underwriter offering the best bid. For a more detailed discussion of the competitive and negotiated sales, please refer to CDIAC's *Issue Brief #1: Competitive versus Negotiated Sale of Debt.*)

Bond Counsel Services. The issuer will also require a bond counsel to render an opinion that the bonds are valid and binding and, generally, that interest on the bonds is tax-exempt. In general, the bond counsel's opinion addresses the bond issue's compliance with State laws and federal tax and securities laws. The bond counsel also prepares and reviews proceedings, documents, and covenants related to the bond issue. On complicated transactions, the bond counsel may be required to provide additional research services, as well.

Trustee/Fiscal Agent Services. Another outside professional an issuer may require is a trustee/fiscal agent. The trustee/fiscal agent generally stays through the life of the issue and performs any number of administrative duties related to the issue. The trustee has a fiduciary relationship with both the issuer and the bondholders. It protects the interest of the bondholders by monitoring issuer compliance with bond covenants and enforcing remedies in the event of default. On behalf of the issuer, the trustee/fiscal agent establishes and holds funds and accounts related to the bond issue, manages those funds (disbursing payments, collecting deposits, crediting interest earnings, etc.), tracks the ownership of the bonds, and pays the interest and principal of the bonds.

Before finalizing the scope of work for any of the financial services described above, the internal team should conduct an assessment of the agency's internal resources to determine if any of the outlined tasks can be performed by internal staff at a lower cost. By using internal staff whenever it is deemed cost-effective, issuers can keep a lid on their contract costs.

ESTABLISHING EVALUATION CRITERIA

To ensure that the proposals are responsive to the issuer's needs, and as a matter of fairness to those submitting such proposals, the RFP should specify the criteria upon which the selection will be based. Key tasks of the internal team will be to establish the evaluation criteria for the proposals and assign relative weight to each criterion. To keep the evaluation unbiased, the internal team should assign the weights before the proposals are due. While the evaluation criteria will vary depending on the issuer's needs and priorities, some commonly used criteria in RFP evaluations include:

Qualifications, Experience, and Management Capability of the Firm. An important function of the RFP is to allow the issuer to determine the firm best qualified to handle the planned financing. The reputation, network, institutional memory, management, and resources of the firm are all critical factors in assessing the qualifications of prospective providers.

Financial Advisor Qualifications. In the case of financial advisors, the issuer should ask for information that demonstrates the respondent's ability to assist the issuer in the sale of debt. However, because a public agency may require advice and assistance on matters that are not expressly covered as part of a bond transaction, the issuer may also be interested in the qualifications and experience of a financial advisor in the areas of capital planning, budgeting, and debt management. In addition, issuers should apply evaluation standards that ensure that a financial advisor's experience is truly applicable to the issuer's needs. Thus, the Anywhere Public Utility District might be especially interested in a financial advisory firm's experience with utility district revenue bond issues, particularly those transactions done by infrequent issuers. While the overall financial advisory experience of a firm should also be considered, a potential provider's familiarity with an issuer's specific circumstances should not be underestimated. Financial advisors who are knowledgeable about the issuer's circumstances are in a better position to assist the issuer than those with only superficial knowledge of the jurisdiction.

Underwriter Qualifications. In evaluating an underwriting firm's qualifications, the issuer should focus on characteristics that are relevant and necessary to the transaction under consideration. The Anywhere Public Utility District would likely focus on the responding firm's previous experience with revenue bond financings of similar utility districts. To assess comparability, the District would look at the role of the firm in these financings (senior manager, co-manager, syndicate member); the size, date, and rating of the issue; and the names of the staff assigned to the transaction. To determine the firm's compatibility with the District's needs, the firm's experience in underwriting bonds issued by (1) agencies new to the municipal market and (2) California utility districts similar in size and credit to the District, would also be relevant factors. Finally, the District might look at the firm's ranking in terms of underwriting volume over a period of years, as a measure of the firm's overall underwriting experience. To guard against the potential of several firms claiming to be first in the ranking, the District can either specify the basis for the ranking or require respondents to explain the assumptions used to develop the ranking.

In addition to experience, an underwriting firm's resources, both financial and technical, should also be evaluated. Insofar as the success of the financing depends, in large part, on the underwriter's ability to resell the bonds to investors willing to accept the lowest interest rate, many issuers will be interested in the strength of the firm's distribution network. In the event that some bonds remain unsubscribed at the time of the sale, an agency may want assurances that the respondent will be able to underwrite unsubscribed bonds. Thus, the amount of a firm's uncommitted capital may be an important factor. If an issuer wants to target certain investors, such as retail or California-based investors, it will be relevant to evaluate the respondent's presence in these markets.

