

LOCAL GOVERNMENT BOND ISSUANCE COSTS

STATE BOND COMMISSION



PERFORMANCE AUDIT SERVICES
ISSUED JULY 11, 2018

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LOUISIANA LEGISLATIVE AUDITOR
DARYL G. PURPERA, CPA, CFE

July 11, 2018

The Honorable John A. Alario, Jr.,
President of the Senate
The Honorable Taylor F. Barras,
Speaker of the House of Representatives

This report provides the results of our performance audit on the State Bond Commission's oversight of local government bond issuance costs.

The report contains our findings, conclusions, and recommendations. Appendix A contains the State Bond Commission's response to this report. I hope this report will benefit you in your legislative decision-making process.

We would like to express our appreciation to the management and staff of the State Bond Commission for their assistance during this audit.

Sincerely,

A handwritten signature in blue ink that reads "Daryl G. Purpera". The signature is fluid and cursive.

Daryl G. Purpera, CPA, CFE
Legislative Auditor

DGP/aa

BONDISSUANCECOSTS

Louisiana Legislative Auditor

Daryl G. Purpera, CPA, CFE



Local Government Bond Issuance Costs State Bond Commission

July 2018

Audit Control # 40170008

Introduction

We evaluated the State Bond Commission's (Commission) oversight of bond issuance costs (issuance costs) for Louisiana local governments. The Louisiana Constitution of 1974 (La. Const. Art. VII § 8) requires that local government entities obtain the Commission's approval before borrowing money for any purpose. The Commission's oversight helps ensure that local governments do not take on more debt than they can afford to repay. If a local government has difficulty repaying its debts, this could cause interest rates to increase for other local governments in Louisiana and put pressure on the state to provide financial assistance.¹

Local governments borrow money to finance long-term investments, such as roads and buildings; refinance outstanding debt on more favorable terms; and maintain spending levels during temporary shortfalls or delays in revenues. From January 2013 through June 2017, local governments borrowed approximately \$11 billion to finance 915 bond issuances. As part of the bond issuance process, local governments usually enlist and pay for the services of bond issuance professionals, including bond counsel, underwriters, and financial advisors.² As shown in Exhibit 1, local governments spent \$148 million in issuance costs from January 2013 through June 2017.

**Exhibit 1: Summary Information on Local Government Borrowing
Bonds Issued from January 2013 through June 2017
(Dollar Amounts in Millions)***

Item	2013	2014	2015	2016	2017†	Grand Total
Number of Transactions	231	200	223	212	49	915
Principal Borrowed	\$2,389	\$2,482	\$3,062	\$2,137	\$802	\$10,873
Total Bond Issuance Costs	\$34.5	\$30.8	\$40.3	\$31.6	\$10.6	\$147.7
Breakdown:						
Legal	\$11.6	\$9.4	\$12.3	\$9.5	\$2.7	\$45.4
Underwriting	\$9.5	\$10.6	\$10.1	\$6.9	\$2.3	\$39.3
Financial Advisor	\$2.4	\$3.3	\$4.3	\$2.9	\$1.3	\$14.2
Rating Agency	\$1.9	\$1.8	\$2.1	\$1.6	\$0.6	\$8.0
Credit Enhancement	\$2.4	\$1.0	\$4.1	\$1.6	\$0.6	\$9.6
State Bond Commission	\$1.2	\$1.1	\$1.4	\$1.0	\$0.4	\$5.1
Other	\$5.4	\$3.3	\$5.8	\$7.8	\$2.7	\$25.2

* Columns may not sum to totals due to rounding.

† Data for 2017 reflect January through June. Data for remaining months will not be complete until after July 2018.

Source: Prepared by legislative auditor's staff using information obtained from the Commission.

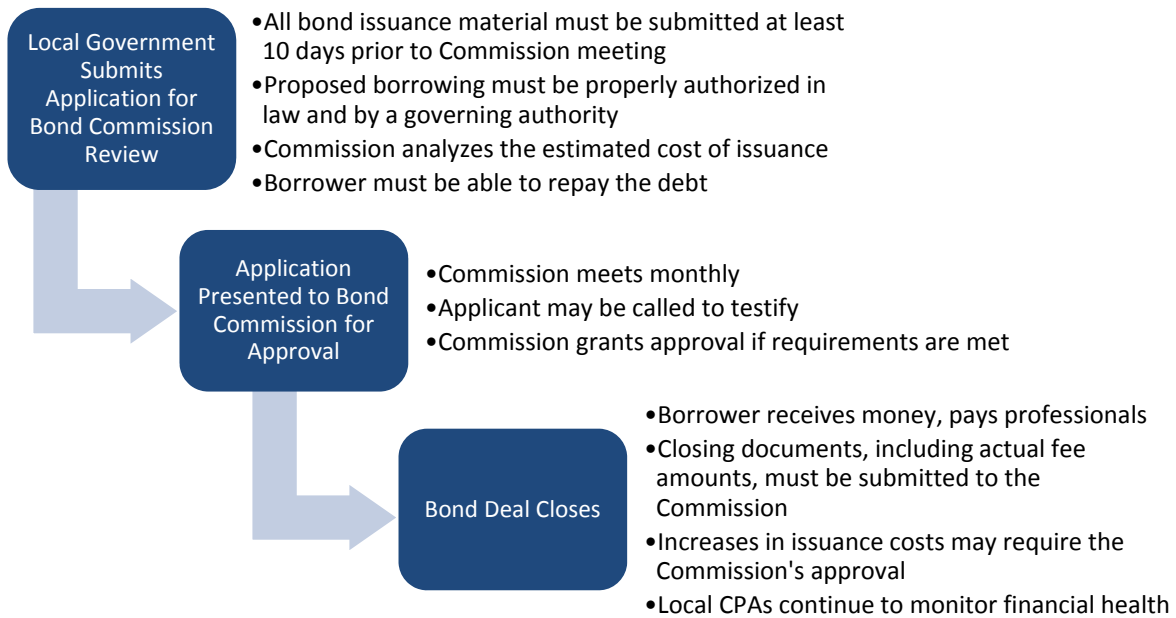
¹ Additional information on this subject can be found at <http://parlouisiana.org/wp-content/uploads/2016/03/Municipal-Bankruptcy-in-Perspective.pdf> (p. 13).

