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WSJ: Some Detroit Bonds Hit by Bankruptcy Filing.

General-Obligation Bonds, Considered Among Safest, Take Hit After Being Targeted for Cuts

Some Detroit bond prices fell sharply on Friday, as the municipal-bond market took a hit one day after the city filed the largest municipal bankruptcy ever.

Debt tied to Detroit's retirement system traded on Thursday, before the city's bankruptcy filing, at 38.5 cents on the dollar, according to Electronic Municipal Market Access. On Friday morning, the bid price, or the price that a dealer is willing to pay for the debt, was listed at 37 cents on the dollar, a 1.5 cent decline, said Gary Pollack, managing director at Deutsche Asset & Wealth Management.

A general-obligation bond issued by the city traded at 84.575 cents on Friday, down from 95 cents on Thursday, even though that particular bond carries insurance, according to the EMMA website.

Bond investors are particularly rankled that the city appears poised to seek significant cuts on general-obligation bonds, which are backed by a municipality's taxing authority. Previously, this debt has been considered one of the safest types of munis.

Overall, yields on highly rated, long-dated muni bonds were up 0.11 percentage point Friday, according to a benchmark scale from Thomson Reuters Municipal Market Data. Prices move inversely to yields, so a higher yield indicates a lower price. The price move "is a reflection of some uncertainty in the market right now," said Domenic Vonella, managing analyst at MMD.

"The weakness today could be attributed to a number of things, but Detroit, Chicago, those are a couple of the bigger concerns in the market right now," said Mr. Vonella, also referring to a decision by Moody's Investors Service this week to downgrade Chicago's credit rating.

Mr. Pollack said that although Detroit's troubles had been well-telegraphed, the bankruptcy filing "is not a positive news item, and at a time when people are withdrawing money from bond funds to begin with, it makes me nervous as an investor." Mr. Pollack, who oversees $12 billion in investments, said he didn't hold Detroit bonds.

Muni investors said Detroit's bankruptcy petition could hurt demand for bonds from all Michigan localities. Michigan Gov. Rick Snyder authorized Detroit's bankruptcy filing, and it is expected that bondholders stand to take significant losses. The governor also previously appointed an emergency manager, Kevyn Orr, who has steered the city into bankruptcy court.

The Securities Industry and Financial Markets Association, a trade group of securities firms, banks and asset managers, took issue with the proposed treatment of the general-obligation bonds, which would be repaid at pennies on the dollar.

In a letter Thursday, the group implored Gov. Snyder to "act deliberately and be aware that your actions … could have potentially significant, negative municipal securities market implications."

In Portage, Mich., which is planning to sell $3.13 million in general-obligation bonds next week, finance director Daniel Foecking said he didn't think the bankruptcy would derail his city's sale. Mr. Foecking, whose city of about 46,000 is about 140 miles west of Detroit, acknowledged the filing could result in slightly higher interest rates for Portage, but he didn't think the increase would be significant.

Mr. Foecking pointed out there are key differences between Detroit and Portage. For one, Standard & Poor's gives Portage a double-A rating. Detroit's rating is single-C.

"It's been my personal philosophy, when you start budgeting, the first thing you do is factor in debt service," Mr. Foecking said.

Some investors said the filing, though not necessarily a surprise, seemed almost out of character for the state.

"Michigan has been touted for years as one of the most bond-friendly states out there," said Robert Miller, senior portfolio manager at Wells Capital Management, which oversees $32 billion in munis. "That reputation is shot."

Mr. Miller said his firm didn't own any general-obligation bonds, but it did have some exposure to Detroit's sewer bonds. He said he felt more comfortable owning the sewer debt because the sewer system serves not just the city, but the surrounding area. Those bonds are backed specifically by sewer-system revenues.

Nonetheless, Standard & Poor's downgraded the city's water and sewer bonds to double-B-minus earlier in this month. And on Friday, S&P placed those bonds on CreditWatch negative. The general-obligation bonds were previously at double-C, but were lowered to single-C on Thursday after the bankruptcy.

"Why would you own a Michigan general-obligation bond if the state's letting Kevyn Orr take a very aggressive approach to existing debtholders?" said Anthony Valeri, fixed-income strategist at broker-dealer LPL Financial. "We would certainly caution investors about investing in Michigan GOs. Or if you do, that you're compensated for the risk."

Not all investors were overly perturbed. Matt Dalton, chief executive of Belle Haven Investments, said his firm was still comfortable holding bonds from Michigan municipalities, despite the harsh line Mr. Orr is taking with some bondholders.

"The state has had a good history of fiscal oversight of communities and they've already done a lot for Detroit," said Mr. Dalton, whose firm oversees about $1.6 billion in assets and owns some Detroit school-district debt, as well as of the city's water and sewer bonds.