Bond Counsel Qualifications. A bond counsel respondent must be able to demonstrate that its opinions are accepted in the municipal finance market. Thus, in evaluating bond counsel proposals, issuers should be looking for breadth and depth of experience in legal and tax matters. The issuer, for example, should evaluate the depth of the respondent's expertise on Section 103 of the Internal Revenue Code. Experience can also be demonstrated by the number, variety, and complexity of municipal bond transactions in which the firm has participated. Once again, the issuer should pay particular attention to experience in providing bond counsel services to other issuers with similar structure and requirements. The respondent should also demonstrate that it has the necessary expertise to handle the legal and tax issues related to the type of financing contemplated by the issuer. This factor is especially important for transactions that require specialized legal and tax expertise, such as landbacked securities and assessments.

The issuer should also verify that the respondent carries malpractice insurance. While a clean, unqualified opinion from the bond counsel is sufficient to complete a financing, the issuer will want to know that its bond counsel has sufficient resources to indemnify it for negligent actions should problems arise in the future.

Trustee/Fiscal Agent Qualifications. Much like the evaluation of financial advisor, underwriter, and bond counsel proposals, the evaluation of trustee/paying agent proposals should include a look at the breadth and depth of experience of the respondent. Experience with similar transactions and similar jurisdictions should be considered. How long has the respondent been providing trust services? Does the respondent have adequate capital to cover potential liabilities? If the location of the trustee/paying agent respondent is important, then the issuer should see if the respondent have operations, offices, or account representatives in California. Does the respondent offer online access to account records? Finally, because the trustee/paying agent function entails a great deal of tracking and data management, the issuer should make sure that the respondent has an excellent information management system. The issuer should also make sure that the respondent prepares clear and understandable reports and statements.

Qualifications, Experience, and Availability of the Individuals Assigned to the Financing. The issuer should evaluate the qualifications of the individuals who will be assigned to the financing to make sure that they have the capability to provide the services identified in the RFP. Thus, it is important for an issuer to pay close attention to the breadth of knowledge and experience of the personnel expected to work on the financing, especially the project leader. As was the case for evaluating interested firms, the issuer should pay close attention to an individual's previous experience with financings and jurisdictions which are similar in nature to the issuer's.

The issuer should closely review the proposed distribution of work among members of a firm's team. In many cases, a respondent will list a number of professionals who are available to work on the project or financing. Yet, unless the proposal specifies the amount of time each professional will spend on the project, the issuer has no way of knowing who within the firm will be responsible for various services identified in the RFP. Thus, while a proposal might indicate that the firm and its senior members have been involved in related transactions worth billions of dollars, this positive feature may be offset by the fact that junior members of the firm with limited experience will actually perform the work on the financing. In order to avoid any misunderstanding, the RFP should require prospective providers to prepare workplans that provide a detailed breakdown of the tasks involved, the staff assigned to perform each task, the number of hours each individual will spend on each task, and dates when tasks will be completed. The issuer should also ascertain whether assigned staff would be able to respond on short notice.

Methodology and Approach. The respondent should be able to adequately demonstrate that it understands and is sensitive to the specific needs, circumstances, and goals of the issuer. One method of establishing a respondent's credentials in this area is to have the firm detail its methodology and approach for the financing or project. In hiring financial advisors and/or underwriters for a particular financing, an issuer might seek answers to some of the following questions:

- What credit structure (e.g., covenants, reserve requirements, coverage ratios, etc.) would the respondent recommend for the issuer's debt?

- Does the respondent believe that the issuer can obtain an investment grade rating? What credit rating strategy does the respondent recommend for the issuer?

- Does the respondent recommend that the issuer consider using credit enhance-ment (bond insurance, letter of credit, etc.)?

- What other credit issues does the respondent envision for this particular financing and how does it propose to address them?

- What types of investors does the respondent believe are likely to invest in the issuer's bonds?

- How does the prospective financial advisor or underwriter propose to attract investor interest to the issuer's debt sale? In other words, what is the respondent's marketing plan for the issue?

- For a less frequent issuer like the Anywhere Public Utility District, what additional actions will the respondent suggest to address the investor community's lack of familiarity with the issue and issuer?

In terms of evaluating prospective bond counsels, the issuer should ask the respondents to discuss the legal and tax issues related to the transaction. The issuer should also ask the respondents to discuss other legal and tax issues that need to be addressed, including those not anticipated by the issuer but that may come up in the course of the transaction. Finally, with the increasing importance of disclosure, the issuer should ask bond counsel respondents to address disclosure issues related to the financing.

For trustee/fiscal agent, the issuer might ask respondents to describe their approach for handling the bond funds, bond accounts, registration and transfers, and reporting requirements. What type of *tickler system* to track bond payments does the respondent employ? Is the tickler system automated? How does the respondent handle bondholder inquiries? How does the respondent propose to assist the issuer with secondary market disclosure? The issuer should also ask the respondents to discuss any concerns or suggestions they may have regarding the arrangement of the bond funds and transfers.

