

California Local Agency General Obligation Bond Cost of Issuance 2009-2011

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INTRODUCTION

Under Government Code 8855(j) California state and local government issuers must submit bond issuance information to CDIAC. Government Code section 53509.5(b) requires California cities, counties, school districts, community college districts or special districts secured by the levy of ad valorem taxes to submit an itemized summary of the issuance costs for bond sales to CDIAC. Education Code 15146(c)(2) requires California school district and community college governing boards to submit an itemized summary of the issuance costs for their bond sales to CDIAC. CDIAC compiles and tracks this information in the California Public Debt Issuance Database.

The purpose of this review was to collect and analyze cost of issuance for local agency general obligation (GO) bonds issued during calendar years 2009 through 2011. Providing a summary of issuance may help issuers to identify and plan costs associated with future bond issuance. Although all deals are unique, this review should provide the reader a foundation for determining applicable ranges of costs when issuing general

obligation debt. There was no effort to account for differences in the type or level of services provided by members of the financing team. As a result, differences in fees may or may not be the result of differences in services provided.

Bond issuance costs are comprised of a variety of fees charged by participants and consultants associated with the issuance. Some examples are rating agency fees, bond insurance premiums, printing costs, filing fees, and trustee or paying agent fees. Typically the underwriter's spread, financial advisor fees, and legal fees comprise the largest portion of the total cost of issuance. To narrow the scope and produce comparable data, this report focuses on these three fees.

The reported cost of issuance information for all local agency GO bond issuances from 2009 to 2011 were compiled. Figure 1 represents par size on a per issue basis. Issuers issuing multiple series on the same date were assumed to be a single issuance. In

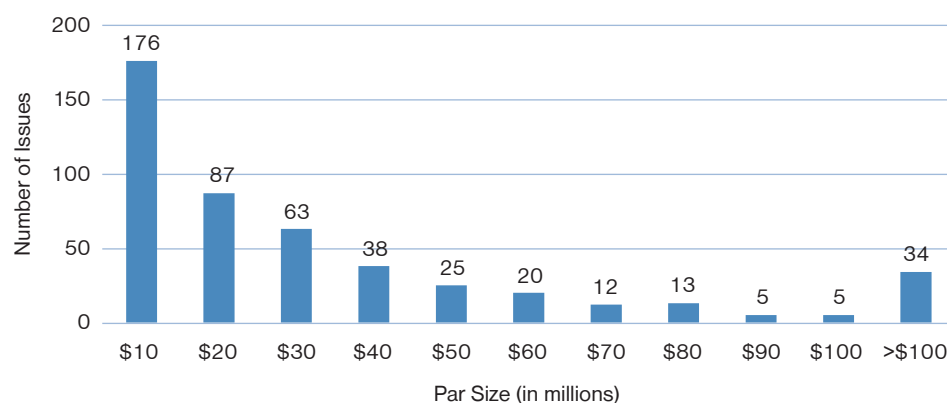
total, CDIAC reviewed a 478 local agency GO issuances.¹ Approximately 60 percent of all issuances reviewed had par amounts less than \$25 million, with 36 percent less than \$10 million.

The majority of local agency issuances were originated by school districts, followed by community college districts. Figure 2 details the issues reviewed by issuer type.

FINDINGS

Figure 3 displays the median underwriter spread, financial advisor fee, and legal fees for selected ranges of issue size for GO bonds issued during the 2009 - 2011 period. The median was used as a measure due to the wide variation in fees within the ranges reviewed. The data is presented in four ranges by par size to allow for a more uniform distribution and to show the effect of issue size on underwriter spreads, financial advisor fees, and legal counsel compensation. The data is categorized by par value with underwriting,

FIGURE 1
LOCAL AGENCY BOND ISSUES REVIEWED



¹ Issues sold either through competitive bid, private placement or a joint powers authority were not included in this review.

FIGURE 2

ISSUES REVIEWED BY ISSUER TYPE

ISSUER TYPE	NO. OF ISSUES	PAR AMOUNT ISSUED	% OF TOTAL
K-12 School Districts	409	\$15,959,173,349	75%
Community Colleges	55	4,716,337,538	22
Water Districts	5	412,965,000	2
Cities	8	303,885,000	1
Recreation & Park Districts	1	\$20,000,000	<1%

