

Brookings Institute 13th Annual Municipal Conference

Markup or Markdown: National Underwriters' Exit
and the Changing Landscape of Municipal Finance

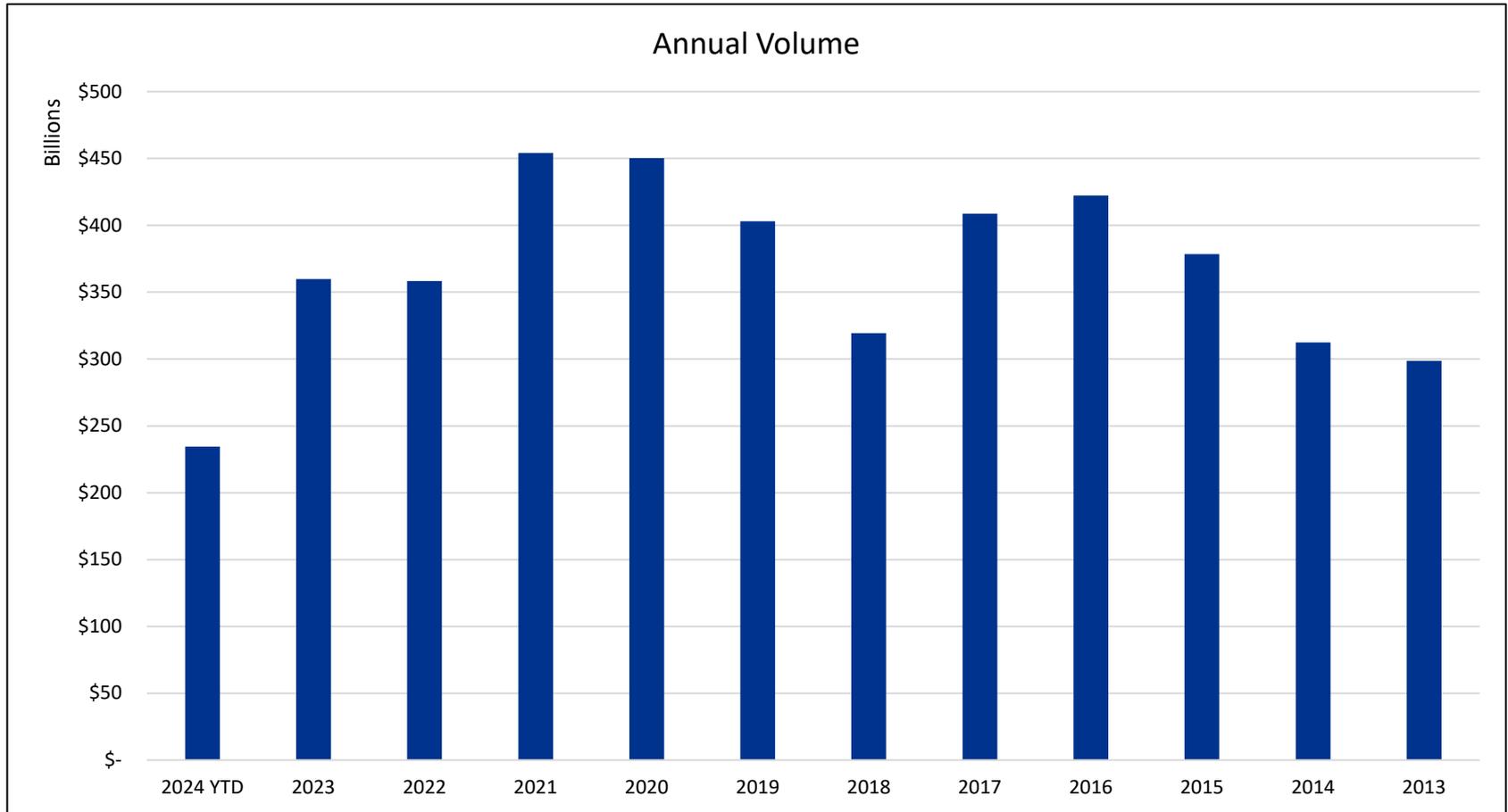
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Thursday, July 18th





