Bond Case Briefs

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Startups Seek to Democratize the Muni Market.

They're bringing in new investors, big and small, to disperse the power and lower interest rates. It's already paying off for some governments.

For all the post-recession financial market reforms, few ultimately made their way to the municipal bond market. For the most part, the muni market remains a low-tech place by Wall Street standards, and one that's still largely controlled by the same group of big investors.

"The muni market has a lot to do with relationships, power and influence," said Rob Novembre, a former trader who has spearheaded a new alternative bond trading system. "The bigger you are as an account, the more attention you get from sellers. If you buy bigger blocks [of bonds], that gets you more power."

Thanks to Novembre's new startup and another in San Francisco, though, that's starting to change. The two companies are not only set to give the market a tech update but also to bring it more buyers. The idea is that more buyers will increase demand for municipal bonds and, in turn, will net governments lower interest rates on their debt.

The startup in San Francisco, Neighborly, goes about finding new buyers by marketing muni bonds to investors with a personal or social interest in the project those bonds are funding. A key component of Neighborly's tactic is that it uses technology to cut down on the costs associated with brokering bonds. This allows it to sell the bonds directly to individuals and in smaller denominations — such as $1,000 blocks — than is typical.

"Like any financial product, it's supply and demand," said head of public finance, James McIntyre. "What we're trying to do is increase the demand side … by helping individuals and institutions find the bonds that meet their investment criteria."

Neighborly recently announced six projects it plans to help take to market next year, ranging from parks improvements in Burlington, Vt., to a new fire truck for Lawrence, Kan.

The other startup, ClarityBidRate, brings in new buyers by focusing on variable rate debt, which went out of fashion after the 2008 market collapse but is making a comeback in the current low interest rate environment. Unlike a 30-year bond that pays out the same "fixed" interest rate for the life of the bond, variable rate debt's interest rates reset weekly. It's a way of paying short-term rates, which are lower, for debt that is long term.

Traditionally, marketing agents for an issuer reset the interest rate themselves. The rate is determined by what the buyers who work with that agent's trading desk will accept. But Novembre's Clarity sidesteps the middleman and essentially works like an electronic stock exchange solely for variable rate debt. So instead of an agent resetting the price, buyers bid on the bonds every week. The buyers aren't just big institutions but anyone who has signed up to trade on the platform. The interest rate is set by the lowest price for which the bonds will sell each week.

Clarity has already drawn the attention of Ohio, which recently put $32.3 million of its variable rate debt on the platform. Up until now, rate-setting by marketing agents has been done “in a black box,” said Seth Metcalf, the state’s deputy treasurer. Metcalf says he’s never sure if he’s getting the best possible interest rate every week on his debt.

“I want to trust these people but … I’m concerned there’s disproportionate influence within the buyers’ market,” he said.

The experiment is paying off. On the fifth interest rate reset, Ohio’s variable rate debt fetched a better interest rate on Clarity than the industry average for issuers like Ohio. The rate even beat three of the four marketing agents that Ohio has working on a separate package of variable rate debt it issued through traditional channels.

Clarity also gives sellers the benefit of seeing real-time information about who’s buying his debt, and he’s been pleased to find that it is indeed attracting buyers large and small.

“It democratizes power,” he said. “It doesn’t matter if you’re a little broker dealer in small town Ohio or the largest fund in the world. I’m going to pay the best interest rate that somebody’s willing to take.”

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