² Financial advisors who advise state and local government entities about issuing bonds are also called "municipal advisors."

State law does not require local governments to obtain the services of bond issuance professionals, other than the Commission. However, lenders and investors often require a legal opinion from bond counsel, and the Government Finance Officers Association recommends that state and local government issuers hire a financial advisor. Local governments hired bond counsel in 97% of borrowing transactions, and hired a financial advisor in 45% of transactions from January 2013 through June 2017.

Louisiana Revised Statute (R.S.) 39:1405.4 requires the Commission’s pre-approval for all local government issuance costs, and additional approval is required if actual costs at closing exceed the pre-approved costs in total or by 10% or more for any one line item. Evaluating whether costs are excessive is important because at least 70% of issuance costs are paid for with bond proceeds, which local governments will repay over time with interest. Exhibit 2 summarizes the Commission’s process for approving local government bond issuances.

Exhibit 2
State Bond Commission’s Process for Approving Local Bond Issuances



Source: Prepared by legislative auditor’s staff using information obtained from the Commission.

Because bond issuance costs for local governments average \$30 million annually, it is important for the Commission to identify potentially excessive costs so local governments can obtain these services at the most favorable terms possible. For this audit, our objective was:

To evaluate the State Bond Commission’s oversight of local government bond issuance costs.

The issues we identified are summarized on the next page and discussed in detail throughout the remainder of the report. Appendix A contains the State Bond Commission’s response, Appendix B summarizes our scope and methodology, and Appendix C provides a description of the bond issuance services local governments use when issuing a bond.

Objective: To evaluate the State Bond Commission's oversight of local government bond issuance costs

Overall, we found that while the Commission uses data to evaluate whether *estimated* issuance costs charged to local governments are excessive, the Commission could collect data on *actual* issuance costs and better leverage its existing resources to help local governments obtain bond issuance services at lower costs. We found the following:

- **The Commission does not track actual local government issuance costs in an electronic format. Although not required by law or policy, tracking this information would enable Commission staff to more efficiently analyze costs from comparable bond transactions when reviewing a bond issuance application.** We estimated that local governments paid approximately \$6.7 million from January 2013 through June 2017 in issuance costs that exceeded the average costs of similar bond issuances. Tracking this information would enable the Commission to identify and investigate whether these costs were higher than necessary.
- **The Commission could potentially help local governments reduce their borrowing costs by providing resources to help them use competitive bidding to select bond issuance professionals, as recommended by national best practices.** We found that competitively bidding out services could potentially enable local governments to reduce their bond issuance costs by approximately \$1.2 million annually. Only 38% of local governments use competitive bidding to select bond issuance professionals.

These findings, and recommendations to help the Commission strengthen its oversight of bond issuance costs, are explained in more detail on the following pages.

The Commission does not track actual local government issuance costs in an electronic format. Although not required by law or policy, tracking this information would enable Commission staff to more efficiently analyze costs from comparable bond transactions when reviewing a bond issuance application.

R.S. 39:1405.4 requires local governments to submit their expected bond issuance costs for pre-approval *before* closing on a deal, and their actual bond issuance costs *after* closing to ensure that actual costs did not exceed the amounts initially approved by the Commission. Commission staff collects documents that outline estimated bond issuance costs and prepares and maintains an analysis sheet with a side-by-side listing of each bond's estimated issuance costs. Staff then presents to the Commission the estimated costs of the proposed bond along with the estimated costs of similar bonds to determine whether the fees are excessive. However,

Commission staff do not record or track any information on the actual costs of issuing a bond in an electronic format. As a result, they can only compare the estimated cost in bond applications with the estimated cost of other bonds, not the actual costs, when determining if fees are excessive in a bond application.

Tracking actual issuance costs in an electronic format would enable Commission staff to more efficiently identify comparable transactions and compute aggregate statistics like averages, minimums, and maximums across similar bonds. This analysis could help the Commission identify excessive costs. Although Commission staff currently reviews each bond application for excessive issuance costs before pre-approving, they cannot easily compare similar bonds with their current analysis sheet. In addition, they can only compare the estimated costs in the bond applications with the estimated costs of other bonds, not the actual costs. Tracking actual issuance costs in an electronic format would enable the Commission to rely more on conclusive, objective, quantitative criteria in evaluating whether issuance costs are excessive. While having this information in an electronic format would not eliminate the need for judgment and experience in evaluating issuance costs, it would help Commission staff efficiently identify similar bond transactions and the actual costs of issuing these bonds for comparison purposes.

