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Moody's: Detroit Bankruptcy May Change How Other Distressed Cities Approach Obligations.

Detroit's bankruptcy filing is profoundly meaningful for the small number of local governments in the US that are financially distressed, says Moody's Investors Service, as it may create precedents for how they will deal with long-term liabilities. For the vast majority of the rated local government universe, over 99% of which are rated investment grade, the impact will be limited.

Moody's says that Detroit's bankruptcy, assuming bankruptcy protection is granted by the bankruptcy judge, could influence market expectations and issuer behavior at the fringe of municipal credit: those at risk of default or municipal bankruptcy. Moody's only rates 34 local governments below investment grade, out of a universe of more than 7,500 rated entities.

"Bankruptcy may become more appealing to other stressed local governments if Detroit succeeds in reducing pension benefits and discharges most of its general obligation debt," says Moody's Managing Director for Public Sector Ratings Anne Van Praagh in the report "Detroit Bankruptcy May Change How Other Distressed Cities Approach Their Pension and Debt Obligations."

"If Detroit is bogged down in years of expensive proceedings and fails to restore solvency or materially restructure its liabilities, other distressed issuers would be unlikely to emulate Detroit's approach," says Moody's Van Praagh.

Even should a local government decide to emulate Detroit's approach, obtaining bankruptcy protection in the first place can be very difficult. Bankruptcy remains a long and onerous process, and the outcomes for other cities will be uncertain even if Detroit emerges as a tone-setter.

As for municipalities not currently in distress, the implications of the Detroit bankruptcy are limited.

"Detroit is an outlier. Although many of Detroit's problems are common, the magnitude of its problems is not. Other cities in the US have undergone post-industrial depopulation and an erosion of the tax base, and now carry debt burdens that are heavy relative to the remaining tax base and population. But no large city lost as much as Detroit, " says Moody's Van Praagh.

Moody's expects the number of local governments in severe distress to remain small. Since 2010, Moody's has expected the default rate among local governments, historically minimal, to increase and for strong post-default recoveries to decrease. However, both changes will be marginal.

In the years following the financial crisis of 2008-09, the majority of local governments continued to make tough decisions that allowed them to balance their budgets and meet their debt and pension obligations, says Moody's , despite substantial loss of housing market values, weak or moderate economic performance, and persistent pressure on revenues and spending.

Moody's does not expect other major US cities to enter the same "downward spiral" that Detroit did.

For more information, Moody's researcher subscribers can access this report at http://www.moodys.com/viewresearchdoc.aspx?docid=PBM_PBM156771.