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Muni Mispricings Seen Stinging Taxpayers for Up to $25 Billion.

- **Consultant study finds prices rise 1.6 percent in early trades**
- **That suggests the debt was priced too low, Fideres says**

Every time America's states and cities sell bonds to build new roads, schools and bridges, they may be leaving a big chunk of money on the table.

Investment banks, which governments hire to line up buyers for their bonds, routinely underprice the securities, delivering gains to early investors at taxpayers' expense, according to a study by Fideres Partners LLP, a London-based consulting firm. It found that bond prices increased by an average of 1.6 percent soon after they were first sold — indicating governments could have raised over $25 billion more from 2006 to 2015 if the debt was sold at those higher prices.

"The reason why these bonds trade so heavily and go up in price so much right after issuance is because people think the issuers overpaid — that that bond is worth more," said Alberto Thomas, who worked on the study. "Someone in that process has not done their job properly."

The $3.8 trillion municipal-bond market is the key way that local governments finance construction projects, so any failure to adequately price the securities would be felt broadly. President Donald Trump has sought to encourage states and cities to pump more money into airports, roads and other infrastructure, some of which was neglected as governments dealt with the economic fallout of the Great Recession.

Other research has raised questions about the efficiency of the municipal market. A study released more than a decade ago by professors at Carnegie Mellon University found "substantial" underpricing of new issues. And others have asserted that governments could save money by selling their debt more frequently in competitive auctions, instead of the typical practice of relying on underwriters picked ahead of time.

Fideres, which also studied the rigging of the Libor benchmark interest rate and often prepares research for use in class-action lawsuits, looked at 8,000 tax-exempt bond issues sold between 2006 and 2015 worth about $1.1 trillion. It was limited to fixed-rate deals above $50 million sold through both negotiated and auction sales.

The price increase from the day the bonds were awarded until the settlement date was "abnormally high" compared to other asset classes, the report said. Corporate bonds rose about 0.64 percent — less than half as much as the munis — while U.S. Treasuries gained 0.33 percent, the firm said. Fideres has previously asserted that the gap shows that corporate debt is being "systematically underpriced," too.

For municipal bonds, those early increases have been shrinking, potentially because low interest rates — which have pushed up debt prices — have given the securities less room to rise. In 2010, prices rose an average of 1.88 percent between the initial pricing and the close date, according to

Fideres. That shrank to 0.85 percent in 2015.

The Securities Industry and Financial Markets Association, the trade group for underwriters, hadn't seen the study and declined to comment, spokesman Katrina Cavalli said.

Underwriters may have a reason to underprice securities: They often retain a portion of the bond issue after a sale, which means they'll benefit if the price climbs, the report said.

"Knowing a bond price will increase shortly after issuance allows them to generate trading profits, incentivizing them to set lower issuance prices," the report said.

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