

CHAPTER 13

The Secondary Market in Municipal Bonds*

1. INTRODUCTION

The purchase of a new issue of municipal bonds from the issuer by an investment banker (or by a group of investment bankers in a syndicate) and the resale of the bonds by the investment banker or securities dealer constitutes the primary or new issue market. Any subsequent sale of the bonds by an investor or dealer is in the secondary market.

Like any other security there are times when the municipal bond must be disposed of before maturity. Heirs sell, institutions have different securities needs, and commercial banks see deposits and commercial loans rise and fall cyclically and so on. A change in money rates often will see an underwriting syndicate forced to break up and divide the unsold bonds among its members. What ever the reason, the bond returns to the market to be offered to the investigating public for the second time.

Hence, the term "secondary market." This secondary market is almost without exception far more voluminous at any given date than the primary (new issue) market.

2. SIZE AND OPERATIONS OF THE SECONDARY MARKET

There are no accurate estimates of the annual volume of secondary market transactions in print but a check of many thoughtful and serious dealers and dealer banks who are active in this market leads us to the conclusion that approximately \$22 to \$25 billion is a reasonable estimate. When one considers that there are close to \$100 billion of municipal bonds outstanding and last year's new issue financing totaled \$11 billion this seems quite feasible.

An investor desiring to dispose of a block of bonds has a choice of a number of methods. If the amount is not large, his best method may be simply to sell the bonds to the investment banker from whom he purchased the bonds or to some other reputable dealer at a mutually satisfactory price. If the amount of bonds involved is large, the owner may prefer: (1) to give a selling order to a dealer with instructions to place the bonds with a municipal bond broker to sell at the best bid; (2) to give a selling order to a dealer to sell the bonds on an agency basis at a stated price; or (3) to contract with a dealer to advertise the bonds for competitive bidding over the dealer's name.

Municipal bond traders could be called secondary market specialists because traders are simply investment bankers who buy, sell, and trade

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