WSJ: Detroit Bankruptcy May Spell Trouble for Other Distressed Municipalities.

A Michigan county's decision to postpone a $53 million bond sale highlights the difficulty fiscally strapped issuers everywhere may face in the wake of Detroit's record bankruptcy filing, investors said.

Portfolio managers say they are more cautious now about buying bonds from local governments in Michigan and may demand higher interest rates to lend them cash. Genessee County, Mich., on Thursday shelved an offering after potential buyers wanted much higher yields than the county was willing to pay, said people familiar with the offering.

But some also say their leeriness extends beyond the state's borders, to other local governments struggling with their finances in the wake of the recession. Indeed, some investors say the Motor City's filing on July 18 acted as a fresh reminder for them to look at all holdings again and reassess risk.

"With attention on Detroit, it only heightens attention… on other distressed issuers," said Jim Colby, senior muni strategist and portfolio manager at Van Eck Global. Investors should demand higher yields from these municipalities, given the uncertainty surrounding Detroit's bankruptcy and how much bondholders will ultimately get repaid, Mr. Colby said.

"You could argue with Detroit that the whole [muni] world is turning upside down," he said.

One key test comes in the coming week, when Puerto Rico's electric and power authority plans to sell about $600 million in debt. The deal is the first from an issuer in the commonwealth this year as the island continues to struggle with a sluggish economy and a high unemployment rate.

The bonds have ratings that are barely investment grade. Puerto Rico bonds are widely held in the municipal-bond market because interest on them is exempt from federal, state and local taxes. They also offer relatively higher yields than other muni debt because of the island's fiscal troubles.

The Puerto Rico electric deal "will certainly be a bellwether" for lower-rated muni credits, said Gary Pollack, managing director at Deutsche Asset & Wealth Management. Already, he said investors were demanding a higher yield premium for other lower-rated local government bonds. He said his firm was reducing exposure to such bonds.

Detroit's bankruptcy, as well as Chicago's multinotch downgrade last month due to its pension issues, "is a reminder for investors to do additional homework," Mr. Pollack said. "You have to dig deeper."

Puerto Rico's electric authority isn't the only lower-rated borrower wanting to sell bonds in the coming week, according to Ipreo LLC. Chicago is also planning a $247 million debt sale for O'Hare International Airport, a deal with ratings in the lowest investment-grade category. Indiana Finance Authority is selling about $38 million in debt in a junk-rated charter-school deal, while there is also a nonrated $37 million North Carolina senior-living deal on tap, Ipreo said.

Sharon deGuzman, senior portfolio manager at Baird Advisors, said she has noticed a change in investors' attitudes recently, especially with Detroit's bankruptcy filing.

Before, investors' appetite for additional yield was so voracious that lower-rated, riskier munis were generally outperforming those with higher ratings. But that wasn't the case in July, when Detroit filed for bankruptcy. Lower-rated munis didn't perform as well as higher-rated munis, she said, citing Barclays indexes.

Detroit was a "gut check," she said.

Investors have yanked about $17 billion from weekly-reporting muni mutual funds and exchange-traded funds over the past 10 weeks, according to Thomson Reuters unit Lipper FMI. Benchmark muni yields have also risen while prices have fallen, as investors fret about the possibility that the Federal Reserve will siphon off its support of the bond markets sooner rather than later. Year-t--date, munis have seen a negative total return of 3.66% on Barclays muni index.

By KELLY NOLAN