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Muni Bonds Contain New Fine Print: Beware of Climate Change

The underwriters of municipal bonds are disclosing more about cities' exposure to higher temperatures and rising seas.

Investment banks have begun quietly sounding alarm bells about climate change. Their worries are showing up in the documents that accompany municipal bonds they underwrite.

When state and local governments issue debt, federal securities laws hold their bankers accountable for making sure that states and cities adequately disclose the risks bond buyers are taking on. These might include any lawsuits a town is facing, or how the sales taxes used to pay back bondholders could fluctuate in a recession. Now many of these documents include language about climate change, hurricane risks, and rising seas. "Every bank should be asking their clients about this risk," says Christopher Hamel, a senior fellow at Municipal Market Analytics and former head of municipal finance at RBC Capital Markets.

Bloomberg News analyzed more than a dozen due diligence questionnaires prepared by banks or legal counsels and sent to governments in coastal Florida, and over 40 official statements for prospective bond investors. About half of the questionnaires and the majority of the statements included language on storm-related risks or climate change. The questions about climate risk sometimes come from the banks or their lawyers, and sometimes from disclosure counsels who are hired by cities to prepare for a bond deal.

During the preparations for Jacksonville's sale of \$197 million in bonds in August, a disclosure counsel asked if the city had long term plans to implement projects that increased resilience against storm related risks. Questions like that are new, says Randall Barnes, the treasurer of Jacksonville, Florida's largest city. "We had been asked about impacts of hurricanes before, but not specifically on what we are doing for the future," he says.

Scientists predict that global warming and rising seas could lead to more intense storms such as Hurricane Maria, which devastated Puerto Rico in 2017. Tidal flooding—already happening in Miami Beach and other cities—could force residents to move inland. BlackRock Inc. says that within a decade, more than 15% of debt in the S&P National Municipal Bond Index will come from regions that could suffer average annualized losses from climate change of as much as 0.5% to 1% of their gross domestic product.

The questions asked by the banks or legal counsels in the documents Bloomberg reviewed varied in specificity. For example, before JPMorgan brought \$162 million in bonds to market for Miami Beach, one of its counsels asked the officials to answer three questions that directly address climate change and its effects on the city's financial health. The Florida Keys Aqueduct Authority was asked by Citigroup to explain the impact of Hurricane Irma on the utility system. Michael Carlson, JPMorgan's head of public finance infrastructure, says that the climate discussion is "very much a part of our due diligence," and he's seen an "exponential increase" in disclosures in recent months.

Thomas McLoughlin, head of munis at UBS Financial Services, says the turning point in awareness came when Superstorm Sandy hit the New York area in 2012. As the storm forced the Hudson River into the streets and subways of lower Manhattan, Wall Street financiers saw first-hand the damage those types of events could do to cities' infrastructures, most of which are financed by muni bonds. McLoughlin says concern was elevated in the last two years as fires ravaged California and hurricanes slammed the East Coast.

Climate risk isn't necessarily showing up in muni bond pricing yet—communities that are more susceptible to these hazards do not seem to pay any penalty in the form of higher yields. Even so, some investors say many bond issuers still aren't disclosing enough. "Climate disclosure has to increase," says Daniel Rabasco, head of municipal bonds at Mellon Investments Corp. "There is a broad trend to do it, but more needs to be done." Most official statements analyzed show a paragraph or two, mentioning that climate change is an investment consideration. Tom Doe, president of Municipal Market Analytics, says these are usually "enough to satisfy investors today," but he thinks bond buyers will be demanding more within the next five years. "Vague presentations of adaptation strategies and cursory actions taken will not suffice," he says.

Florida's director of bond finance is trying to get ahead of that shift. Ben Watkins says he's talking with investors to get an understanding of what kind of climate-risk information they want. "What we have now is just the start," he says. "We have more work to do about that."

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