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Junk Status on the Rise Among Local Governments.

The number of local governments rated at junk status has nearly doubled over the past four years, according to a recent Moody's Investors Service report. Although less than 1.1 percent of rated local governments — cities, counties, school districts and special districts — are rated at what's called speculative grade, as of March of this year, 92 local issuers had at least one speculative-grade rating on either general obligation, special tax, lease, revenue or tax increment debt, the June 5 report said. Excluding California tax allocation districts (which were devastated by a 2012 law that significantly altered the payment mechanics of those types of credits), the number of speculative-grade local governments has nearly doubled since 2011, to 51 from 33, Moody's said.

Of those 51 credits, 13 are local school districts — up from six rated at junk in 2011. Cities and towns account for about half of the junk bonds, jumping from nine to a total of 24 in four years. Notable examples include Woonsocket, R.I.; Central Falls, R.I. (which emerged from bankruptcy in 2012); Salem, N.J.; and East Greenbush, N.Y. All four have had speculative-grade debt since 2011, which shows how difficult it is to get back to investment grade (bad news for Chicago, which Moody's downgraded to junk last month and was not included in this tally). "Once a credit is rated below investment grade for more than two consecutive years … it is much more likely to remain there for some time," the report said.

But munis are scrappy. While many local governments with speculative-grade ratings remain weak for long periods, Moody's said a significant number ultimately return to investment grade. Vadnais Heights, Minn., for example, sold off a costly sports arena to meet obligations on its debt. The sale, along with keeping strong general fund reserve levels, contributed to an upgrade to Baa2 in October 2014. This upgrade and others, the report said, shows "the resiliency of local governments and underscore that the sector remains one with very few defaults."

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