We analyzed the actual issuance costs paid from January 2013 through June 2017 and identified instances in which local governments paid significantly higher costs for professional services even though they were issuing similar types of bonds for similar principal amounts. Local governments that paid higher costs may have been able to obtain the same services at lower costs had they known what other local governments paid for similar bond-issuance type services. We analyzed issuance costs from January 2013 through June 2017 and found that local governments paid \$6.7 million, for an average of \$1.5 million annually, in costs that exceeded the average costs for other bond issuances with similar principal amounts, similar types of issuers, and with a similar pledge of repayment (e.g., general obligation, revenue, limited tax).³ While this does not mean that all of these costs were excessive, it could indicate the need for further explanation from bond issuance professionals on why their costs appear to be higher than the average.

In addition, tracking issuance costs could help Commission staff gain an understanding of how much bond issuance costs should increase when additional services are rendered. Exhibit 3 summarizes the amount that local governments actually paid in legal, underwriting, and financial advising issuance costs in excess of the average for similar bonds, grouped by the percentage above average. Legal, underwriting, and financial advising services are further described in Appendix C.

³ As further explained in Appendix B, we compared each bond's issuance costs (on a per bond, or per \$1,000 of principal, basis) to the average costs for similar bonds, including the bond in question.

Exhibit 3						
Issuance Costs in Excess of the Average for Similar Bonds						
January 2013 through June 2017						
% Above Average	Legal Services		Underwriting Services		Financial Advising Services	
	No. of bonds	Difference in costs	No. of bonds	Difference in costs	No. of bonds	Difference in costs
≤0%	598	\$0	827	\$0	790	\$0
>0%-10%	132	259,729	42	300,489	28	37,001
>10%-20%	69	617,809	15	334,760	25	118,604
>20%-30%	53	562,704	12	453,574	20	73,972
>30%-40%	24	341,328	9	688,161	15	258,231
>40%-50%	18	343,392	4	349,117	12	191,959
>50%-60%	11	402,322	2	56,995	10	94,133
>60%	10	312,494	4	508,758	15	409,102
Subtotals	915	\$2,839,778	915	\$2,691,854	915	\$1,183,002
Total Legal, Underwriting, and Financial Advising Costs Exceeding Average of Comparable Bonds						\$6,714,634
Source: Prepared by legislative auditor's staff using information obtained from the Commission.						

The Commission should make data on issuance costs available to local governments for their use in evaluating and negotiating proposed fees from bond issuance professionals. By tracking issuance costs, the Commission could also help local governments better understand how much services should cost and may help them to secure more favorable rates and higher quality services from their bond issuance professionals. For example, as shown in Exhibit 4 below, in 2014 City A issued a bond for \$4.9 million and paid \$29.87 per bond (or per \$1,000 of principal) in issuance costs when the average for this type of bond for a similar amount is \$25.52 per bond based on other bond issuances with similar principal amounts, similar types of issuers, and with similar pledge of repayment (e.g., general obligation revenue, limited tax). As a result, City A potentially overpaid in issuance costs by \$21,241. While it is possible that City A may have received additional services to justify the expense, it is also possible that this City could have obtained the same services at the same rate paid by other municipalities. Additional examples are shown in Exhibit 4, which lists examples of sales tax bonds issued by municipalities who may have overpaid in issuance costs by at least 10% when compared to similar bonds.

Exhibit 4				
Examples of Sales Tax Revenue Bonds (similar bonds) with Disparate Fees				
Issuer Name	Principal Amount	Costs Per Bond*	Average of Comparable Per Bond Amount	Potential Excess Costs**
City A	\$4,885,000	\$29.87	\$25.52	\$21,241
City B	\$2,000,000	\$18.56	\$15.59	\$5,941
City C	\$4,590,000	\$29.31	\$25.52	\$17,390
City D	\$3,500,000	\$17.22	\$15.22	\$7,014
* Costs per bond are equal to the cost divided by the principal amount times \$1,000.				
**Amount may not agree between columns due to rounding.				
Source: Prepared by legislative auditor's staff using information obtained from the Commission.				

We surveyed municipalities, school boards, parish governments, and sheriffs (local governments) to learn more about local government bond issuance practices and their perspectives on the bond issuance process, including how they could benefit from better tracking of bond issuance costs. Of the 199 such entities that had issued bonds since 2013, we received 74 responses (37% response rate). Of these 74 responses, 65 (88%) stated that having comparable data would be beneficial when selecting and evaluating bond issuance professionals. In addition, one local government official stated that their financial advisor resisted saying how much their fee would be until the end of the process when the deal was about to close, which this financial advisor said was standard practice.

Recommendation 1: The Commission should consider tracking actual bond issuance costs in an electronic format that can be readily analyzed.

Summary of Management’s Response: The Commission agrees with this recommendation and stated that the database we created for this audit will assist it in tracking actual local government issuance costs. See Appendix A for the Commission’s full response.

Recommendation 2: The Commission should make information on bond issuance costs available to local governments for their use as a guideline when evaluating proposed fees from bond issuance professionals.

Summary of Management’s Response: The Commission agrees with this recommendation and stated it will work to implement the public availability of the database to continue with the transparency of the office. See Appendix A for the Commission’s full response.

The Commission could potentially help local governments reduce their borrowing costs by providing resources to help them use competitive bidding to select bond issuance professionals, as recommended by national best practices.

