CITY OF CAMBRIDGE
Finance Department
City Hall, Cambridge Massachusetts 02139

Administration	**349-4212**
Tax/Utility Coll	**349-4220**
Treasury	**349-4212**
Payroll	**349-4290**

March 15, 1995

TO: Robert W. Healy
City Manager

FROM: James P. Maloney
Finance Director

SUBJECT: Council Order No. 22, dated February 13, 1995

The City Council has asked that we explain the possibility of issuing City general obligation bonds in denominations of $1,000 rather than $5,000. These small denomination bonds or minibonds are generally issued by municipalities in order to achieve one or more of the following: build support for the municipality's capital improvement program; provide positive public relations for the community; and expand the market for jurisdiction's regular bond issues.

Here in Cambridge, in a conventional bond sale, the winning underwriter reoffers the City's bonds to individuals, mutual funds, banks, and insurance companies in denominations of $5,000. Lowering the denomination to $1,000 will not guarantee that the underwriter will increase its efforts to sell the City's bonds to City residents or even to individual or retail investors. In fact, some larger investment banks may not bid on an issue that has non-conventional small denominations because of the additional administrative and sales work associated with selling those "odd lots." In the secondary market, this "odd lot" effect may also hinder liquidity of the City's bonds as some brokerage firms might refuse to make a market in small securities.

Other characteristics of the municipal market also discourage the issuance of non-conventional denomination bonds. Some larger brokerage firms have minimum investment levels of $10,000 for municipal bonds, although smaller regional firms regularly sell single denominations of $5,000. Due to the nature of the tax-exempt market, typical municipal investors make purchases of $10,000 or greater. Most investors are attracted to municipal securities because of the ability to shelter portions of their income from federal and state income taxes. These investors are usually in higher tax brackets and have more income to invest and therefore to shelter, forcing minimum purchases higher so they can meet their tax sheltering goals. Finally, high transaction costs (broker's commissions, etc.) encourage investors to make larger purchases.

As a result of these factors, the generally held belief in the municipal bond business is that lower denominations, alone, in conjunction with a regular competitive bond sale will not ensure that Cambridge residents have access to City bonds and in fact could cause some volatility in marketing City bonds. Therefore, I recommend against a competitive minibond sale.

An Alternative:

As an alternative to competitive minibonds, some communities have issued small denomination bonds to their citizens. In order to ensure that residents have priority in receiving these minibonds, the municipality typically sells bonds directly to local investors. The municipality itself will serve as underwriter, marketing agent, and paying agent/registrar. In its role as marketing agent, the municipality usually undertakes an intensive marketing campaign, including print, phone hotlines, radio and even television ads. During the order period, the jurisdiction takes sales orders itself and fills those orders by the settlement date. As underwriter, the jurisdiction takes on the risk for selling the entire issue. As paying agent/registrar, the jurisdiction must track reissuances and transfer of securities between investors and make principal and interest payments as they come due. Combined, these expenses make issuance much more expensive than a regular competitive general obligation bond sale on a per bond basis, especially given the general decline in underwriting spreads over the last three to five years.

Most minibond issues are usually floated for small capital projects (par amounts of less than $5 million) that have good public support. The small size reduces the risk that the issue may not sell out and can give the jurisdiction a good sense of local demand for bonds. Many jurisdictions issue shortly after (within 15 days) a regular competitive sale so they can use the interest rates set on the competitive sale for their minibonds. This avoids the risk that the municipality might face in estimating appropriate interest rates. In addition, minibonds are often structured as zero coupon or capital appreciation bonds (CABs) with short maturities (three to five years), allowing small investors to purchase securities at a discount and to plan in advance for retirement or college education with certainty about the value of their investment at maturity. Denominations range from $250 - $1,000, with the average purchase being in the range of $6,000 - $8,000.

Because a minibond program where the City issues directly is not a cost effective method of bond issuance, I cannot recommend this practice either. With a highly desirable credit rating and a supportive population, the public relations gain is not a marketing necessity when measured against the increased issuance and management cost.

15.

CITY OF CAMBRIDGE
CAMBRIDGE, MASSACHUSETTS 02139

TEL. 349-4300
FAX. 349-4307

EXECUTIVE DEPARTMENT
ROBERT W. HEALY
City Manager

RICHARD C. ROSSI
Deputy City Manager

March 20, 1995

To The Honorable, The City Council:

Please find attached a response to Awaiting Report Item No. 31, regarding the feasibility of issuing municipal bonds to residents of Cambridge, received from Finance Director James Maloney.

Very truly yours,

Robert W. Healy
City Manager

RWH/mev
attachment

Consent Agenda # 15 S-97

Response to Awaiting Report Item Number Thirty-one regarding the feasibility of issuing municipal bonds to residents.

for original order see Order # 22 of 2/13/95.

In City Council,

March 20, 1995

Placed on file