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No-Bid Sales Drop as Philadelphia Chooses Auctions.

U.S. states and cities are selling bonds via competitive bidding at the fastest pace in more than a decade as officials strive to cut costs almost five years after the recession.

Localities have issued $22.8 billion of bonds via auction this year through May 2, or about 27 percent of sales in the $3.7 trillion market, data compiled by Bloomberg show. That's the highest rate since the figures begin in 2003, and is up from 15 percent in 2009.

Auctions account for almost half of New York's sales, marking a shift from negotiated deals where rates are set in discussions with underwriters. Philadelphia said in April that its first competitive deal in eight years saved $7 million on a $65 million offer. Buffalo said last month that 18 bidders for $33 million of securities reduced borrowing costs.

"It's helping us get the lowest possible rates for our taxpayers," said Patrick Curry, executive assistant to Buffalo Comptroller Mark Schroeder. "We're finding we get very good rates when there is more competition."

Wall Street banks are fighting for dwindling business. The municipal market shrank the past three years as officials hesitated to embark on projects even with yields close to generational lows. Soliciting bids for bonds means governments are choosing the same process they use to buy asphalt and toilet paper. They've cut costs elsewhere: Combined state and local payrolls are about 660,000 below 2008 peak levels.

On Target

New York, the third-most-populous state, raised competitive sales to 49 percent in fiscal 2013-2014 from about 2 percent in 2009, state data show.

"Our goal of selling half our bonds on a competitive basis reflects our belief that doing so will lower borrowing costs, increase transparency and provide an essential benchmark for bonds sold on a negotiated basis," Morris Peters, spokesman for New York's budget division, said in a statement.

Municipalities' use of bidding may increase as a ban on underwriters serving as advisers takes effect July 1, said Joy Howard, principal with WM Financial Strategies, a financial adviser in St. Louis.

Advisers' Duty

"Financial advisers have a fiduciary duty and will have to recommend the method of sale they believe will produce the best result," said Howard, whose clients often use bidding. "For most highly rated general-obligation bonds, it will be difficult to suggest that a method of sale other than competitive bidding is best."

Missouri's state auditor, Thomas Schweich, pushed legislation this year to boost competitive sales

after a 2013 study found local issuers, who used negotiated deals 88 percent of the time from 2008 to 2011, could have saved $43 million with auctions. The plan drew opposition from investment banks that stand to earn fees on negotiated business, said Jeff Earl, senior legislative adviser to the auditor.

“The opposition was able to get enough lawmakers to keep it from passing,” Earl said. “This could save school districts some money.”

While local officials and academics say that negotiated sales are needed during volatile markets, “the competitive method is less costly for government in most cases,” Craig Brown, assistant professor of finance at the National University of Singapore, said by e-mail.

Pricing Variation

Securities sold in negotiated sales are underpriced by as much as 4.7 percent, according to a 2011 study by Brown, whose research includes methods of sale in the U.S. municipal market.

“The competitive method seems to be better for taxpayers on average,” said Brown. That route also is “less prone to corruption” because auctions determine which underwriters win the deals, he said.

In October, St. Louis-based underwriter L.J. Hart & Co. agreed to pay a $200,000 fine to settle charges by the Financial Industry Regulatory Authority that it violated rules on gifts by giving local official tickets valued at $183,546 to sports events over three years. The firm didn’t admit or deny breaking Municipal Securities Rulemaking Board rules.

The gifts were to thank clients, not to win business, Larry J. Hart, founder and principal, said in an interview.

“Our firm’s policy on giving tickets to sporting events has always been restricted to existing clients as appreciation for past business transactions and as reminder advertising between financings,” he said. “We never offer tickets as an inducement to non-clients to select our firm as the municipal bond underwriter.”

California Approach

California, the most-indebted state, uses both methods, sometimes within weeks. The most-populous state sold about $1.8 billion of bonds through negotiation in March, followed by $750 million in April via bidding.

In eight segments with similar maturities, the competitive sale had narrower yield spreads than the negotiated, by as much as 0.36 percentage point, Bloomberg data show.

The sale method didn’t drive the lower yields on the competitive sale, said Tom Dresslar, spokesman for Treasurer Bill Lockyer. He attributed the lower cost to an improving financial picture as the state enjoys its biggest surplus in more than a decade.

“In both the March and April deals, we got the best possible price for taxpayers,” said Dresslar. “It’s difficult to provide a valid comparison when you look at the spread.”

Size Matters

The state generally sells deals under $1 billion competitively and those over $1 billion via

negotiated. The larger deals often require added compensation for underwriters, he said.

“A one-size-fits-all approach would not serve our citizens well,” he said.

Competitive sales have risen in part because of a drop in refinancing to lower interest costs, according to the Securities Industry and Financial Markets Association, which represents investment banks. One type of refunding requires negotiated sales to complete the transactions.

“In the last few years, refundings have comprised a big part of the market,” said Michael Decker, managing director and co-head of munis at the group.

About 49 percent of issuance this year through April 23 was related to refunding, compared with 61 percent a year earlier, according to Bank of America Merrill Lynch data.

‘Strong Pricing’

Philadelphia, which sold long-term debt competitively in April for the first time since 2006, said it doesn’t plan to halt negotiated sales. At the same time, it cited $7 million in savings, partly because 14 bidders competed.

“We got very strong pricing, and part of that is because of the competitive sale,” Nancy Winkler, city treasurer, said in an interview. “It saved us money.”

Municipalities’ challenge in negotiated sales is showing that they got a good price, said Bob Eichem, chief financial officer for Boulder, Colorado. The case for negotiated sales is stronger with new or infrequent borrowers, he said.

“The thing with a competitive sale is that you know on the day you sold you got the absolute lowestinterest rate possible,” said Eichem, who has been in city finance for 35 years. “With negotiated sales, it’s difficult to say you got the absolute lowest.”

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