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Transaction Costs for Municipal Bonds Rose for Retail Investors.

- **MSRB report says spreads surged as securities' prices dropped**
- **Effective spread widened to 54.5 basis points from 40 in 2021**

Transaction costs for retail investors buying municipal bonds in the secondary market have jumped since 2021 as falling bond prices have made the securities riskier for dealers to hold, according to a study released on Tuesday.

The gap between the yield where dealers buy or sell a security, known as the effective spread, has widened to 0.545 percentage point, or 54.5 basis points as of March. That's up from 52.9 bps in 2022 and 40.1 bps in 2021, according to the report from the Municipal Securities Rulemaking Board, an industry regulatory body.

The steady rise in interest rates since last year has broadly eroded the value of fixed-income securities. The Federal Reserve started increasing the so-called federal funds rate in March 2022 to combat inflation. After 11 increases, the top of the range for the rate stands at 5.50%.

That's pushed down the price of bonds, with longer-term debt generally hit the hardest. Municipal bonds that trade at below their face value are often harder for dealers to sell, because any gains on the principal can be taxable, making the debt less attractive to the wealthy investors that often focus on tax-free bonds.

Dealers finding it harder to sell the bonds can translate to wider gaps between the prices at which brokerages will buy and sell securities, according to the MSRB. Also, brokers often charge fixed markups on securities, so when bond prices fall, transaction costs as a percentage of the purchase price will rise.

The report focused on trading costs for transactions in about the \$25,000 to \$100,000 range, often viewed as a proxy for retail trades. For institutional investors, trading costs moved much less. The effective spread on trades over \$1 million rose from 17.4 basis points in 2019 to 17.9 in 2021 and 18.1 in 2023.

The kind of customers who engage in transactions of \$1 million and above probably agree upon a price with their dealers before a trade goes through, said Simon Wu, MSRB chief economist and lead author of the report.

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By Joseph Mysak Jr

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