Bond Case Briefs

Municipal Finance Law Since 1971

Moody's Warns Cities to Address Climate Risks or Face Downgrades.

- **Communities in Texas, Florida, other coastal states at risk**
- **Credit rating agency says it's adding climate to credit risks**

Coastal communities from Maine to California have been put on notice from one of the top credit rating agencies: Start preparing for climate change or risk losing access to cheap credit.

In a report to its clients Tuesday, Moody's Investors Service Inc. explained how it incorporates climate change into its credit ratings for state and local bonds. If cities and states don't deal with risks from surging seas or intense storms, they are at greater risk of default.

"What we want people to realize is: If you're exposed, we know that. We're going to ask questions about what you're doing to mitigate that exposure," Lenny Jones, a managing director at Moody's, said in a phone interview. "That's taken into your credit ratings."

In its report, Moody's lists six indicators it uses "to assess the exposure and overall susceptibility of U.S. states to the physical effects of climate change." They include the share of economic activity that comes from coastal areas, hurricane and extreme-weather damage as a share of the economy, and the share of homes in a flood plain.

Based on those overall risks, Texas, Florida, Georgia and Mississippi are among the states most at risk from climate change. Moody's didn't identify which cities or municipalities were most exposed.

Bond rating agencies such as Moody's are important both for bond issuers and buyers, as they assign ratings that are used to judge the risk of default. The greater the risk, the higher the interest rate municipalities pay.

Bloomberg News reported in May that towns and counties were able to secure AAA ratings despite their risks of flooding and other destruction from storms, which are likely to be more frequent and intense because of climate change. If repeated storms and floods are likely to send property values — and tax revenue — sinking while spending on sea walls, storm drains or flood-resistant buildings goes up, investors say bond buyers should be warned.

Jones said Tuesday that the company had been pressured by investors to be more transparent about how it incorporates climate change into the ratings process. Some praised the move, while also urging it to go further.

Think Harder

"This kind of publication shoots for municipalities to think harder about disclosure," Adam Stern, a senior vice president at Breckinridge Capital Advisors in Boston, said in an interview. "The action would start to happen when and if you start seeing downgrades."

Jones, the Moody's managing director, said he couldn't recall any examples of the company downgrading a city or state because it failed to address climate risk.

Eric Glass, a fixed-income portfolio manager at Alliance Bernstein, said real transparency required having a separate category or score for climate risk, rather than mixing it in with other factors like economic diversity and fiscal strength.

Still, the new analysis is "certainly a step in the right direction," Glass said by email.

Others worried that Moody's is being too optimistic about cities' desire to adapt to the risks associated with climate change.

Shalini Vajjhala, a former Obama administration official who consults with cities on preparing for climate change, says that won't happen on a large scale until cities start facing consequences for failing to act — in this case, a ratings downgrade.

"Investors and governments alike are looking for clear market signals to pursue, and perhaps even more importantly, to defend investments in major adaptation and resilience projects to their constituents and taxpayers," Vajjhala, who now runs Re:Focus Partners, said in an email. "Outside of the rating agencies, it is not obvious who else could send a meaningful market-wide signal."

Rob Moore, a senior policy analyst at the Natural Resources Defense Council, said increased attention from rating agencies could push cities to reconsider where they build.

"If I was a city official, I'd be asking a whole lot of questions about what vulnerabilities their community has, and how each new proposed development adds to that vulnerability," Moore said in an email. "Because at some point, your creditors certainly will."

Bloomberg

By Christopher Flavelle

November 29, 2017, 1:00 AM PST

— With assistance by Tiffany Kary