GFOA Best Practice

Debt Issuance Transaction Costs

Background. State and local governments incur various costs and fees in conjunction with publicly offered bond transactions. This Best Practice provides an overview of the types of costs and fees that an issuer can expect to pay in a typical bond transaction. Finance officers need to be aware of and understand the costs and fees that are charged in a bond transaction in order to ensure that the charges are reasonable and for legitimate services provided to the issuer.

There are two types of costs that issuers incur in the debt issuance process:

Direct Costs of Issuance: Costs that the debt issuer pays directly to financial and legal advisors, the trustee (if any), paying agents, auditors, rating agencies and other providers of services to the issuer. This is in addition to internal costs incurred by your government for staff work or fees to other government departments.

Underwriter's Discount: Costs paid indirectly by the issuer to the underwriter of the bonds for services relating to selling the bonds to investors and managing elements of the transaction. These costs are deducted from the proceeds of the bonds by the underwriters at closing and therefore issuers typically do not "write a check" for these services.

Finance officers also should be aware that certain costs are embedded within the bids received from underwriters in a competitive sale. These costs and fees are usually not specified in a competitive bid and are outside of the issuer's control. Such costs include CUSIP fees, DTC fees and certain internal expenses of the bidder.

This Best Practice focuses on direct costs of issuance. Best Practices relating to costs paid by issuers through the underwriter's discount may be found in the following Best Practices:

- Selecting Underwriters for Negotiated Bond Sales
- Expenses Charged by Underwriters in Negotiated Sales

Finance officers, working with their financial advisor, should understand all costs and fees, so that they can be controlled and managed throughout the financing process. A thorough discussion with the financial advisor and other professionals involved in the transaction should be expected. These discussions should occur at the time that compensation is being determined for key members of the financing team, including the financial advisor, bond counsel and other service providers. As
always, cost must be balanced with quality, as it is of critical importance that the issuer receives high quality services and work products from all parties.

Recommendation. GFOA recommends that finance officers be aware of the parties likely and necessary to be involved in the transactions and be prepared to select these parties in a manner that ensures that needed services are obtained at a fair and reasonable cost. Additionally, an issuer should carefully review all invoices to ensure that an expense is not billed to multiple parties.

1. Financial Advisor. Financial advisors assist the issuer on matters such as selecting the method of sale (competitive, negotiated, private placement, direct bank loan, etc.), structuring the financings, sale timing, marketing, fairness of pricing, obtaining credit ratings, evaluating cost effectiveness of credit enhancement and other matters. Unlike the underwriter of the bonds, the financial advisor has a fiduciary obligation to represent the interests of the issuer and therefore, should be one of the first financing team members retained by the issuer.

The financial advisor should typically be retained prior to selection of the remainder of the financing team and should assist the issuer in determining the appropriate method of sale, the selection of other members of the financing team and the negotiation of fees of the financing team members. GFOA recommends that financial advisors be selected as the result of an RFP or RFQ process. Compensation paid to financial advisors can vary based on the scope of services to be provided. If an advisor is being retained for services related to a bond transaction only, then the complexity of the transaction, the type of security and the type of issuer will have an impact on the fees charged. Fees can be paid on an hourly, or fixed fee bases. However, the FA fee may also be based on an $1,000 of par value. However, an issuer should use caution if using this payment method, as it could impact the overall size and structure of the transaction.

2. Legal Counsel.

a. Bond Counsel. Bond counsel’s duty is to represent the interests of the bondholders. Bond counsel is retained by the issuer to give a legal opinion that:

a. Issuer is authorized to issue proposed municipal securities and has met all legal and procedural requirements necessary for issuance.

b. If interest on the proposed securities will be excluded from gross income of the holders (Federal and/or State and/or local)

c. Generally responsible for the preparation of financing documents including Trust Indenture and Bond Resolution; assists with preparation of the Official Statement
Compensation paid to bond counsel varies depending on complexity of the transaction, the type of security and the type of issuer. These fees can be assessed based on a flat fee or by hourly billing. If the fee is paid by $/$1,000 of par value of the issuance, an issuer should use caution and ensure a reasonable cap is in place.

b. **Issuer Counsel.** Government’s may have in house counsel or may hire outside counsel to represent only the interest of the issuer.

c. **Disclosure or Tax Counsel.** In addition to bond counsel, some transactions will involve the use of disclosure counsel and tax counsel.