Although Louisiana’s Public Bid Law (R.S 38:2211-2226) does not require local governments to use competitive bidding for professional services, the Government Finance Officers Association (GFOA)⁴, which provides best practices for local government bond issuances, recommends that local governments select attorneys and financial advisors via a competitive selection process. In addition, the Louisiana Legislative Auditor’s Local Government Section recommends that the dollar thresholds contained in the Public Bid Law be used as a guide in contracting for services at the local government level.⁵ Specifically, our office

⁴ <http://gfoa.org/selecting-bond-counsel> and <http://gfoa.org/selecting-and-managing-municipal-advisors>

⁵ See “Best Practices in Government Checklist” pg. 9 from <https://www.la.gov/local-government-entities/best-practices/index.shtml>

recommends that three quotes be obtained for services costing between \$10,000 and \$30,000, and bids should be solicited/obtained for the purchase of services exceeding \$30,000.

We found that competitively bidding out services could potentially enable local governments to reduce their bond issuance costs by approximately \$1.2 million annually.⁶ We surveyed local governments and found that only 38% (28 of 74) of those who responded use competitive bidding to select bond issuance professionals. We then analyzed differences in issuance costs between these two groups and found that local governments using competitive bidding obtained services at a lower cost.

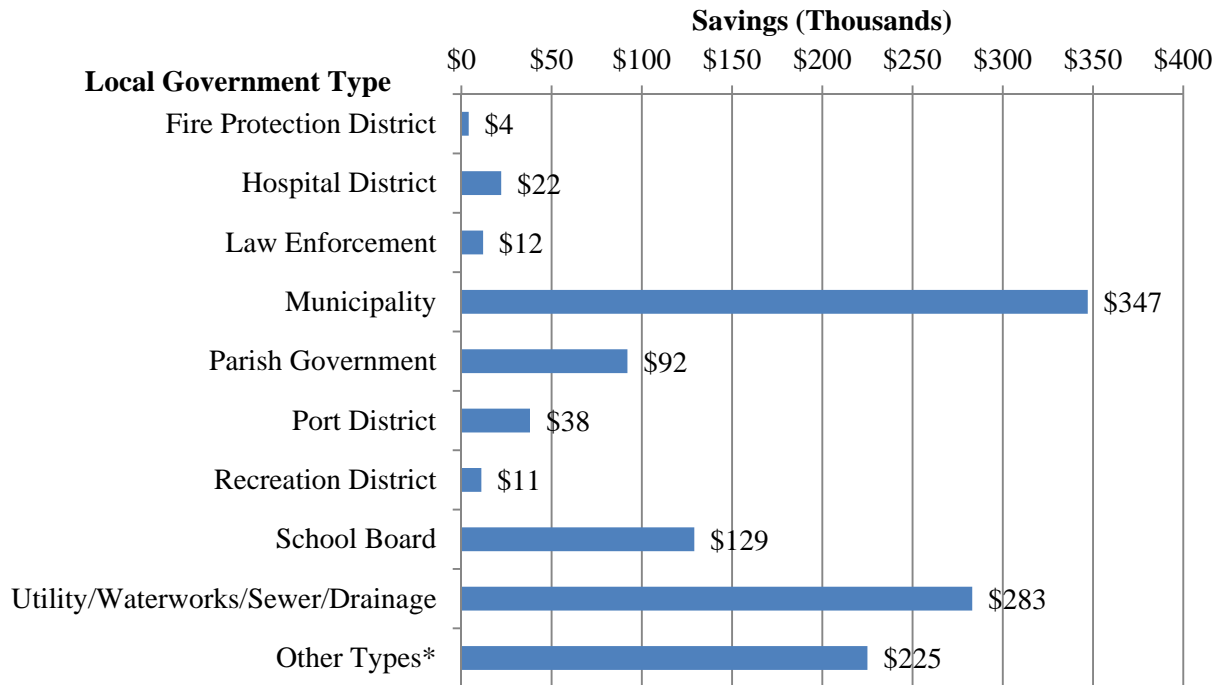
Of the 129 municipalities, sheriffs, school boards, and parish governments that issued multiple bonds from January 2013 through June 2017, 96 (74%) used the same bond issuance professionals every time.

Source: Analysis of Commission's data by legislative auditor's staff.

The increased use of competitive bidding could also lead professionals to compete on the quality of services provided, in addition to price. For example, competitive bidding may lead financial advisors to offer more comprehensive services that include monitoring a more extensive portfolio of financial market data sources to remain competitive. Although more extensive data sources may require higher financial advising fees, local governments may benefit from lower interest rates on their debt, which would still result in a decrease in overall borrowing costs. In addition, for smaller contracts (i.e., below the \$30,000 threshold described previously), it may suffice for local governments to simply ask for bids from specific firms rather than posting a formal request for proposals. Exhibit 5 summarizes how much local governments could have saved by fiscal year by bond issuance professional type if they had used a competitive process.

⁶ See Appendix B for our methodology.

**Exhibit 5
Annualized Savings from Competitive Bidding by Issuer Type
Based on Bonds Issued January 2013 to June 2017**



*Other types include animal shelters, assessment districts, communications districts, judicial districts, levee districts, sales tax districts, and transportation districts.

Source: Prepared by legislative auditor’s staff using information obtained from the Commission and survey responses from local governments.