Proposed Fee Arrangements. The fee should also be considered in the selection of municipal finance professionals. The key to evaluating fee proposals is to make sure that the fees are quoted on the same basis. It is much easier for the issuer to evaluate pricing proposals when they are submitted in a standardized format. Thus, it is important that the issuer state the parameters of the fee proposal explicitly in the RFP. Possible parameters for the various types of finance professionals involved in debt financing include:

Financial Advisor, Bond Counsel, and Trustee/Paying Agent Fee Proposals. In the case of financial advisors and bond counsels, the fee standard to be used may be in the form of fixed fee plus cost, hourly rate plus cost, hourly rate with a maximum amount plus capped expenses, an amount per $1,000 bond, or retainer. The issuer should pick a format with which it is most comfortable and require financial advisor and bond counsel respondents to use that format in their fee proposals. The trustee/paying agent fee generally includes an upfront fee, including trustee counsel costs, on ongoing administrative fee, and expenses.

Underwriting Spread Proposals. For underwriters, there is an already established fee structure in the form of the underwriting spread. The issuer, however, should make sure that underwriter respondents provide a breakdown of the four components of the underwriting spread: management fee, underwriting fee, expenses, and takedown. The issuer should note that in a negotiated sale, the respondents might not be able to provide a firm quote for all four components of the spread at the time the proposals are submitted. Specifically, the takedown may need to be modified (up or down) on the day of the sale because it is closely linked to interest rate pricing. However, the management fee, some of the expenses, and even the underwriting fee can be priced in advance of the sale. At a minimum, the issuer can use the RFP to set cost parameters for these three components of the underwriting spread. (For a more detailed discussion of the underwriting spread, please refer to CDIAC's *Issue Brief #2: Understanding the Underwriting Spread.)*

In hiring any municipal finance professional, the issuer should be clear in the RFP that the fees quoted will be considered *not to exceed* amounts. This requirement makes the price comparison easier and yet allows the issuer some room for negotiation. The issuer should be prepared, however, to renegotiate the fee if the scope of the services or the original parameters of the work radically change (e.g., the financing takes longer to complete and/or becomes more complicated than originally anticipated). Finally, the issuer should require the respondents to explicitly state in their proposals which costs are not included in the fees and are reimbursable, to avoid any surprises later on.

Fee Consideration is Only Part of Total Evaluation. One note of caution, issuers should be careful about putting too much weight on the fees or cost proposal because the lowest bidder is not necessarily the best qualified service provider. While it is tempting to focus exclusively on fees, issuers should remember that they are buying services, not a standard product. Because the level and quality of services can vary significantly, the qualitative information found in other parts of the RFP are invaluable in determining the respondent's ability to help the issuer achieve its goals for the financing. A low fee quotation, for example, might indicate relative inexperience on the part of the respondent. At times, the quoted fee can even be misleading. In the case of underwriters, for instance, a low spread quote does not necessarily translate to low issuance cost since the quoted spread does not take into account interest rates and carrying costs of the debt. Issuers can guard against overemphasizing the fee proposal through the weighting process described previously.

If the issuer is using a two-stage proposal review/interview process, it is advisable that the issuer defer the fee evaluations until the interview stage. By so doing, the issuer makes sure that the proposal review stage is focussed solely on an evaluation of the qualifications and expertise of the respondents, and that only the most qualified respondents are invited to the interview. Ultimately, this approach allows the issuer to apply fee considerations to its list of most qualified respondents.

Interviews and Reference Checks. As indicated earlier, one of the weaknesses of the RFP process is that a respondent's proposal seeks to put its best foot forward while glossing over its deficiencies. The challenge for the issuer is to discern if the image presented in the proposal matches reality. Issuers can use two tools to get a better perspective of the respondents: **interviews and reference checks.**

In many respects, the process for engaging an outside professional is similar to hiring an employee. Before an employer decides to hire someone, the employer usually invites the applicant in for an interview and checks the applicant's references. The same process should be used in choosing outside financial professionals. The issuer should interview prospective providers to get a better idea of the prospective provider's background and plans for the financing. If the number of proposals received makes it impractical to interview all respondents, the issuer may want to reserve the interview for the final selection round.

All key personnel assigned to the financing should be required to attend the interview. To allow the respondents to plan for the interview, the issuer should include potential interview dates in the RFP. The interview should be structured to allow the issuer to control the flow of the conversation, thereby ensuring that all relevant questions and concerns are addressed. It is advisable that the issuer asks all finalists the same questions, thereby allowing for an easier comparison among the finalists. The issuer also has the option of sending the questions to the finalists ahead of time so that they come to the interview prepared to discuss the issuer's concerns.

