Negotiated Sale Analysis

The Division of Bond Finance is currently seeking approval to sell certain bonds through a negotiated sale. Under Florida Statutes and rules of the Division, there is a presumption that bonds of the State will be sold at competitive sale. However, bonds may be sold at negotiated sale if the Governing Board of the Division determines by resolution that a negotiated sale is in the best interest of the State.

Under Rule 19A-3.003, Florida Administrative code, there are certain factors which the Governing Board must consider in determining that a negotiated sale is in the best interest of the State. Those factors are: (1) unstable market conditions; (2) concerns regarding the credit quality of the State; (3) an unusually large bond issue; (4) whether the bond issue is for a new program; (5) the use of an innovative structure; and, (6) anticipated changes in laws or regulations which would make the prompt sale of bond desirable. The most important factor in determining the best method of sale currently is the unstable market conditions.

The credit crisis precipitated by sub-prime mortgages and mortgaged-backed securities has ripple throughout the financial system. The municipal bond market has also been caught-up in this turmoil. Since mid-September, the municipal bond market has experienced unprecedented volatility and has been frozen for all practical purposes. The number and dollar volume of transactions executed in the municipal bond market has been a very small percentage (15%-20%) of normal weekly flow. The dysfunctional bond market has prevented the State and other issuers from selling bonds needed to finance capital projects.

The interest rates available in the market has reflected the lack of demand by traditional institutional investors. Interest rates have been extraordinarily volatile. Interest rates have varied by as much as 10-20 basis points or more on any given day. The market clearing rate has been difficult to ascertain because of this volatility and limited primary market activity which normally facilitates price discovery.

Recently, the market has begun to operate on a limited basis. Investors are gradually becoming interested in high quality debt, such as that issued by the State. This demand, however, has been sporadic and varies day to day, particularly from institutional investors. The retail investor, on the other hand, is playing a much more significant role than experienced in the past.

Although the retail investor is assuming prominence in the current market, the use of competitive sale makes it difficult to access that sector of demand. Bidders are not able to make extensive pre-sale marketing efforts by contacting potential retail customers because they do not know whether they will win the bid for the bonds. As a result, the retail investor does not play a significant role in the competitive sale of bonds.

The significant turmoil and volatility of the credit markets makes assessment of the potential investor base at any point in time extremely difficult, particularly through the
normally successful competitive bidding process. A negotiated sale is more likely to be the most effective method of sale given the difficult market conditions, to access the retail market, identify times when institutional investors are interested and enter the market to take advantage of opportunities as they present themselves. Furthermore, a negotiated sale would allow for the necessary pre-sale marketing to effectively access the retail investor base.

Given the current instability and volatility in the municipal bond market, I believe that providing the Division with the authority to sell State bond issues on a negotiated basis is in the best interest of the State as it would provide the best opportunity to strategically access the credit markets and provide a more thorough marketing and distribution of the State’s bonds to achieve the lowest possible interest rates. Therefore, it is my recommendation that the Governing Board authorize the negotiated sale of State bonds as may be determined to be necessary by the Director of the Division from time to time based on prevailing market conditions and that a syndicate of underwriters be selected to execute any negotiated sale of bonds.