Bond Case Briefs

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WSJ: Rolling the Dice on Municipal Bankruptcies.

Want to gamble but can't make it to Vegas? Then buy bonds from an ailing municipality.

The amount of money that bond investors get back in municipal bankruptcies varies widely – even among creditors who own debt with similar characteristics, Moody's Investors Service said this week.

The commentary is timely given the ongoing drama in Puerto Rico, which has about $70 billion in outstanding debt that is widely owned among U.S. investors. The commonwealth has been downgraded to junk recently by two major rating firms, Moody's Investors Service on Friday and Standard & Poor's Ratings Services earlier this week.

Puerto Rico, which has faced a struggling economy in recent years, is not eligible for Chapter 9 municipal bankruptcy, but it is unclear how bond investors would fare if the island could not pay back its debt. Island officials say they are working to improve the commonwealth's finances and have assured investors they will get their money back.

Moody's analysts noted that in the bankruptcy case of Jefferson County, Ala., which was weighed down by more than $3 billion in sewer debt, investors who owned sewer bonds got back 54.1% of their money. However, J.P. Morgan ChaseJPM +0.25% ended up with a recovery closer to 30%. (Moody's did not include in its calculations a fine that J.P. Morgan paid related to a bribery investigation connected to the sewer bonds.) Other creditors got as much as 80%, Moody's said.

Meanwhile, investors who owned general-obligation bonds issued by Central Falls, R.I., made it out of bankruptcy with a 100% recovery. In Vallejo, Calif., investors who owned debt tied to the city's general fund made a recovery of 60% to 75%. In Stockton, Calif., the city wants investment firm Franklin Advisers to accept a 1% recovery rate, while some other investors are getting 100%, Moody's said.

In Detroit, which filed the largest municipal bankruptcy ever last summer, officials are still negotiating with creditors. Still, the city's original proposal included a potential plan for water and sewer bondholders to take a cut. The end result for Detroit bondholders remains uncertain—and the previous cases are unlikely to offer much guidance.

"Recent outcomes in Chapter 9 bankruptcies are distinguished by the circumstances of the particular cases, and therefore do not set broadly applicable precedents," the Moody's analysts wrote.

The data could be skewed by the small number of municipal bankruptcies. From 1980 to 2010, there were just 239 municipal filings, according to the American Bankruptcy Institute. In contrast, there were nearly 44,000 commercial bankruptcy filings in 2013 alone, according to Epiq Systems.

But if you're a betting man, you still might want to wager on municipal bonds than other types of debt. Moody's has said that the ultimate recovery for defaulted municipal debt from 1970 to 2012 was about 60%, compared to 49% for senior unsecured corporate bonds from 1987 to 2012.

By Mike Cherney