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Muni Underwriters Cut Fees in Takedown Race-to-Bottom.

- **Massachusetts' documents show how little banks' will charge**
- **But there may be a hidden downside for states and cities**

Every once in a while, a state or local government's request for underwriting services will have a question that illuminates what's going on in the municipal-bond market at large.

Massachusetts' request from May 2020 is one of them. It asked for something rather mundane — their underwriting takedown for every $1,000 of bonds sold. That's effectively what the banks' main fee would be upfront, a key measure of the total cost of floating a bond issue.

Underwriting fees have declined steeply since the 1980s, when negotiated fees were more than $20 per $1,000 of bonds, and had more or less continued on the downward drift in recent years. This year, they're around $5.15 overall, according to data compiled by Bloomberg.

But for a big-name client like Massachusetts, underwriters, it seems, are willing to work for much less. Sue Perez, the state's Deputy Treasurer for Debt Management, said the takedowns on its bond deals has been in the $2 to $3 range since at least 2014.

Sixteen banks applied to underwrite all three transactions mentioned in the RFP. None wanted more than $3, according to copies of the responses received through a public records request. Bank of America Corp., the market's underwriting behemoth, was willing to work for just 50 cents, as was Morgan Stanley, on one-year maturities. Both won top slots.

I was shocked because I hadn't realized takedowns had shrunk to so little. But David Erdman, Wisconsin's capital finance director, assured me in an email that this collapse had come in the past two or three years, and that "starting 3-4 years ago firms have stopped even asking for a management fee," formerly levied for running a syndicate.

This takedown death-ride has come as a result of both issuers and their advisers pressing for it, but also banks on their own just offering it, said Erdman. There's often been a shortage of bonds to go around, and banks have been eager to land inventory for their clients.

All told, this seems like a great thing. That means it costs municipalities less to gain access to the bond market, right?

And this is true, but there are two elements to "how much you pay." The first is one-time professional fees, like those for underwriters, that are transparent. The second is how the actual bonds are priced, which has a much more long-term and costly impact, and is more murky.

Lee McElhannon, director of bond finance for the Georgia State Financing and Investment Commission, said the more those transparent fees are cut the more important it is to see whether the banks are underpricing the bonds.

That would make it a lot less work to sell them and maybe even deliver a quick gain to early investors. But all that would come at the government’s expense, which perhaps could have paid a lower interest rate for many years to come.

This seems especially important for smaller issuers who may not have the knowledge or ability to evaluate how their bonds are priced, or who may not even care. You would do well to remember that most of the municipal market’s issuers — beyond states, major authorities, some large cities and counties — are small and relatively unsophisticated.

“Your financial adviser better be very good at pressing them on preliminary and final scales, and even then you might see some interesting secondary market trades for a week or so after pricing,” McElhannon said in an email. “Underwriters are pricing bonds so they move the bonds and don’t take on any (significant) risk.”

That may not be the case for big, sophisticated issuers like Massachusetts, who comprise a very small portion of the market. Yet other public officials chasing after those rock-bottom fees may do well to remember that sometimes, well, you get what you pay for.

Bloomberg Markets

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August 24, 2021