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WSJ: What a Struggling Jail Means for Investors, Small Towns.

Rhode Island's Donald W. Wyatt Detention Facility has struggled since officials at U.S. Immigration and Customs Enforcement pulled out their detainees in 2008, following the death of a Chinese national held there. That pullout happened shortly after the facility expanded to hold 770 detained people.

The detention center, which owes about $97.3 million in bonds, was taken over by an outside financial professional earlier this year.

The facility is supposed to kick in money to the city of Central Falls, R.I., which had its own financial problems and eventually filed for bankruptcy in 2011. When the city's lawyers redrew revenue forecasts as part of its financial revival, lawyers pointed out that they hadn't been getting—nor did they expect to receive—payments from the facility, which takes in detained people from Rhode Island, Connecticut, Massachusetts, New Hampshire, Maine and Vermont, according to its website.

An article in Wednesday's Wall Street Journal shows how some cities and states that took on risk to build jails or prisons are hurting after crime unexpectedly fell and the inmate population declined.

While the reduction in crime and incarceration has many social benefits, municipalities are having a tough time finding new uses for prisons. Old office buildings can be converted to apartment buildings or hotels. Outdated government buildings can be used for retail or as schools.

Jails in particular also pose a risk to investors in the relatively safe and stable $3.7 trillion municipal bond market, and financial hardship can spread to the small towns where the facilities are often located.

Bonds that pay for jails have the second-highest default rate in the municipal sector, at 2.1%, behind retirement community debt, which has a 4.9% default rate, according to data from the research firm Municipal Market Advisors. Jail debt also has the second fastest-growing default rate, rising from 1.1% in the second quarter of 2013.

Eighteen jail bonds have defaulted since 2010, with a par value of about $400 million, said Matt Fabian, managing director at the firm.

To be sure, the jail bond sector is small, and its hardship is unlikely to infect the overall market. Jail bonds are often unrated and sought out by high-yield funds or others aware of their risks—not by mom-and-pop investors who make up most of the municipal bond market. "The impact on the market as a whole is small," Mr. Fabian said.

The economy of a small town that extended municipal bonds to build a big facility, however, might not be so insulated.

The Glades County Detention Center in Florida—the largest employer in the 13,000-resident Glades

County—has a fraction of the 114 workers it once employed after two rounds of layoffs, said Robert DeMann, chief deputy in the sheriff's department.

County officials were preparing to build a 50-bed jail, but officials from U.S. Immigration and Customs Enforcement pushed for the much larger facility that eventually opened in 2007, Mr. DeMann said. The facility can hold 626 people but it has taken in far fewer inmates than that after the agency instructed its officers in 2011 to use discretion when deciding to detain people in order to save money.

"Obviously, we don't have control" over how many people become detained, Mr. DeMann said, adding that the immigration-enforcement agency pays $80.54 a day for each detained person.

It's unclear what will happen next. The facility dipped into it reserve money to make a Sept. 1 payment that was due to bondholders who extended $33 million to build the facility.

The Irwin County Detention Center in Ocilla, Ga., had trouble repaying $55 million in bonds sold in 2004 to pay for an expansion after it took in fewer-than-expected detainees. Hamlin Capital Management LLC and a fund managed by OppenheimerFunds Inc. forced the facility into bankruptcy in early 2012.

Local leaders then rallied to overthrow a national detention center operator that won a bankruptcy auction for the 1,200-bed facility, arguing that the operator might shut it down. In court papers, the county's lawyer said that even though the winning $13,048,000 bid had a higher dollar value than another bidder's offer, the effect of the potential closure would hurt the community.

"This will be devastating to Irwin County," the county's lawyer, Roy E. Barnes, in court papers filed in U.S. Bankruptcy Court in Atlanta, noting that the facility's manager employed between 150 and 200 workers. Mr. Barnes said that the facility was the 9,500-resident county's largest private employer.

A bankruptcy judge later declared the second-highest offer to be the best one.

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