The Commission could help facilitate competitive bidding for local governments by providing local governments with a list of qualified professionals. Several local governments who responded to our survey indicated that they would be better able to solicit bids if they knew which professionals were qualified to assist in government bond transactions. Bond counsel firms, financial advisors, and underwriters are all regulated by other entities, so the Commission would not need to independently determine who is qualified as long as the firm is approved by the appropriate regulatory agency. Officials from the Commission stated that they can already provide a list to local governments upon request; however, the list is not posted on the Commission’s website, and many local governments are not aware that such a list is available. Many local governments do not even interact with the Commission directly and instead interact through their bond counsel, which reduces the likelihood that local governments would learn about the Commission’s resources. The Commission could make this list more visible by putting it on their website, in much the same way that a list of CPAs qualified to perform local government financial audits is available on the Legislative Auditor’s website.

The Commission could also provide template documents, similar to the ones the Commission uses for state bond issuances,⁷ for local governments to use as a basis for their own solicitations. The Commission already is responsible for selling bonds on behalf of the state and routinely prepares documents to solicit bids from professionals to assist the state. Template documents could be useful because the quality of the solicitation documents is critical for the success of the competitive bidding process. Professionals in the public finance industry expressed concerns during our interviews that local governments would not be able to properly implement the competitive bidding process. By providing additional guidance and examples for local governments, the Commission could increase the likelihood of local governments' developing effective solicitation documents and successfully implementing a competitive bidding process.

In addition, local government entities may wish to consider the value of their long-standing relationships with their bond issuance professionals when competitively bidding. Several bond professionals that we spoke to said that in some cases, they know more about their clients' financial situations than their clients, and officials from the State Treasurer's Office concurred with this assessment. Professionals and local government officials noted that turnover among local government officials can lead to a loss of institutional knowledge. If this is a concern for local governments, they could account for this relationship when competitively bidding to select bond issuance professionals. The Commission agreed that long standing relationships can be beneficial, but also noted that local governments could benefit from changing advisors as new advisors may bring best-practice lessons based on experience in other engagements.

Recommendation 3: The Commission should consider providing resources for local governments so they can use competitive bidding to select bond issuance professionals, as recommended by national best practices.

Summary of Management's Response: The Commission agrees with this recommendation and stated it will continue to bring more information to the "Other Resources" tab on its website. See Appendix A for the Commission's full response.

⁷ An example RFQ from the Commission is available on the State Treasurer's Office's website at https://www.treasury.state.la.us/wp-content/uploads/2017-RFQ-Bond_Co-Bond-Counsel-Services.pdf. This RFQ may not be suitable for local governments' needs, but it could be used as an example to derive documents appropriate for local governments.

APPENDIX A: MANAGEMENT'S RESPONSE



TREASURER OF THE STATE OF LOUISIANA

John M. Schroder
State Treasurer

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June 27, 2018

Daryl G. Purpera, CPA, CFE
Louisiana Legislative Auditor
P.O. Box 94397
Baton Rouge, LA 70804-9397

Dear Mr. Purpera:

The Department of Treasury and State Bond Commission would like to thank the Legislative Auditor's Performance Audit section for their time and efforts on the research of the oversight of local government bond issuance costs by the State Bond Commission.

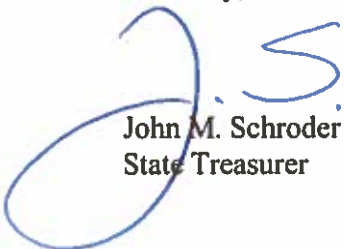
We have reviewed the report and appreciate the recommendations. We also would like to extend our appreciation for the creation of a database by your staff that will assist us in tracking actual local government issuance costs as referenced in Recommendation 1. As you are aware, since the implementation of our NovusAgenda in July 2017, the State Bond Commission has made meeting documents available to the public. We will work to implement the public availability of the database to continue with the transparency of the office as referenced in Recommendation 2.

Additionally, in concert with the release of NovusAgenda in July 2017, we began providing resources on our website and making more information available to local governments through our "Other Resources" tab on the website. We will continue to bring more information to this tab as indicated in Recommendation 3.

Your recommendations are in line with current discussions in transparency and the Department of Treasury and State Bond Commission wants to do everything possible to ensure local governments have as much information as possible to assist them when they issue debt.

Again, we appreciate the dedicated effort your staff provided to this report and their professionalism during the process. Please let me know if we can be of further assistance in any matter.

Sincerely,


John M. Schroder
State Treasurer

JMS//lmf/cob

APPENDIX B: SCOPE AND METHODOLOGY

We conducted this performance audit under the provisions of Title 24 of the Louisiana Revised Statutes of 1950, as amended. The audit evaluated the State Bond Commission's (Commission) oversight of local government bond issuances and covered the time period from January 2013 to June 2017. The audit objective as follows:

To evaluate the State Bond Commission's oversight of local government bond issuance costs.

We conducted this performance audit in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. To answer our objective, we reviewed internal controls relevant to the audit objective and performed the following audit steps:

- Interviewed Commission staff, analyzed relevant provisions of state law, and reviewed Commission policies and procedures to gain an understanding of the Commission's role in the bond issuance process for local governments.
- Reviewed best practices and advisory documents on local government bond issuance from the Municipal Securities Rulemaking Board and the Government Finance Officers Association.
- Created a data collection instrument (DCI) to record data from financial disclosure forms submitted by local governments showing estimated and actual issuance costs for all local government transactions with a closing date between January 2013 and June 2017. Specifically, we performed the following:
 - Extracted all available documents using queries from the Commission's document storage system and obtained 915 transactions that fell within our audit scope.
 - Tested the reliability of the data in our DCI using control totals to ensure that the line item costs in each record add up to the total costs for each record, and we validated all line items on a random sample of 29 records from the data and found that the data were reliable.
- Analyzed issuance costs to identify outliers or disparities in fees between similar local governments in similar transactions.