3. **Bond Trustee.** A financial institution or other required entity with trust powers that acts in a fiduciary capacity for the benefit of the bondholders, enforcing the terms of the trust indenture and often acting as:

a. Paying agent (transmitting payments from issuer to bondholder)

b. Dissemination agent (for ongoing disclosure requirements)

c. Escrow agent on refunding transactions (hold funds in escrow account until time of disbursement)

d. Disburse bond proceeds based upon procedures established by trust indenture or bond resolution.

e. Place investment of bond proceeds based on instruction of issuer.

f. Trustee fees frequently include a one-time upfront fee (acceptance fee), an annual fee (trusteeship fee), and often transaction fees. The selection of the Trustee should be done through an RFP process, with price not being the sole determining factor.

4. **Escrow Verification Agent.** An escrow verification agent should be hired in conjunction with a refunding transaction. The role of the escrow verification agent is to determine that the cash flow from the securities purchased to defease the refunded bonds will be sufficient to make remaining debt service payments on the refunded bonds until the bonds are called, if applicable, or to maturity. It is recommended that the selection of an escrow verification agent is competitively procured.

5. **Auditor.** Under auditing standards generally accepted in the United States of America, independent auditors are presumed not to be associated with financial statements included in an offering statement. Still, an “association” may be created between the independent auditor and the offering statement if the auditor takes one of several actions specified in the auditing standards, such as inserting a provision in the audit contract that requires prior approval before
including audited financial statements in an offering statement. It is important to note that the audited financial statements belong to the issuer, which GFOA believes should be free to publish in offering statements. Audit contracts in general should be negotiated to reflect this, but to the extent that consent is required, the level of effort required is minimal and no additional fee should be required.

6. Rating Agencies. Rating agency fee quotes can be obtained by your financial advisor or a member of your staff. The fees are and should be considered negotiable. Fees vary by bond size and security type. Consideration should be given to how many ratings are necessary, through discussion with your financial advisor and underwriter. Additionally, considerable caution should be exercised if a rating agency requests that an issuer sign a rating application or rating engagement letter. Legal counsel must be consulted if an issuer is inclined to sign such documents, because they are binding contracts.

7. Printing and Distribution Costs. Issuers will typically incur costs relating to electronically posting their official statement to websites and information services that potential underwriters and investors rely upon to access information about proposed bond offerings. In some cases, traditional hard copy printing costs may also be incurred. It has become more common for POS to be electronically posted and for a small number of final OS to be printed. The use of electronic only copies for the POS can save on printing costs.

8. Pricing Verification Agent. Issuers should use the services of the financial advisor for the transaction, or obtain the services of a separate financial advisor or other outside professional to review the pricing of a transaction and the underwriter’s discount. This fee is usually based on a fixed rate basis.

References.

GFOA Best Practice, Expenses Charged by Underwriters in Negotiated Sales (2012)
GFOA Best Practice, Pricing Bonds in a Negotiated Sale (2009)
GFOA Best Practice, Issuer’s Role in Selecting Underwriter’s Counsel (2009)
GFOA Best Practice, Selecting Underwriters for Negotiated Bond Sales (2008)
GFOA Best Practice, Selecting Bond Counsel (2008)
GFOA Best Practice, Selecting Financial Advisors (2008)
GFOA Best Practice, Selecting and Managing the Method of Sale of State and Local Government Bonds (2007)
GFOA Advisory, Auditor Association with Financial Statements Included in Offering Statements or Posted on Web Sites (2006)

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