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Detroit Bankruptcy Decision May Mean Big Trouble for Muni Holders.

The U.S. Bankruptcy Court decision Tuesday that Detroit can proceed with its bankruptcy filing was a warning shot for municipal bond investors around the country.

Detroit's bankruptcy, unlike past municipal bankruptcies, treats general obligation (GO) muni bondholders as unsecured creditors. The city already has defaulted on some GO bonds.

"If they allow Detroit bondholders to be impaired significantly, this could cause in Michigan and maybe also municipalities across the country their GO bondholders to have the perception that this could happen anywhere," Patrick Stoffel, municipal bond analyst at Wells Fargo Advisors, told CNBC.

"That could increase borrowing costs for municipalities and issuers. It could cause prices of GO bonds to be affected in the market."

But Richard Larkin, director of credit analysis at HJ Sims, said Detroit won't necessarily start a trend.

"If this is the future for Detroit, it doesn't necessarily set the tone for the future for other state and local governments," he said in a commentary obtained by CNBC.

"Detroit has yet to feel the fiscal pain of being treated as a pariah by the municipal bond market over the long term."

Judge Steven Rhodes ruled that Detroit can use bankruptcy to cut employee pensions and relieve itself of other debts, handing a defeat to the city's unions and retirees.

The judge ruled pensions can be altered just like any contract because the Michigan Constitution does not offer ironclad protection for employee benefits.

"This once proud and prosperous city can't pay its debts. It's insolvent," Rhodes said in formally granting Detroit the largest public bankruptcy in U.S. history. "At the same time, it also has an opportunity for a fresh start."

The court ruling throws into question whether retired public workers' pensions can be reduced.

"It does send a message to retirees that you can't assume that because there's a state constitutional protection that your pension can't be cut," Peter Henning, a professor of constitutional law at Wayne State University in Detroit, told Bloomberg.

Elsewhere, analyst Mark Palmer of BTIG Research told Forbes.com that the Detroit ruling is actually good news for municipal bondholders and the companies that insure them.

"The fact the judge in the Detroit bankruptcy case ruled that pensions are not sacrosanct, and they can be cut, translates into potentially higher recoveries for bondholders in future bankruptcies," Palmer told Forbes. "The assumption was pensions were super-senior, and bondholders would get any residual value beyond the pensions."

By Dan Weil