- Surveyed local governments to learn their perspectives on bond issuance, including how they interact with industry professionals and the Bond Commission. Of the 199 municipalities, parish governments, school boards, and sheriff's offices that issued bonds from January 2013 through June 2017, we obtained 74 responses (42 via a web survey and 32 via telephone interviews) for a response rate of 37%.
- Interviewed stakeholders in the public finance industry, including underwriters, financial advisors, and bond attorneys to learn their perspectives on the Commission's oversight of local government bond issuance.
- Analyzed differences in issuance costs for local governments based on whether or not they use competitive bidding. Additional results of this analysis are shown below.

Additional Scope and Methodology

Analysis of Potentially Excessive Issuance Costs Based on Comparison with Similar Bonds

After compiling the Commission's records on bond issuance costs into an electronic format that could be readily analyzed, we wanted to know if costs were consistent for similar types of bonds. In particular, we wanted to know about instances in which local governments paid fees that were higher than the average for comparable bonds. To calculate the average cost for comparable bonds, we grouped together bonds based on the following attributes:

- Issuer type, i.e., municipality, parish government, school board, sheriff, fire protection district, waterworks, etc. We determined this using the issuer name on the Commission's closing fee documentation forms.
- Pledge type, i.e., general obligation, sales tax, limited ad valorem tax, other revenue bonds, and certificates of indebtedness, with all remaining types grouped into one category. We determined this based on the instrument description on the Commission's closing fee documentation forms.
- Principal amount. Bonds were grouped together by rounding the principal amount to the most significant non-zero digit. For example, a bond for \$3,700,000 and a bond for \$4,400,000 would both be rounded to \$4,000,000 and would be in the same principal amount category. In addition, a bond for \$370,000 and a bond for \$440,000 would both be rounded to \$400,000. We determined this based on the principal amount from the Commission's closing fee documentation.
- Non-zero issuance costs for a particular category of costs. Bonds that had underwriting expenses were only compared to other bonds that had underwriting expenses. The same was true for financial advising expenses and legal expenses. We did this so that bond transactions that were accomplished without the use of

an underwriter would not form the basis of comparison for bonds that did use an underwriter, and likewise for financial advisors and bond counsels. We determined this based on the cost data from the Commission's closing fee documentation.

Transactions were grouped based on the categories above. For example, Exhibit B.1 shows the calculation of potential excess legal fees for the category of sales tax bonds for municipalities for principal amounts that rounded to \$10,000,000. There were six bonds in this category. Their legal costs are shown in column C of Exhibit B.1. The average cost per bond for these six bonds is \$7.54. The bonds in the first and third rows had above-average fees, but the other four were below-average. The difference between the actual cost per bond and the average from similar bonds is shown in column F as potential excess costs per bond. The corresponding amount for the entire transaction is shown in column G, which equals the cost per bond times the principal amount divided by \$1,000. The same calculation was performed for all 915 bonds in our audit scope, and we identified \$6.7 million in potentially excessive fees in this manner.

Exhibit B.1						
Example Calculation of Disparate Issuance Costs						
(A) Issuer	(B) Principal Amount	(C) Legal Costs	(D) Cost Per Bond*	(E) Average Cost Per Bond	(F) Potential Excess Costs Per Bond	(G) Total Potential Excess Costs
City A	\$12,000,000	\$128,825	\$10.74	\$7.54	\$3.20	\$38,323
City B	\$11,000,000	\$70,117	\$6.37	\$7.54	-	-
City C	\$11,825,000	\$110,788	\$9.37	\$7.54	\$1.83	\$21,605
City C	\$12,915,000	\$77,170	\$5.98	\$7.54	-	-
City D	\$11,700,000	\$68,428	\$5.85	\$7.54	-	-
City E	\$13,180,000	\$91,585	\$6.95	\$7.54	-	-
*Cost per bond in column D equals the costs in column C divided by the principal amount in column B, multiplied by 1,000.						
Source: Prepared by legislative auditor's staff using information obtained from the Commission.						

Analysis of Survey Results

We analyzed issuance costs to identify patterns, including potential differences in issuance costs between local governments that use competitive bidding and those that do not. We surveyed local governments via a web survey and via telephone to learn more about how they select professionals.⁸ The results of this survey are summarized in Exhibit B.2.

Exhibit B.2 Local Government Survey Results					
Local Government Type	Number of entities	Number of Responses	Response Rate	Number Using Competitive Bidding	% Using Competitive Bidding
Sheriff	25	13	52%	7	54%
Municipality	105	27	26%	9	33%
Parish Government	22	11	50%	5	45%
School Board	47	23	49%	7	30%
All Types	199	74	37%	28	38%
Source: Prepared by legislative auditor's staff using information from the 74 local governments.					

We wanted to determine whether local governments that use competitive bidding generally obtain services at lower cost. To do this, we merged the survey responses with issuance cost data obtained from the Commission, which we transcribed into an electronic format. Descriptive statistics for the Commission's issuance cost data, including data for the subset of bonds that were matched to our survey responses, are shown in Exhibit B.3.