By the same token, the issuer should check the prospective provider's references to determine if the image presented in the proposal is indeed consistent with the firm's track record. Some issuers consider these contacts with other units of government one of the most valuable tools in gauging a service provider's ability to serve the issuer. Again, the issuer should pay close attention to references from jurisdictions with similar transactions or which share some commonalties. Examples of questions the issuer should ask as part of the reference check include:

- Is the referred project comparable to the issuer's project?
- Did the personnel assigned to the issuer's project also work on the referred project?
- Did the firm and the personnel assigned to the referred project deliver at, above, or below expectations?
- Did the personnel act professionally and respond to questions, needs, and concerns of the referred agency promptly and adequately?
- Did the respondent keep the referred agency consistently advised and informed regarding developments with the financing?
- Were the representations, statements, and data provided to the referred agency accurate and comprehensive?
- Would the referred government unit retain the provider again?

ESTABLISHING TECHNICAL REQUIREMENTS

The internal team is responsible for making sure that all necessary technical requirements are identified and included in the RFP. For instance, the team should determine what contractual requirements will be necessary for the bidders to fulfill. Provisions governing minority-, women-, and disabled veteran-owned business enterprises (M/W/DVBE), labor certifications, and any standard form contract requirements should be covered.

Many of these requirements may be "boilerplate" and can be left to the procurement staff to fill in. Some technical requirements, however, should be discussed every time an agency prepares an RFP. Samples of these items include:

- How many copies of the proposal should be submitted to the issuer and to whom should the proposal be submitted?

- Is there a particular person to whom questions concerning the RFP should be directed? Is there a cutoff date for inquiries?

- If the RFP is for financial advisor services, will the issuer allow the selected financial advisor to underwrite the issue in a competitive sale?

- What about conflict of interest provisions and disclosure requirements? Should financial advisor, underwriter, and bond counsel respondents be required to disclose fee-splitting arrangements and joint accounts? For bond counsel respondents, which types of existing client relationships need to be disclosed? Is multiple representation allowed? Are there lobbying and political contributions restrictions for any or all financing team member(s)?

COMMUNICATING WITH POTENTIAL PROVIDERS

As with other procurement arrangements, the RFP process to solicit municipal finance services is best served when a large number of responses are received and meaningful competition occurs. To maximize this possibility, the issuer should allow potential providers sufficient time to develop their responses to the RFP. Moreover, the RFP should be distributed as widely as possible. Agency staff may consult professional associations' directories – the Government Finance Officers Association's *Directory of Financial Services for State and Local Governments*, *The Bond Buyer's Municipal Marketplace* (also known as *The Red Book*) – as well as other public finance officers to draw up an RFP mailing list. In addition to the direct mailing of the RFP, the agency should consider, if it is not already required to do so, advertising in newspapers, periodicals, and other public finance publications.

Once the RFP is in circulation, the issuer should be prepared to respond to questions or requests for clarification from interested providers. The issuer may respond to individual questions either verbally or in writing. In order to keep the competition fair, all prospective providers should have equal access to the same information. Thus, every time the issuer dispenses substantive information to one prospective provider, that same information should be shared with the others also. In addition, some issuers choose to hold a "prebid" conference before the proposal submission deadline. In a prebid conference, the issuer invites all interested providers to meet with the staff to discuss provisions of the RFP or to answer questions. By discussing these issues in a conference setting in the presence of competitors, the issuer ensures equal access to information.

MONITORING AND EVALUATING PERFORMANCE

The proposal evaluations and interviews should allow the issuer to select the respondent to whom the contract shall be awarded. In most jurisdictions, however, a contract may only be awarded after it has been approved by the governing body. The issuer's legal counsel can provide an opinion as to the need of such an approval prior to the award of the contract.

After the official award of the contract, the contractor may commence providing services. As the work progresses, it is the issuer's job to monitor the performance of the contractor. The issuer should also make it a point to review the performance of the contractor after the financing is completed. Using the standards and requirements established in the RFP as a rule of thumb, the issuer should evaluate the extent to which the contractor met or surpassed the issuer's expectations and financing needs. This task is especially important if the issuer intends to obtain similar contract services in the future. If the type of services being provided allows for periodic reviews, the issuer may want to establish a schedule for such review as part of the contract. This will permit mid-point corrections which enhance the likelihood that the contractor will deliver the appropriate services or products sought by the issuer.

PARTING COMMENTS

To the extent that a well-conceived request for proposals assists the issuer in forming reliable, efficient, and knowledgeable financing team, the issuer's ability to borrow needed capital funds at the lowest possible cost will be enhanced. As this document hopefully makes clear, however, an effective RFP process does not materialize by itself. Rather, issuers must be willing to invest time and effort to develop both a good RFP and a smooth solicitation process. It is the California Debt and Investment Advisory Commission's hope that the instructions and advice offered herein assists public agencies in fully realizing the benefits of such an investment.