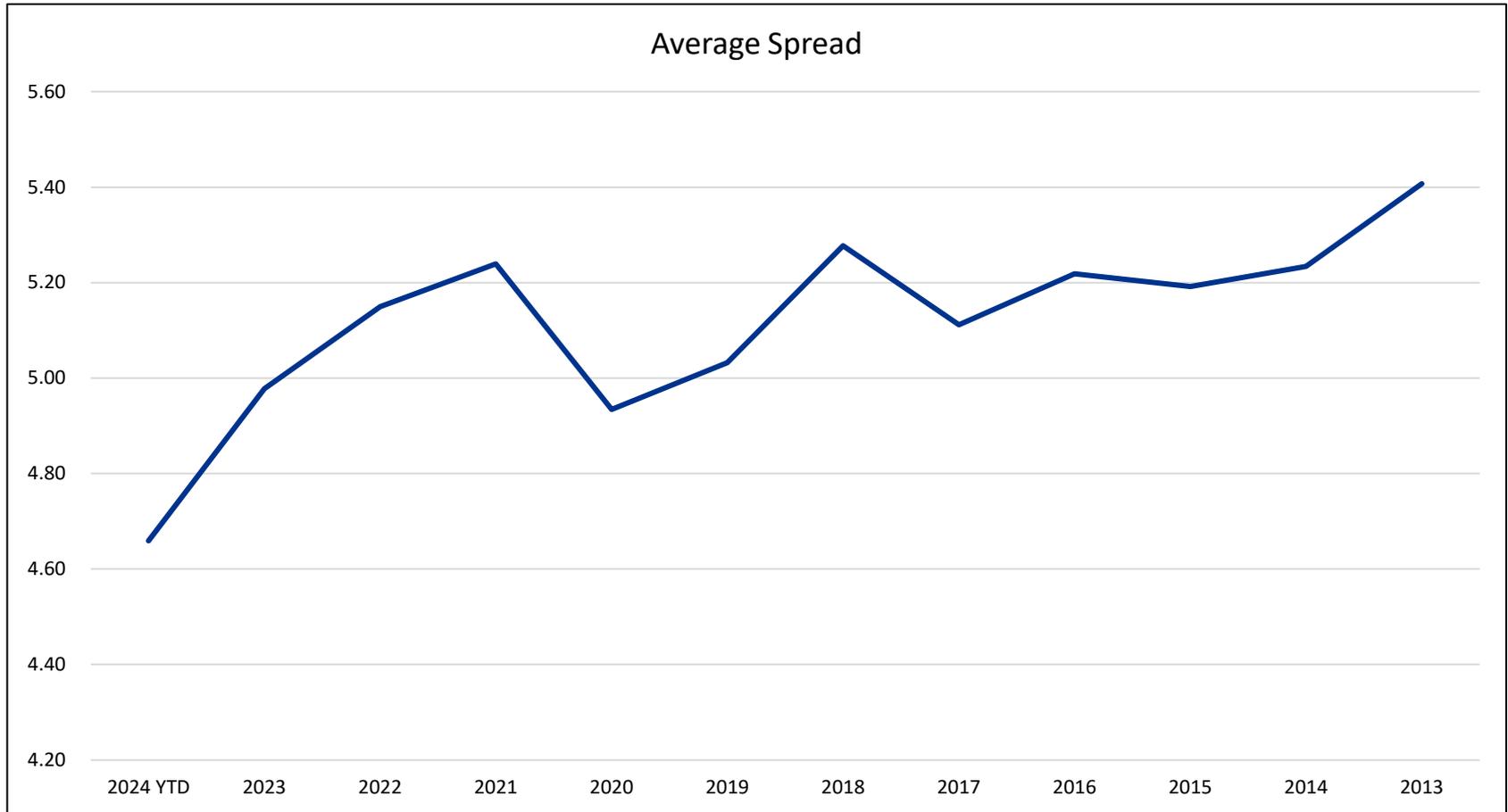
Annual Municipal Bond Issuance



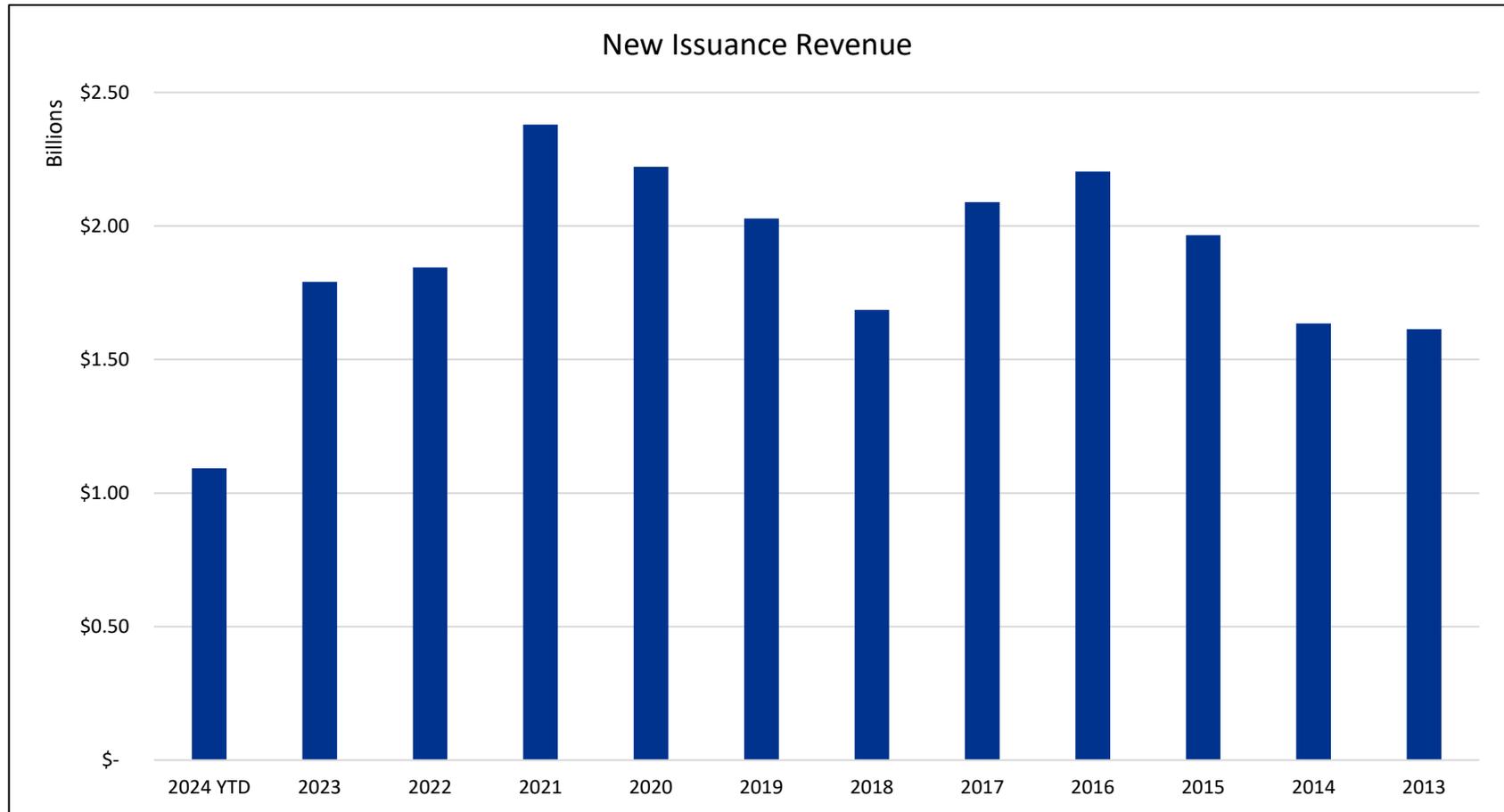
Source: Bloomberg



Average Price Per Bond