⁸ Local governments were asked the following question: "How often does your municipality use a competitive selection process for professionals assisting with bond issuances and borrowing transactions?" Local governments that responded "never," "unsure," or "not applicable" were categorized as not using competitive bidding. Local governments were counted as using competitive bidding if they responded "always," "sometimes, but less than half of the time," "about half of the time," "more than half of the time, but not always," and "always."

Exhibit B.3
Descriptive Statistics

	Full Sample					Merged Survey Results				
	No. of Observations	Mean	Standard Deviation	Min.	Max.	No. of Observations	Mean	Standard Deviation	Min.	Max.
Principal Amount (Millions)	915	11.88	32.71	0.02	565.33	211	9.89	15.90	0.15	120.00
ln(Amount)	915	15.00	1.64	10.00	20.15	211	15.27	1.39	11.92	18.60
FA Costs Per Bond	915	1.71	2.90	0.00	23.05	211	1.49	2.96	0.00	20.00
ln(FA Costs per Bond)	416	0.99	0.86	-1.87	3.14	91	0.79	0.98	-1.87	3.00
Underwriting Costs Per Bond	915	2.51	4.76	0.00	38.50	211	2.34	5.25	0.00	38.50
ln(Underwriting Costs Per Bond)	261	2.02	0.61	-1.39	3.65	48	2.21	0.45	1.56	3.65
Legal Costs Per Bond	915	10.26	7.27	0.00	88.43	211	9.08	7.67	0.00	54.60
ln(Legal Costs Per Bond)	887	2.11	0.77	-0.80	4.48	205	1.91	0.87	-0.80	4.00
General Obligation Bond Indicator	915	0.22	0.42	0.00	1.00	211	0.35	0.48	0.00	1.00
Limited Tax Bond Indicator	915	0.10	0.31	0.00	1.00	211	0.09	0.28	0.00	1.00
Sales Tax Bond Indicator	915	0.10	0.30	0.00	1.00	211	0.09	0.29	0.00	1.00
Revenue Bond Indicator	915	0.32	0.47	0.00	1.00	211	0.28	0.45	0.00	1.00
Certificate of Indebtedness Indicator	915	0.16	0.36	0.00	1.00	211	0.08	0.27	0.00	1.00
Other Instrument Type Indicator	915	0.14	0.35	0.00	1.00	211	0.13	0.33	0.00	1.00
Competitive Bidding Indicator	211	0.40	0.49	0.00	1.00	211	0.40	0.49	0.00	1.00

Source: Prepared by legislative auditor's staff using information obtained from the Commission.

We used regression analysis to control for observable differences between bonds issuances and the local government entities issuing them. Specifically, we developed a regression model in which the natural logarithm of costs per bond are a function of the natural logarithm of the principal amount of the bond, the local government entity type, the bond type, and an indicator for whether the local government entity uses competitive bidding at least some of the time. We also included separate fixed effects for each calendar year. Separate regressions were estimated for each of the three major types of costs: legal, underwriting, and financial advising. Additional specifications were considered in which the competitive bidding indicator was interacted with categorical indicators for principal amounts; this enabled us to estimate separate differences in issuance costs associated with competitive bidding for small, midsize, or large bond issues.

We also considered the possibility that, because instrument type is a choice variable for the local government, it could be correlated with the local government's choice to use competitive bidding. To test the sensitivity of our results to this possibility, we employed additional specifications in which the bond type fixed effects were omitted. The results of these regressions are shown in Exhibit B.4. Overall, the coefficients on the competitive bidding indicator are negative, with few exceptions. The small, positive coefficients on competitive bidding for legal costs in columns 2 and 3 could be a result of the dominance of the Attorney General's Fee Schedule in determining rates for bond counsel, with less to be gained from using competitive selection. Owing in part to the small sample sizes involved, the coefficients on the competitive bidding indicator do not attain conventional levels of significance. However, the consistency with which the estimated coefficients are negative, in combination with the consistent recommendations in best practice literature⁹, provide support for the approximately \$1.2 million in estimated potential savings cited previously.

To estimate how much local governments could save each year by using competitive bidding, we used the estimated regression coefficients from Exhibit B.4 to predict the change in issuance costs for each bond transaction if the local government had used competitive bidding. The predicted savings for each bond issue was calculated as follows:

- For local governments that responded to our survey that they already use competitive bidding, the potential savings calculation was zero.
- For local governments that responded to our survey that they do not use competitive bidding, the potential savings calculation was the full difference between using competitive bidding and not using competitive bidding.
- For local governments that did not respond to our survey, the potential savings calculation was the difference between using competitive bidding and not using competitive bidding, times 62%. This accounts for our estimate that 38% of local governments are already using competitive bidding.

As shown in Exhibit B.5, the estimated savings from using competitive bidding ranges from \$560,217 when the competitive bidding indicator is interacted with principal amount category dummies to \$2,100,354 when bond type fixed effects are excluded. Although the results using a single competitive bidding coefficient (the middle column in Exhibit B.5) suggest that legal fees were projected to increase slightly if competitive bidding were universally used, this increase is small and is more than offset by the decrease in underwriting and financial advising fees, and the other models still suggest that legal fees would decrease.

