Underwriting: Behind the Scenes

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The Essentials

Presentation Overview



Overview of a Bond Transaction



Bond Structuring and Sizing



Marketing a Negotiated Bond Issue



Post Pricing

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I. Overview of a Bond Transaction

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Financing Participants

- Bond Counsel
- Borrower's Counsel
- Credit Enhancer
- Credit Provider's Counsel
- Disclosure Counsel
- Issuer
- Issuer's Counsel
- Municipal Advisor

- Obligated Person
- Paying Agent/Registrar
- Rating Agency
- Trustee
- Trustee's Counsel
- Underwriter
- Underwriter's Counsel

The Underwriter

The financing participants typically only see the investment bankers supporting the transaction:

Managing Director

Executive Director/Director/SVP

Vice President

Associate

Analyst

Who Supports the Investment Bankers

Compliance

In-House Legal

Underwriters

Sales Desk

Credit and Risk

Quant Analysts

Transaction Approval Committee

Other Lines of Business

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Key Documents from Underwriter's Perspective

Authorizing resolutions/ordinances

Trust Indentures/Agreements

Notices to bondholders/insurance companies/trustee

Feasibility studies/Engineering reports

Preliminary Official Statement/Official Statement

Due Diligence Questionnaire

Continuing Disclosure Undertaking Agreement (CDUA)

Accountant Certificates/Letters (inclusion/agreed-upon procedures)

Preliminary Blue Sky/Final Blue Sky Memorandum

Bond Purchase Agreement/Contract of Purchase

Agreement Among Underwriters (New Electronic SIFMA Master Form)

Selling Group Agreement

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II. Bond Structuring and Sizing

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Preliminary Steps to a Transaction



Identify purpose of the borrowing



Identify projects, Issuer/Obligated Person's debt capacity, savings



Assemble team



Develop a financing plan and schedule

- Type of sale
- Structure
- Timing and scope of due diligence
- Draft relevant transaction documents

- Other deals coming to market
- Rating meetings
- Investor meetings
- Bond marketing, pricing, closing

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Evaluation of Capital Needs and Cash Flow Capacity

Prior to structuring a bond issue, it is important to analyze the capital and borrowing needs of the Issuer/Obligated Person AND the ability to repay the debt borrowed.

Measures to repay General Obligation Bonds

Overall taxing base/per capita income levels/local and regional economy

Cash and levels of liquidity: fund balances

Amount of debt previously borrowed

Ability and willingness to raise taxes

Measures to repay Revenue Bonds

Source of funding (dedicated taxes, user fees, tolls, excise taxes, etc.)

Levels of "coverage or cushion" above debt service

Economic base associated with revenues pledged for debt

Legal covenants (additional bonds test, non-impairment clauses, non-bankruptcy opinion)

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Public Offerings

Competitive (Public) Sale

- Bonds are advertised for sale (notice of sale)
- Any broker-dealer or bank may bid at the designated date and time
- Bonds are awarded to the bidder offering the lowest True Interest Cost ("TIC") or Net Interest Cost ("NIC")
- Selling syndicate

Negotiated Sale

- Terms of the bonds and of the sale are negotiated with the Issuer/Obligated Person
- Issuer/Obligated Person and underwriter agree upon a yield level at which the underwriter will offer bonds to potential investors
- Underwriter markets bonds and gets investor interest
- Initial interest scale may be adjusted depending on investor demand
- Underwriter may commit to underwrite unsold balances

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Private Placements

- Bonds (or loan obligations) are placed to one or a few investors (they are not sold in a placement setting)
- Placement Agent finds investors or direct lenders (regulatory responsibility similar to Underwriter)
 - Investors/lenders typically certify that they are the end purchaser and do not have intent to reoffer or resell
- Due diligence obligations shifted in part to investors/lenders
- Issuer/Obligated Person disclosure responsibilities are negotiated as part of the placement agreement
- Sales are limited to a more sophisticated investor base, which is typically documented through an Investor/Lender Letter

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III. Marketing a Negotiated Bond Issue

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The Negotiated Bond Issue

Create Investor Target Plan

- Investor Site Visits
- Investor Call
- "Road Show"
- Banking/Sales/Trading Coordination

Define/Develop Syndicate

- Liabilities/Participation
- Priority of Orders
- Allocation Policies

Pre-Pricing Evaluation

- Investor Questions
- Scale
- Market Demand
- Structure

Distribution Channels

- Retail
- Institutional
- Restricted Investor Types: QIBs and Accredited Investors

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Bond Marketing & Pricing – Another Perspective

 Analyze relevant market data • Pre-pricing call to discuss proposed rates and market tone Bond • Entry into market / deal execution pricing • Develop deal momentum **Pre-pricing** Critical component investor dialogue Coordinated effort with sales and banking • Tier 1: major funds/broad coverage Engage multiple tiers of • Tier 2 & 3: less coverage/strong appetite investors Goal is broadest distribution Educate sales staff Internal pre-marketing Coordinate /communicate market intel Generate early focus • In-depth financial analyses Intense pre-pricing credit work Understand organizational profile • Bondholder communication strategy Ongoing investor relations • Periodic investor conference calls and/or meetings

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Elements of a Pricing

Par amount - Face value of a bond to be paid back to the bondholder on the maturity date

Principal Payments – Date(s) on which principal payments are due

Coupon - Annual interest rate payable to the bondholder

Yield - Net annual interest cost to the Issuer, taking into account the discount or premium on the purchase price, the interest rate and the length of time the bond is held

Price - Total amount paid by the Issuer for the bonds

Serial vs. term bonds

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Redemption Schedule

Bond Pricing Process

Pre-pricing call:
Issuer/Obligated
Person, Municipal
Advisor and
Underwriter discuss

- Market conditions
- Comparable transactions
- Proposed interest rates (coupons, yields)

"Verbal Award"

Issuer/Obligated
Person approves
release of the bonds
via a "pricing wire" at
proposed interest rates

Repricing: Adjustment of interest rates, if necessary

Order period begins – investor feedback

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IV. Post-Pricing

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Post-Pricing Process/Logistics

Bond counsel and underwriter check that sales fit within legal parameters

• (i.e. were at least 10% of the Bonds sold to the Public at the Initial Offering Price?)

Confirmation of insurer premium and verification (if refunding)

Monitor for disclosure issues during the underwriting period

Bond Counsel/Underwriter's Counsel revise Bond Purchase Agreement

Issuer/Obligated Person and underwriter finalize Bond Purchase Agreement ("Written Award")

Underwriter's operations team begins to work on logistics

- Write tickets with investors
- Order CUSIP Numbers
- MSRB Filings

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Pre-Closing and Closing

Pre-Closing Activities

- Finalize documents with final "numbers"
- Print/Mail final OS within required timeframe
- Closing memo highlighting flow of funds

Closing Activities

- Relevant parties execute documents and certificates
- Relevant attorneys deliver opinions

Call DTC

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Questions

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