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Safeguard for Michigan Bond Market Up in Air.

The experts call it "the Detroit penalty."

That's the extra cost Michigan municipalities face when selling new debt now that Detroit is trying to make investors holding its bonds eat a loss of 80 cents on the dollar.

How expensive can it get?

The authority that runs Cobo Center plans to sell $315 million in bonds this fall to refinance old debt. When Cobo's financial advisers added up the numbers, they estimated the authority could pay a combined "Michigan penalty" and a "Detroit penalty" that could raise the interest rate by as much as a full percentage point.

Over 25 years, that higher rate would cost the authority about $56 million that would otherwise flow to each of the state's 83 counties.

Michigan could stave off higher bond rates by passing legislation similar to laws in Rhode Island, California and a handful of other states that protect bond investors. But even with the threat of higher rates, both state Treasurer Kevin Clinton and Gov. Rick Snyder say there's no need to erect a legal firewall to keep the state's other cities, townships and authorities from being hit with higher bond rates.

Behind the bond market's pique is the feeling that the city wants to stiff holders of its unlimited tax general obligation bonds. General obligation bonds are an integral part of financing any city or municipal authority that needs to raise a large lump sum to build schools, fix sewers or buy buses. These bonds are paid from city taxes, which, if the city falls short, can by hiked until there's enough money to make the payments — that's the unlimited part.

In the past, a city in trouble would either refinance general obligation bonds or, in the rare event of a municipal bankruptcy, treat the bonds as secured debt, giving the bond investors first shot at whatever assets were available. Since the Great Depression, the average recovery on such bonds has been 75 percent, not the 20 percent Detroit proposes. After that, pensioners, or their widows, would join other unsecured creditors who, in many cases, received nothing.

In Detroit's case, the governor's appointed emergency manager wants to put pensioners first and hand bondholders a huge loss.

"You have to recognize that you're going to need to borrow again," said James Spiotto, managing director of the bond consultancy Chapman Strategic Advisors in Chicago. "If you take the short-term view and say, 'I'm going to stomp on bondholders so I can pay others,' what you wind up doing is costing yourself more in the long term."

A spokeswoman for Snyder said she's not aware of any discussion about such legislation.

"We acknowledge the questions and potential concerns out there, but believe that Detroit is an

incredibly unique situation," spokeswoman Sara Wurfel said in an email. "We have strong confidence in the amount and type of sound, smart investments to be made in Michigan and our local communities across the region and state."

Anthony Minghine, associate executive director of the Michigan Municipal League, said he's heard the suggestion that the state pass legislation securing general obligation bonds, but that it hasn't picked up support in the state Capitol.

"Some of the bond community is hyper-focused on protecting the creditors, which is understandable, but I have not heard that being talked about in Lansing," Minghine said.

When Detroit's bankruptcy was announced, "I know the market kind of hiccuped, but from everything I've seen it seems like it's settled down," Minghine said.

The hiccups included Saginaw County postponing an August bond issue after Detroit declared bankruptcy, then paying more to issue those bonds in January. Despite a top credit rating, Troy paid half a point to a full point more for bonds it issued in September, while Genessee County paid 1 percent more, according to Bloomberg News.

Even the state took a hit, with two-year general obligation bonds going at a 20 percent premium in November, according to Bloomberg.

Nonetheless, "It is important to note that municipalities and the state have successfully completed a number of transactions, some of which received exceptional interest rates," Treasury spokesman Terry Stanton said in a statement to The Detroit News. "Michigan is home to some 650 local communities which are rated by the credit agencies, and only a scant few are not considered investment grade."

Some Michigan bonds aren't suffering — the ones that are guaranteed to be paid off. The credit agency Standard & Poor's just reaffirmed its high-quality rating on a batch of Detroit state aid bonds. There's little to no risk to investors because the money is guaranteed by the state.

But without such guarantees for general obligation bonds, any sense that the market has gotten over the shock of Detroit's bankruptcy filing could come undone if bankruptcy Judge Steven Rhodes OKs the city's plan to slash millions of dollars of value from its general obligation bonds.

"If this is approved, issuers in Michigan and in other states that don't have protection for general-obligation bonds could see their borrowing costs rise," said Lisa Washburn of Municipal Market Advisors, a Concord, Mass., municipal bond consultant.

That's part of what's fueling fears that bond rates will rise for Cobo Center. The worst case scenario is an interest rate that's a full percentage point higher, although Patrick Bero, chief executive officer of the Detroit Regional Convention Facility Authority that runs Cobo, thinks he can make a strong case to investors and keep the damage to just a quarter of a point or less.

But as Detroit and its bondholders continue to wrestle in court, what happens between now and September is anyone's guess.

Washburn and other bond analysts say the way to wipe out the doubts and fears dogging bonds from Michigan is simple: Get the state Legislature to pass a law stating that general obligation municipal bonds are protected as property liens in a bankruptcy.

That's what happened when Central Falls, R.I., fell into bankruptcy in 2010. After the city of 19,376

filed for Chapter 9 protection, the Rhode Island assembly moved to protect all the state's bonds, including those in Central Falls, explained Rosemary Booth Gallogly, director of the state's Department of Revenue.

"Even as small as Central Falls is in the state, we were concerned about the impact of contagion on other municipalities and the rates they'd have to pay," Gallogly said. Once a law was signed creating a statutory lien for state bonds in 2011, "We did not see a negative impact for other municipalities," she added.

The bottom line was that the Central Falls bonds were paid off at 100 cents on the dollar and other cities — even those in trouble — haven't seen any increases on their bond rates, Spiotto noted.

"Rhode Island has not suffered," Spiotto said. "Actually, I think they've gotten some benefit in access and cost that they wouldn't have gotten otherwise. When Providence had problems, they still had access to the market at a reasonable cost."

For now, the market is taking a wait-and-see attitude about bond rates in Michigan, at least until the bankruptcy judge rules and the inevitable chain of suits and appeals wend their way through court to reveal the bottom-line hit for Detroit bondholders. Until then, fears of the "Detroit penalty" will continue to play out, Spiotto warned.

"Some states are already saying 'We're different than Detroit, we have a statutory lien and you should have no fear,' " Spiotto said. "You really want your state to be able to claim the lowest borrowing cost, not the highest."

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