[Bond Case Briefs]

Municipal Finance Law Since 1971

[The Democratic Municipal Bond Market.]

***In response to a Barron's story from September 22, 2020**

In "'[You're Cornered if You're a City.' How Concentration in the Municipal Bond Market Is Raising Borrowing Costs]" (Barron's, September 22, 2020), Garphil Julien tries to make the case that a "concentration of power" among banks and securities firms in the municipal bond market harms state and local governments. Unfortunately, the author does not have a clear understanding of the market and made several factual misstatements. Further, the author never explains the concentration of the municipal bond market or how the purported concentration increases borrowing costs.

The municipal bond market is the opposite of concentrated. It is instead the most democratic sector of our capital markets.

A defining characteristic of the municipal market is its breadth and diversity. There are 15,000 states, cities, towns, school districts, water and sewer authorities and numerous other categories of issuers who access the market and more than one million individual municipal securities outstanding. Most deals in the municipal market are small—the average new issuance last year was just $37 million. The diverse and small nature of the market drives its structure. Most big Wall Street firms focus on big transactions and simply are not interested in the hundreds of small deals sold every year.

The diverse nature of the market means those who serve the market are also diverse. Look at the 2019 "league tables," the market share rankings for municipal bond underwriters. Big Wall Street firms certainly feature prominently among the nation's top 20 underwriters. But so do "Main Street" regional underwriters in places like Minneapolis, Dallas, Chicago, and Great Falls, Montana. Due in part to decades of effort by local governments around the country to engage women and minority owned firms in their transactions, several MWBE underwriters are also in the top 20 municipal underwriters.

These smaller regional companies serve their clients well. But they are hardly Wall Street powerhouses, and their success demonstrates the lack of concentration in the market.

The diverse nature of the market makes it possible for small towns and school districts to borrow at low fixed rates for terms up to 30 years and longer. The municipal market is an extraordinary product of our federal system of government and is the envy of other countries.

There are other issues with the piece. The author seems to conflate two widely used municipal pricing benchmarks, the Refinitiv MMD Scales and the SIFMA Municipal Swap Index. The two benchmarks are used quite differently. MMD is an estimated yield curve generally used to price new municipal bond issues. The SIFMA Swap Index, on the other hand, is compiled from re-marketings of certain variable rate municipal bonds and was designed as a means to set rates for municipal interest rate swaps. We are aware of no controversies surrounding the SIFMA Index.

In addition, the author quotes a source referring to local governments saying "You have no choice but to turn to financial markets, and they are well-positioned to extract high interest rates." This is perhaps the most misleading point in the piece. High grade municipal issuers today can sell bonds at the lowest rates since the 1940s. Where are these "high interest rates" that underwriters are ostensibly extracting?

Without identifying municipal market concentration or how that purported concentration leads to higher borrowing costs, the author argues that state bond banks may be a solution to the phantom "concentration of power". Bond banks can be an effective financing tool, but they do not change the nature of the issuance process or the relationship between the issuer and the market.

Instead of, say, a school district accessing the market on its own, the state serves as issuer and re-lends the proceeds of the sale to the relevant borrowers. But the issuance process is the same. The bond issuer still negotiates with underwriters on deal pricing, and investor demand still drives the rates that issuers pay. Moreover, unlike direct bond issuance by the school district, the bond bank transaction is more likely to be underwritten by Wall Street firms that the author seems to think are at the heart of the "problem" in the municipal bond market. Bond banks are not a magic bullet for anything.

One point where we agree with Mr. Julien is that state and local governments are in a fiscal crisis. Governors have told Congress that states need $500 billion of federal help in order to maintain state and local government employment and services as the economy recovers from the pandemic and shutdown.

Bond banks will not fill the gap. Only Congress can address this problem.

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October 7, 2020