When More Banks Compete for Municipal Debt, States and Towns Win.

- **Number of banks bidding on new deals rose in last decade: MSRB**
- **Soliciting more bids lowers interest cost for issuers**

Municipal-bond auctions are getting more competitive, shrinking underwriters' profits and lowering borrowing costs for taxpayers.

The average number of bids state and local governments receive when putting bonds up for auction has increased over the past decade to 5.7 per issuance in the first half of 2019, up from 4.4 in 2009, according to research published Monday by the Municipal Securities Rulemaking Board.

And issuers who get more bids on their bonds have lower borrowing costs. Winning banks' profit margins for competitive offerings decline to less than 0.02% with 18 or more bids compared with 0.19% with one bid, on a true interest cost basis, according to a paper by Simon Wu, the MSRB's chief economist. On offerings with net interest cost bids, spreads declined to around 0.02% with 10 or more bids from 0.36% with one bid.

"All things being equal, soliciting more competitive bids does indeed improve an issuer's selling price and reduce the yield cost for the issuer," wrote Wu, who will present the findings at the Brookings Institution's Municipal Finance Conference.

Last year, about 24% of long-term debt by par value issued by state and local governments were sold through competitive bids, according to data compiled by Bloomberg. Issuers post public notices asking banks to make proposals and award the debt to the bidder offering the lowest interest cost. The other 76% are done through negotiated underwriting, where municipalities select a bank to price and sell the bonds, similar to an initial public offering in the stock market.

On short-term note sales, municipalities favor the competitive method, auctioning 84% of all notes.

Some academics have found competitive bond-issues result in lower borrowing costs than negotiated deals. While a number of studies compare competitive and negotiated municipal offerings, there's scant research on competitive deals exclusively, said Wu in an interview.

The average number of competitive bids received per issuance increased regardless of the size of the deal, a state's population or per capita income, according to Wu's paper.

And while the average number of bids received has gone up over the last decade, the competitiveness of the bids has also improved. The difference between winning bids and the lowest bid fell to 0.183% in 2019 from 0.383% in 2009. The difference between the winning and cover bid fell to 0.025% from 0.071%

The increase in bids and decline in spreads between winning and other bids may be a result of improved technology and information transparency in the market, as well as factors such as interest rates and volatility, the MSRB paper said.

“As a result, underwriters may be increasingly submitting more informed bids so that competitive bids from different underwriters have become more clustered together.”

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