Source: Bloomberg



Source: Bloomberg



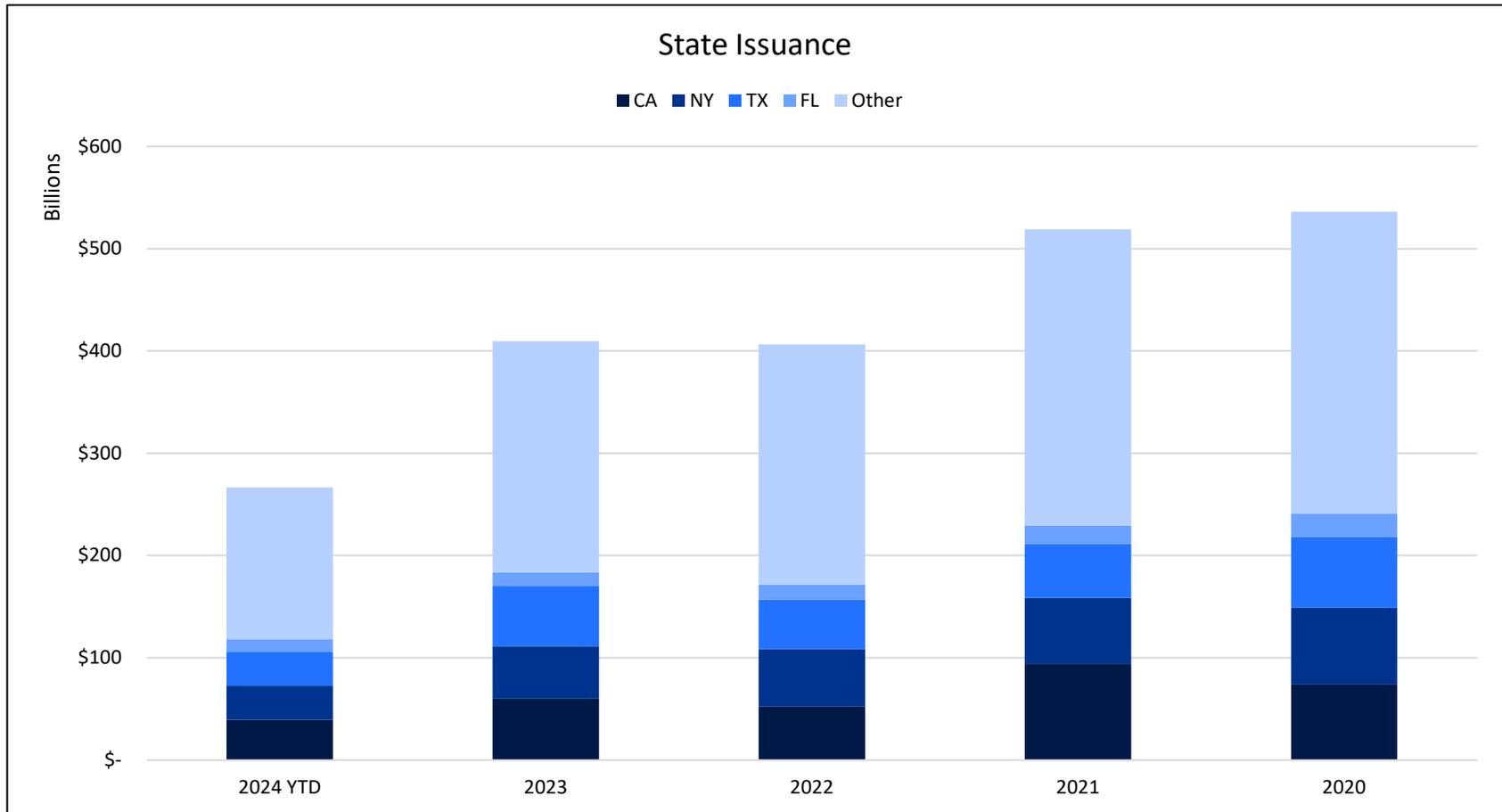
The Article v. The Market

The Article

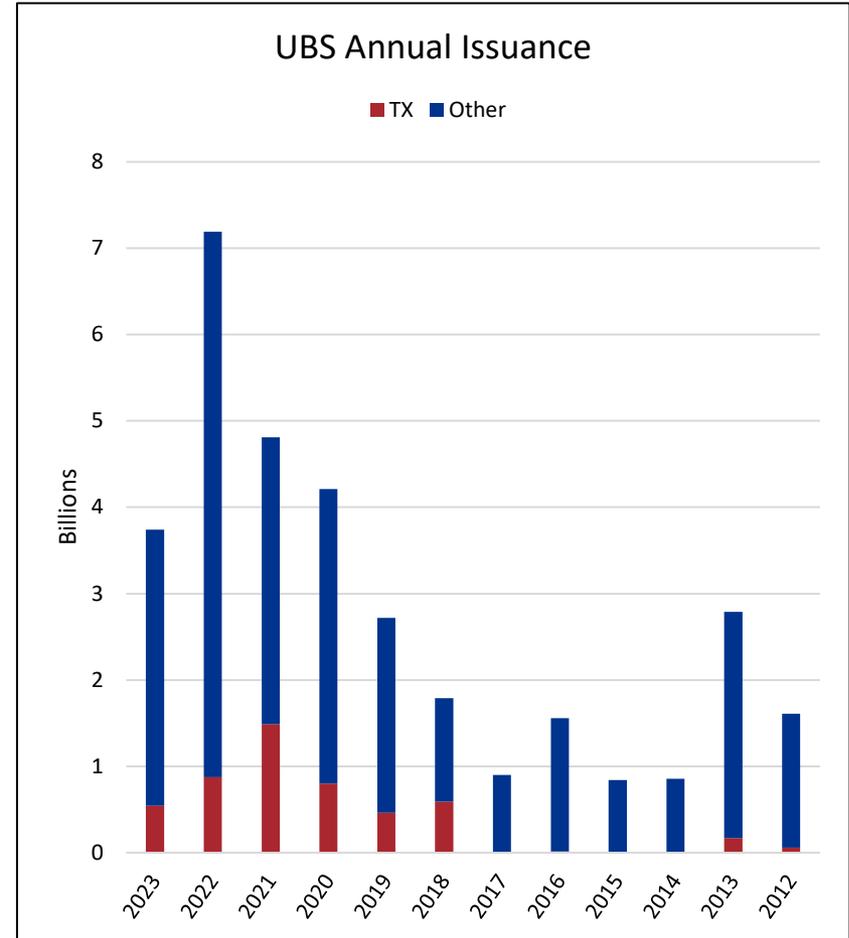
