Columbia Business School

Lowering Borrowing Costs for States and Municipalities Through CommonMuni

The Hamilton Project • Brookings

Andrew Ang

Columbia University

Richard C. Green

Carnegie Mellon University

Municipal Bond Market

- Essential for funding schools, roads, utilities, public buildings, hospitals, and other public infrastructure.

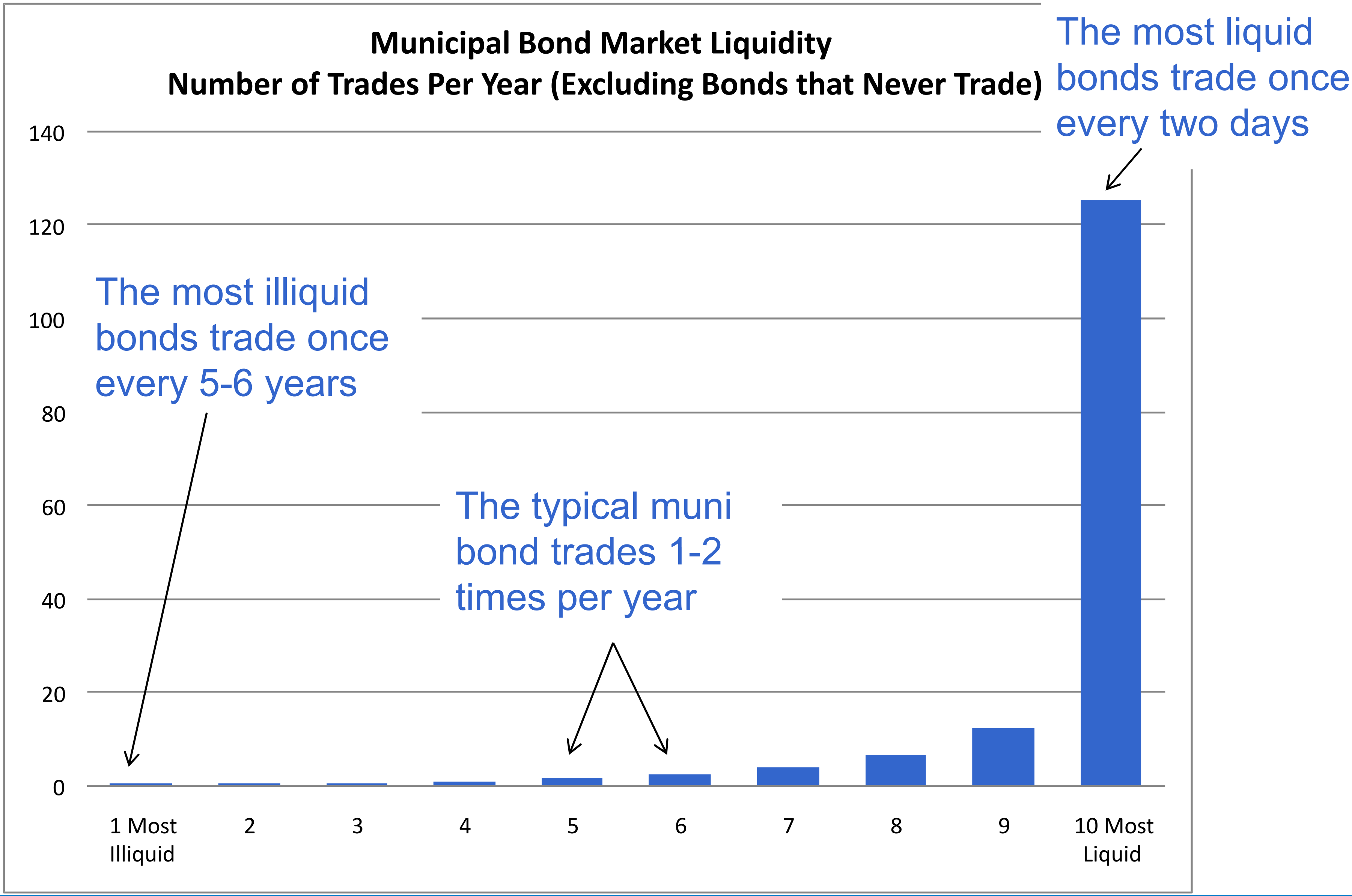
- Millions of Americans save and invest using municipal bonds.

- Large and important market: $2.9 trillion outstanding issues with $0.5 trillion new issues every year .

Municipal Bond Markets Are Inefficient

- Municipal markets are illiquid
  - Transactions costs are high, price adjustment is slow, different buyers pay different prices for the same bond, and bonds are overly complex reducing liquidity.
  - There are over 1.5 million different bonds. Over 60% of these bonds contain hard-to-value embedded derivatives.
- Information is hard to obtain
  - Extremely hard to obtain financial information on municipal issuers for long histories that can be consistently compared across issuers.
- Municipalities pay too much when issuing bonds

Municipal Bond Markets are Illiquid



Costs of Illiquidity and Poor Information

- Researchers estimate the liquidity component of municipal yield spreads relative to Treasuries is 1.1%.

- That is, municipal yields are, on average, 0.9% below U.S. Treasury yields. If municipal yields were as liquid as Treasuries, they would be, on average, 2.0% below Treasury yields.

- Liquidity and access to information are public goods—which everyone can access and utilize—but it is hard for a single issuer to act alone to change the status quo.

CommonMuni

- We propose the creation of a national not-for-profit institution, CommonMuni, through which municipalities can band together and share resources.
- Designed to improve information and liquidity.
- Set up by private funds and modeled on the Commonfund for college endowments.
- Aims:

1. To provide individual issuers with independent advice a single issuer would find prohibitively expensive.
2. Promote the sharing of best practices, information, and benefit from the economies of scale of standardization.
3. Improve liquidity and information quality by helping to coordinate issuers and investors.