



City of Olathe

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Title: Consideration of an Agreement with JP Morgan to serve as underwriter for the 2020-A Temp Notes to provide capital project funding, including redeeming a portion of the Series 2019-A Notes.

Sponsors: Dianna Wright

Indexes:

Code sections:

Attachments: 1. Attachment A: JP Morgan Agreement

| Date | Ver. | Action By | Action | Result |
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DEPARTMENT: Resource Management

STAFF CONTACT: Dianna Wright

SUBJECT: Consideration of an Agreement with JP Morgan to serve as underwriter for the 2020-A Temp Notes to provide capital project funding, including redeeming a portion of the Series 2019-A Notes.

ITEM DESCRIPTION:

Consideration of an Agreement with JP Morgan to serve as underwriter for the 2020-A Temp Notes to provide capital project funding, including redeeming a portion of the Series 2019-A Notes.

SUMMARY:

The City generally issues both general obligation notes and bonds every year during the spring/early summer months. The notes are sold with an approximate one-year maturity and they are paid-off with a combination of new long-term general obligation bonds and a new issuance of short-term notes during the subsequent year. It is very important that the new notes are issued timely so that the City has funds readily available to pay off /roll over its outstanding notes. The City approaches the market with a competitive public market auction. In a competitive auction, underwriting firms are invited to submit their best bid for the City's offering-a process not unlike a bid on a dump truck or a load of road salt. In normally operating markets, our experience shows that for highly rated issuers (such as the City) with straightforward offerings, a competitive auction typically results in the lowest cost financing.

The table below illustrates the bidding history of the City's notes since 2013.

| Note Series | Winning (Best) Bid | Number of Bids |
|-------------------|--------------------|----------------|
| 2019-A JP Morgan | (1.43%) | 4 |
| 2018-A JP Morgan | (1.58%) | 3 |
| 2017-A JP Morgan | (1.03%) | 2 |
| 2016-A Hutchinson | (0.79%) | 4 |

| | | |
|-----------------------|---------|---|
| 2015-A US Bank | (0.51%) | 3 |
| 2014-A Morgan Stanley | (0.23%) | 2 |
| 2013-A Morgan Stanley | (0.23%) | 3 |

COVID-19 and the Municipal Market

Columbia Capital, the City’s financial advisor, has been sending regular market updates to City staff regarding the major market disruption during the COVID-19 crisis. The COVID-19 crisis roiled the municipal bond market much as it did most financial markets in the US and around the world. Since the outset of the crisis in the US, we have seen benchmark ‘AAA’ tax-exempt bond yields increase 2.0% in just 11 trading days, drop 1.5% over the subsequent six trading days, increase 0.8% in the next three trading days, drop 0.7% over the next ten trading days and, finally, increase about 0.3% over the most recent seven trading days.

By mid-March, the municipal bond market had more or less ceased to function. While we have seen gradual healing in the market in recent weeks, the vast majority of transactions being executed today are high-quality (‘AAA’ and ‘AA’ rating categories) with either general obligation (property tax-based) or essential service revenue (water, sewer, electric) sources of repayment. Short-term municipal markets also ceased to function, with interest rates on daily- and weekly-reset variable rate bonds soaring into low double-digits. Subsequent action by the Federal Reserve has returned short-term interest rates to pre-crisis levels, but the short-term municipal market remains fragile.

The City’s note offerings generally fit within the categories of deals getting done in today’s market, but the current market conditions coupled with recent low participation of bidders on the City’s notes via competitive sale gives us pause. As a failed bid for the City’s notes would have negative consequences-and due to concerns about the functioning of the short-term market today-Columbia Capital recommends the City pursue a different method of sale for its notes this year.

Recommendation - Negotiated Public Markets Underwriting

If the City were to not receive a bid, Columbia would likely be able to piece together a private loan or a negotiated sale on a highly condensed financing schedule in time to pay off the existing notes, but that approach is more reactive than proactive. Plus, the outcome is certainly not guaranteed. Given the circumstance, Columbia Capital believes the City is better served with a negotiated public offering on its notes.

For this sale method, the City selects an underwriter to work with directly (as opposed to an auction), and with Columbia’s assistance, negotiates the cost of the loan with that preselected underwriter based on investor demand and market conditions on the day of the sale. Leading into the sale the underwriter will market directly with investors most interested in the City’s notes, going over the structure of the offering and any questions they may have about the City’s credit. Often times, they are able to “pre-sale” the offering before the notes are officially offered for sale. This method creates significantly more certainty that the notes will be sold in this challenged market.

In determining which underwriter to select we looked at the City’s prior competitive auctions to see which underwriters have supported the City’s note offerings. As can be seen in the table above, JP Morgan has won the most (and the last three in a row) bids over the last seven years. This indicates that they (1) understand the City’s note structure and historical issuance practices, (2) are familiar with the City’s credit, and (3) already have key investor marketing leads. JP Morgan is also a top underwriter of municipal credits with a solid reputation and strong underwriting capability. Given the

time sensitivity and importance of this note offering, Columbia Capital recommends the City appoint JP Morgan as underwriter on its 2020-A Notes.

FINANCIAL IMPACT:

The only cost of issuance item that differs from a competitive sale is the addition of an underwriter's counsel. Underwriter's counsel represents the underwriter and reviews (and may contribute to) the offering document and other legal documents. Further, they are also primarily responsible for drafting a note purchase agreement between the City and the underwriter. JP Morgan's proposal has a not to exceed fee of \$18,000 for this service and will pay their counsel directly.

ACTION NEEDED:

Approve the Agreement

ATTACHMENT(S):

Attachment A: JP Morgan Agreement