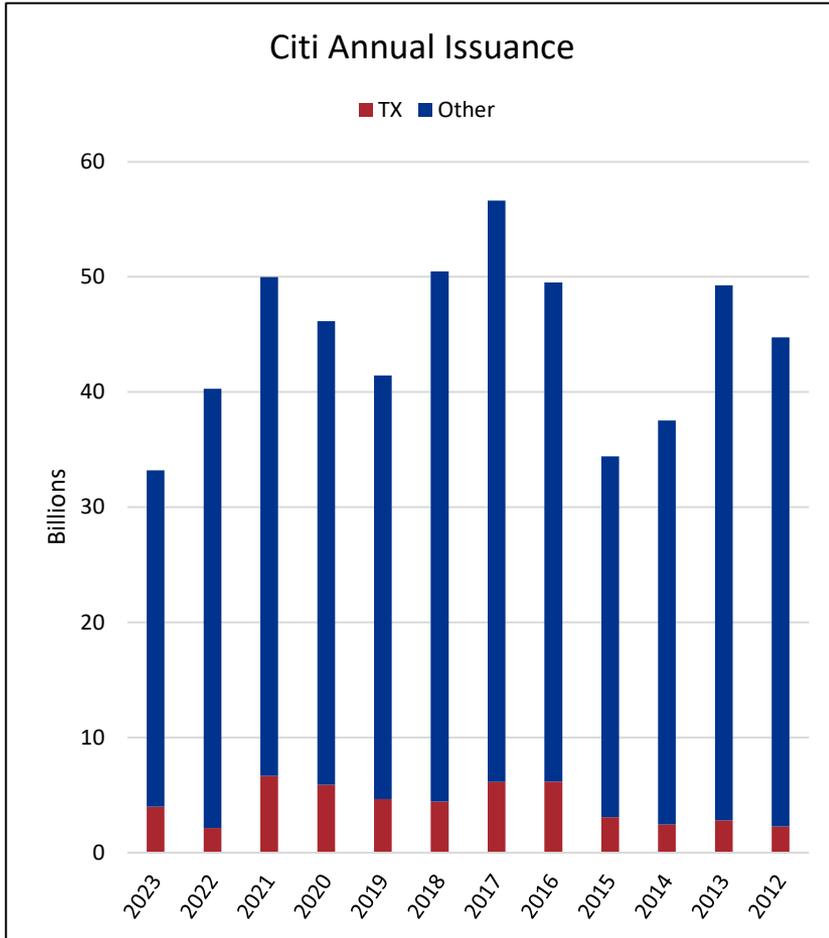
- “Being banned from accessing one market – albeit a large one (Texas) – hardly seems a reasonable justification for exiting the underwriting business altogether especially when these underwriters are present in almost all states across the U.S”.