FIGURE 3

MAJOR ISSUANCE EXPENSES BY PAR VALUE

PAR VALUE			EXPENSES				
CATEGORY (IN MILLIONS)	NUMBER IN CATEGORY	MEDIAN	UNDERWRITER SPREAD	FINANCIAL ADVISOR FEE	LEGAL FEE	TOTAL	
<\$10:	175	\$5,200,000	MEDIAN	\$50,000	\$63,675	\$47,500	\$161,175
			% OF PAR	1.000%	1.180%	0.917%	3.096%
\$10 - <\$25:	118	\$15,070,000	MEDIAN	\$132,654	\$75,750	\$59,000	\$267,404
			% OF PAR	0.946%	0.471%	0.381%	1.798%
\$25 - <\$75	133	\$38,389,923	MEDIAN	\$275,725	\$82,450	\$79,125	\$437,300
			% OF PAR	0.700%	0.206%	0.192%	1.098%
\$75 and Over	52	\$127,500,000	MEDIAN	\$803,318	\$90,221	\$139,549	\$1,033,088
			% OF PAR	0.557%	0.078%	0.106%	0.741%

financial advisor, and legal fees presented as a dollar amount and as a percentage of par value. In contrast to underwriter fees, which are predominantly based on par value, financial advisor and legal fees are predominantly transaction based and represent a smaller percentage of par value as the issue size increases.

Underwriter's Spread

The underwriter spread, also known as the underwriter's discount, is the difference between the amount the underwriter pays the issuer for the bonds and the amount the underwriter receives for initially selling the bonds to investors. The spread is largely comprised of the takedown, which is essentially the commission the underwriter receives for selling the bonds, but the spread may also consist of other expenses

such as a management fee, compensation for the underwriter's legal counsel, compensation for risks incurred by the underwriter in underwriting the bond issue, and other miscellaneous underwriter expenses related to the issuance.

Of the issues reviewed, school districts used 28 unique underwriters, community colleges used 12, cities used 5, and water districts used 4. Two school district issues listed their underwriter's spread as "unknown" and were not included in the review of underwriter spreads.

Although the underwriter's spread is positively correlated with par size, the spread per dollar generally decreases as par size increases, indicating some economies of scale are achieved with larger issues. This is possibly due to the fixed components of the spread

(such as the management fee) representing a smaller proportion of the total underwriter's spread in relation to the takedown in larger issuances. The credit quality or structure of the bonds generally has a significant impact on the demand by investors and has a corresponding effect on the underwriting spread. Bonds that are perceived by the underwriters as difficult to sell normally require higher takedowns to compensate for additional marketing efforts as the takedown is the source of commissions paid to the sales personnel. In addition, varying levels of services provided by the underwriter may also be a factor in the underwriter's spread. These services could include banking, financing or structuring advice (management fee) or issuer-specific needs such as school bond election-related services (development of surveys, ballot language, etc.).

Financial Advisor Fees

A financial advisor is a professional consultant retained to advise and assist the issuer in formulating and/or executing a debt-financing plan. The role of, or necessity for, the financial advisor may depend upon the financial sophistication and workload capacity of the issuer's staff and the division of labor among the staff and other participants in the debt financing. Some issuers hire financial advisors to assist them on a single issuance while others choose to enter into multi-year or multiple issue engagements.

A total of 138 issuers from the 478 reviewed (111 school district, 24 community college district, 2 water district, and 1 city issue) did not use a financial advisor in the bond issuance transaction. It was also noted that certain financial advisory firms that specialize in school district bond financings offer a broader scope of services outside of what is traditionally provided by financial advisors. These can include facilities planning, along with school bond election and campaign advisory services. Facilities planning may involve a needs assessment, demographics analysis, site evaluations, and

community surveys. School bond election and campaign advisory services typically include fundraising, voter polling, and marketing activities.

Of the issues reviewed, school districts used 21 unique financial advisors, community college districts used 8, cities used 5, and water districts used 2.

Legal Counsel Fees

Bond counsel is the attorney, firm of attorneys, or group of firms that give the legal opinion delivered with the bonds confirming that the bonds are valid and binding obligations of the issuer and that interest on the bonds is exempt from federal and state income taxes. Disclosure counsel is the attorney or law firm retained by the issuer to provide advice on issuer disclosure obligations and to prepare the official statement and continuing disclosure agreement. Legal counsel fees as presented in this review is the sum of bond counsel and disclosure counsel fees, which includes issues that did not utilize a disclosure counsel.

Of the issues reviewed, school districts used 18 unique bond counsels, community col-

lege districts used 5, cities used 3, and water districts used 3.

SUMMARY

This report compiled all local agency general obligation bond issuance during calendar years 2009 - 2011 to review underwriter, financial advisor and legal counsel expenses. It is hoped that this information will provide local agency issuers and stakeholders a gauge to identify and plan costs associated with future bond issuance. Although all deals are unique, this review should provide the reader with a foundation for determining appropriate ranges of costs when issuing general obligation debt.

Additional Resources

For additional information on the roles and compensation of underwriters, financial advisors and legal counsels, please see CDIAC's California Debt Issuance Primer at www.treasurer.ca.gov/cdiac.

Information on recommended practices for selecting an underwriter, financial advisor, or bond counsel may be found on the Government Finance Officer Association (GFOA) website at www.gfoa.org.