Bond Underwriter FAQ

Chester ISD

1. What is an underwriter?

A school bond underwriter is a private entity, usually a large investment bank. The underwriter on a bond sale contracts to buy all the bonds being sold in that individual sale, known in the business as a "bond issue."

Underwriters are essentially brokers. They buy bonds from districts and sell them to individual investors.

2. What is an underwriter's role in the school bond process?

Bonds are essentially loans. When a school district sells bonds, it is borrowing money from investors and promising to pay it back, with interest, over a certain period of time.

The investor on these deals, who lends the district money, walks away from the transaction with an investment — basically a piece of paper (a bond) that they can cash in at a later date for the money originally borrowed plus interest.

Bonds, then, are investments that can be bought and sold just like stocks and shares or baseball cards.

School districts aren't in the business of selling investments very often. Most districts only sell bonds perhaps a few times a decade, if at all. Because districts need to find investors to buy all their bonds, they contract with a middleman — an underwriter.

The underwriter agrees to buy all the bonds directly from the district. That means the district only has to negotiate with one buyer instead of the dozens of investors who end up owning its bonds.

An underwriter is a little like a wholesaler. The underwriter buys all the investments, in bulk, at a discount. Then it sells those investments to individual investors.

3. How do underwriters make money from bond sales?

Underwriters make money two ways.

First, underwriters buy bonds from school districts at a "discount." That's essentially a fee that the underwriter gets paid for doing the deal. Fees vary, but in large municipal bond deals, underwriters often get paid hundreds of thousands of dollars in fees.

Second, underwriters can make money by selling the bonds that they have bought from the district. Once an underwriter has purchased a bond, it owns an asset that it can sell at a profit.

4. How do school districts select underwriters?

There is no legal requirement for a district to hold an open, competitive process to choose its underwriter. And districts seldom do. Rather, underwriters are often chosen after making an informal presentation to a school board. Or they're simply chosen by district staff and approved by a school board.

Once an underwriter has worked for a district, the district often stays with the same firm. So, underwriters are often grandfathered in from one bond measure to the next.

5. What are negotiated and competitive bond sales?

When school districts sell bonds via a competitive sale, it means that several underwriters compete to see who can offer the lowest overall interest rate on the deal.

School bonds are rarely sold this way. They are usually sold in negotiated bond sales. That means a district negotiates a deal directly with one underwriter. The two parties agree on all the elements of the deal, from how much interest the district will pay, to how long the loan term will be.

6. Who oversees underwriters and what are they doing to keep the system honest?

Nationwide, the municipal bond business is overseen by the Municipal Securities Rulemaking Board, a federal regulator that can establish rules that bond underwriters must abide by.