



TAXABLE ADVANCE REFUNDING OPEN MARKET DEFEASANCE ESCROWS TECHNIQUES TO GENERATE THE BEST BIDDING OUTCOMES

With the series of Fed rate cuts this year, we are seeing a growing trend in the use of taxable bonds to legally advance refund “in the money” eligible municipal debt. Market participants nationwide expect the market opportunity to last well into 2020.

Puget Sound Capital Services LLC (“PSCS”) has been managing the competitive procurement of open market securities (“OMS”) since the 1990s and has completed over \$3 billion of OMS transactions. In March 2019, with the SLGS window closed due to the federal debt ceiling, PSCS managed the competitive OMS escrow procurement for the City of Warren, MI and their advisor MCFI with a very successful outcome.

The goal is to fund escrow accounts with OMS purchases that create substantial value for municipal issuers, their advisors and underwriters with increased interest earnings and negative arbitrage savings. This requires a highly detailed and disciplined competitive bidding process focused on maximum OMS provider market coverage. The more providers solicited creates a more competitive bidding process and results in the best outcomes.

Pro-active management of the bidding process vs. passive management can result in different outcomes. We have seen many times where a bidding agent dutifully sends a bid package to three OMS providers and hopes for the best. Often in these passively managed situations, the number of bids received is less than the required three bids minimum and results in designation as a non-bona fide bidding process. This in turn results in the need to explain in the bidding agent certificate why the minimum three bids were not received. Often times the reason is OMS provider staffing (which may only be one or two professionals in some shops). A great example of this was during the period from 2017 through Q1 2018, when advance refundings were still permitted. During that period, OMS providers were seeing 50 plus deals a day (the equivalent of ten deals an hour or one deal every six minutes). Furthermore, if a provider was awarded a bid, it would have to stop further bidding in order to execute the awarded trade and process the trade tickets.

Over the years, PSCS has developed various techniques to mitigate the above challenges and increase OMS provider response and participation. Some of these techniques are shared below:

- 1) **Cast A Wide Net:** Instead of sending the bid package to just three providers, solicitations are sent to 8-10 providers thus increasing the chances of a bona-fide three bid plus outcome. The technique not only results in 3 or more bids most of the time, but also



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pushes the market to its limit. An example of this was a \$400 million escrow where the difference between winning and cover bid was \$1.00.

- 2) **Proactive Follow Up and Management of OMS Providers:** Once the bid packages are released to OMS providers, calling each provider by phone to confirm receipt of the bid package is necessary. Then on the morning of the bid, again calling each provider to make sure they are all set to submit their bid. Although this is extra work, the successful outcomes make it worthwhile.
- 3) **Bids Due Time Strategy:** During the heyday of tax-exempt advance refundings, most OMS bids were scheduled due either at the top of the hour or bottom of the hour. This created situations where providers had 3-5 bids all due at the exact same time. Since most providers wait until the last possible minute to submit their bid, it was not uncommon for a provider to miss the bid submission deadline due to bandwidth issues. To avoid this “traffic jam”, we schedule bid submission times to avoid top and bottom of the hour. During that time period, most bid submissions are due (for example) at 2:05pm or 1:50pm to avoid the “traffic” from other transactions.

PSCS can respond very quickly to transaction schedule needs and has successfully completed transactions with same-day notice (initial inquiry, document drafts, provider distribution, pricing and award on the same day). Efficient markets require, responsive, accurate and professional service.

Please reach out if we can help:

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