The Market

- We agree. It is important to review the Citigroup and UBS departures in the context of market dynamics.
- Significant decline in municipal market issuance in 2022 and 2023 decreased revenue potential which likely occurred faster than firms were able to reduce expenses.
- It is important to consider the revenue contribution of public finance to overall corporate revenues. Based on Bloomberg data, new issue municipal revenue accounted for less than 1% of total revenues for Both Citi and UBS.



Source: Bloomberg



Source: Bloomberg



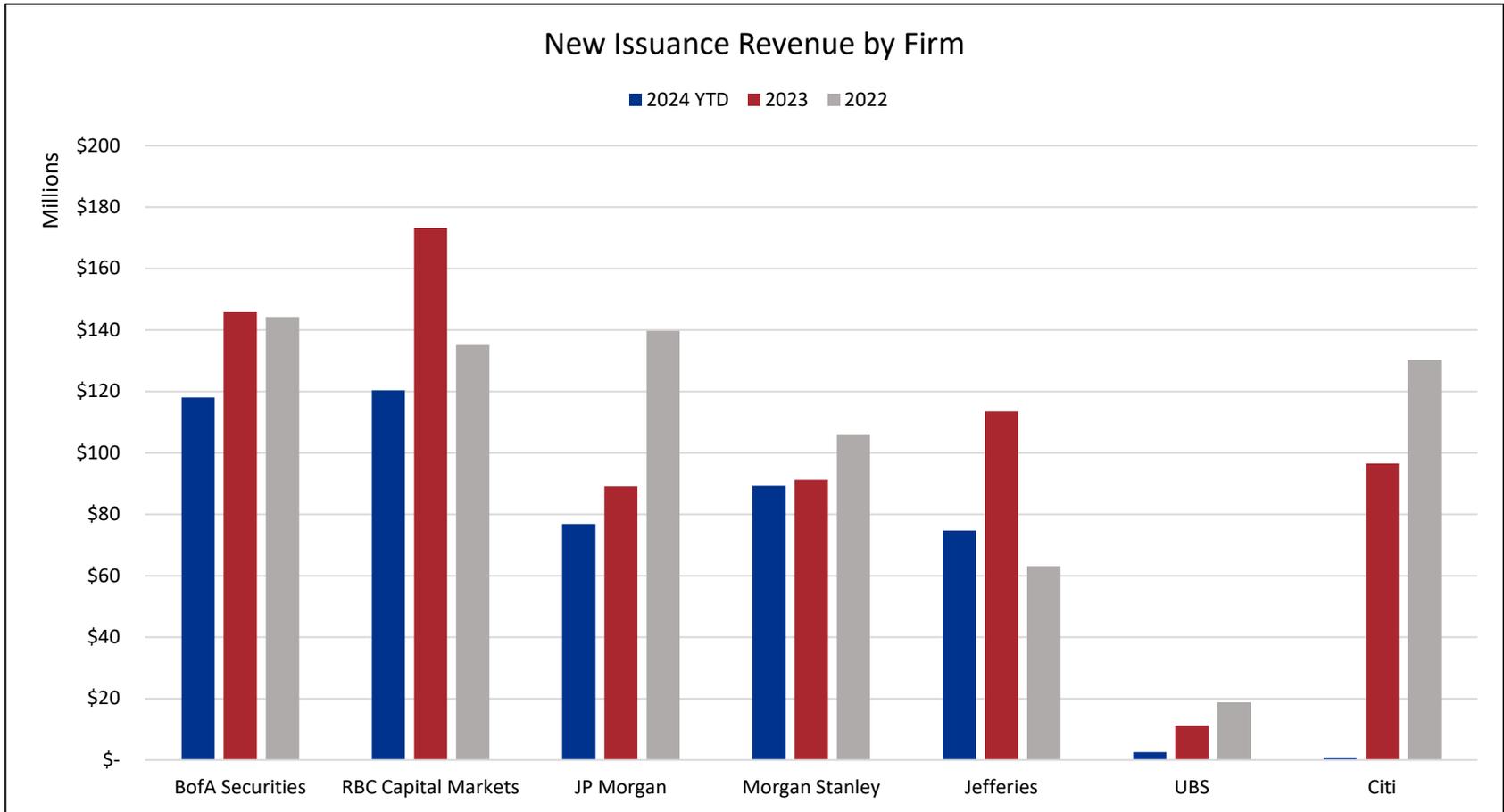
The Article v. The Market

The Article

- **“Underwriters facing increasingly informed investors in the primary market are unable to capture high markups from investors but are also unable to raise costs with issuers.”** (abstract)
- “The Resultant price dispersion, particularly detrimental to retail customers lacking in information gathering capabilities delineates a market where institutional investors secure more favorable term due to repeat interactions and informational advantages.”
- **“Increased transparency has not benefitted issuers but has led to a decline in profitability for the largest municipal underwriters.”**

The Market

- In the primary market, Underwriters make public offerings at stated offering prices. They do not “markup” bonds above the listed offering price.
- Underwriters in the primary market are governed by fair dealing requirements and cannot treat retail and institutional investors differently.
 - Example California retail order period adjusts the rate to sync with institutional orders.
 - Underwriters would assert that there is no “price dispersion” in the primary market.
- Underwriters balance lower fees and the desire to generate more volume and enhance their position on the league tables which in turn can generate more business.
 - Lower fees can result in cheaper pricing because underwriters to generate more orders to sell the bonds
 - Perception of higher market share may lead to better-perceived reputation and more deals.
 - Without access to an underwriter’s expenses (human capital, rent, etc. it is impossible to make a statement of profitability.