⁹ As noted on page 6 of the report, best practices from the Louisiana Legislative Auditor Local Government Services Section ("Best Practices in Government Checklist," page 9, available at <https://www.la.gov/local-government-entities/best-practices/index.shtml>) and the Government Finance Officers Association (<http://gfoa.org/selecting-bond-counsel> and <http://gfoa.org/selecting-and-managing-municipal-advisors>) both recommend the use of competitive bidding.

Exhibit B.4 Change in Issuance Costs Associated with Competitive Selection of Professionals									
	Ln(Legal Costs Per Bond)			Ln(Underwriting Costs Per Bond)			Ln(Financial Advising Costs Per Bond)		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Competitive Bidding Indicator	-0.022	0.009		-0.220	-0.114		-0.259	-0.227	
	[0.075]	[0.076]		[0.130]	[0.118]		[0.145]	[0.147]	
Ln(Principal Amount)	-0.418	-0.425	-0.482	-0.283	-0.271	-0.163	-0.384	-0.378	-0.428
	[0.028]	[0.028]	[0.062]	[0.056]	[0.047]	[0.108]	[0.056]	[0.058]	[0.147]
Competitive Bidding Indicator, by Principal Amount									
\$100,000 ≤ Principal < \$1 M			0.078			†			-0.888
			[0.186]			†			[0.450]
\$1 M ≤ Principal < \$10 M			-0.069			-0.338			-0.057
			[0.095]			[0.180]			[0.202]
\$10 M ≤ Principal < \$100 M			-0.010			0.062			-0.212
			[0.126]			[0.168]			[0.272]
Issue Year Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Instrument Type Fixed Effects	No	Yes	Yes	No	Yes	Yes	No	Yes	Yes
Issuer Type Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Principal Amount Category Dummies	No	No	Yes	No	No	Yes	No	No	Yes
Number of Observations	167	167	167	47	47	47	89	89	89
† There was only one transaction with positive underwriting costs and a principal amount between \$100,000 and \$1 million. Note: Standard errors in brackets Source: Prepared by legislative auditor's staff using information obtained from the Commission and 74 local governments.									

Exhibit B.5			
Estimated Savings from Competitive Selection of Bond Professionals			
Cost Type	No Bond Type Fixed Effects	Single Competitive Bidding Coefficient	Competitive Bidding Interacted with Principal Categories
Corresponding Column in Exhibit B.4	(1), (4), and (7)	(2), (5), and (8)	(3), (6), and (9)
Legal Costs	\$153,082	-\$56,531	\$180,237
Underwriting Costs	1,419,461	751,260	151,835
Financial Advising Costs	527,811	468,739	228,146
Total	\$2,100,354	\$1,163,468	\$560,217
Source: Prepared by legislative auditor's staff using information obtained from the Commission and 74 local governments.			

APPENDIX C: BACKGROUND

Description of Bond Issuance Services	
Issuance Services	Description
Legal (Bond Counsel)	Specialized law firms that provide an opinion on the bonds' validity and, where appropriate, whether the bonds are exempt from federal income tax. State law does not require the use of bond counsel, but many lenders and underwriters require them, and 97% of issuances had them. Fees paid to bond counsel in Louisiana are limited by the Attorney General Maximum Fee Schedule for bond counsel, which is a sliding scale and is calculated as a percentage of proceeds.
Underwriters and Other Financial Institutions	<p>Underwriters and other financial institutions connect local governments with capital markets. This role can be fulfilled in several different ways.</p> <ul style="list-style-type: none"> • Private Placement. For small transactions under \$3 million, local governments often borrow directly from a commercial bank or other institution, and the bank is paid interest along with the bond principal. Sometimes local governments may still borrow from a bank, but a placement agent will broker the transaction and receive a fee. Sometimes the lender is the Louisiana Department of Environmental Quality or the U.S. Department of Agriculture. • Public Offering. For transactions over \$3 million, local governments mostly rely on underwriters, which are investment banks who sell the bonds to investors in the public securities market and charge a commission or “spread” for each bond sold.
Financial Advisor	Financial advisors (FA), also known as municipal advisors, are financial market experts with a fiduciary responsibility to the borrower. They assist in structuring the deal to fit with the borrower's financial situation and to obtain the most favorable terms to the borrower. Most transactions over \$5 million use an FA. Federal regulations prohibit FAs from receiving excessive compensation, but the regulations do not define numerically what is excessive.
Rating Agency	Rating agencies assign a letter grade to the creditworthiness of a borrower or a specific bond issue. In Louisiana, ratings agencies are hired for 71% of bonds sold in a public offering, but they are only hired for 2% of private placements (see “Underwriters and Other Financial Institutions”).
Credit Enhancement (e.g., Bond Insurance)	Local governments may buy insurance or other credit enhancements to provide additional protection for the bondholders. This in turn enables the local government to borrow at a lower interest rate. Local governments buy credit enhancement approximately 3% of the time.
Bond Commission Fees	The State Treasurer's office charges local governments an application and closing fee to cover the cost of staff review of borrowing applications, ranging from 0.035% to 0.065% of bond principal. Non-governmental entities are charged a higher fee.
Other Costs	Other costs include additional law firms who represent a specific party (e.g., the issuer or underwriter) or offer specific knowledge on tax law or disclosure requirements.
<p>Source: Prepared by legislative auditor's staff using information obtained from the Commission, National Association of Bond Lawyers, Louisiana Department of Justice, Government Finance Officers Association, California Debt and Investment Advisory Commission, and Louisiana Administrative Code.</p>	