Source: Bloomberg



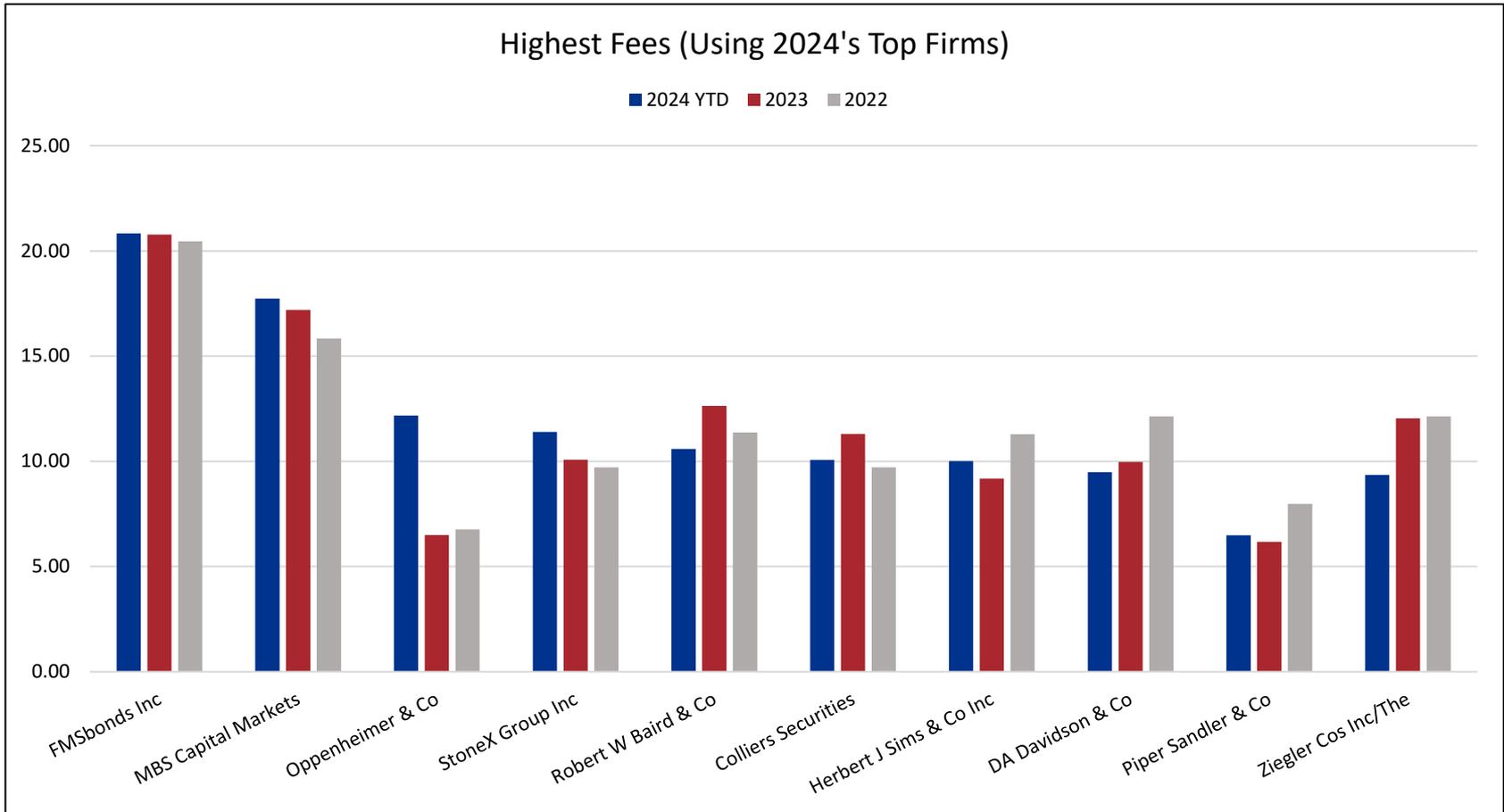
The Article v. The Market

The Article

- National underwriters tend to charge lower underwriting spreads to issuers and lower markups to investors in the new issue market.
- Underwriting fees are negatively correlated with risk and volatility in the Muni market and that using local financial advisors helps reduce such fees.

The Market

- The distinction is not national underwriters necessarily but the composition of the transactions that they are underwriting.
- Fees and Risk are positively correlated. The higher the risk - > the higher the fee.
- High grade rated securities are less risky and are generally perceived as commodities. As such fees are lower. High Yield bonds are riskier to price in the primary markets. They require expertise and result in higher fees.
- The use of financial advisors is less frequent in the High Yield space.



* Excludes Firms with fewer than 10 deals or an average deal size of less than \$10mm
 Source: Bloomberg



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