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WSJ: Municipal Bond Investors Face Elevated Risks From Rising Costs of Natural Disasters

Investors are being more careful with one of the safest asset classes available as catastrophes strain public finances

Quick Summary

- Municipal bond investors are struggling to measure credit risk due to the rising costs and frequency of natural disasters.
- Disasters costing at least $1 billion caused over $115 billion in damages in 2025, nearly four times the annual average in the 1990s.
- Investors expect municipal bond issuers to be transparent about their preparedness, especially in areas highly exposed to natural disasters.

Bond investors are increasingly struggling to measure the credit risk of municipal issuers due to the rising costs and frequency of natural disasters.

Disasters costing at least $1 billion totaled more than $115 billion of damages in 2025, nearly four times the annual average in the 1990s, according to a Ceres study.

The increased costs force investors, already battered by the recent turbulence in global bond markets, to be more careful with one of the safest asset classes available. Catastrophes strain public finances beyond reconstruction costs, often raising insurance premiums and limiting population growth. As households seek lower-cost living elsewhere, tax revenues suffer, adding risks for muni bond buyers.

“It is a real risk. It’s an increased credit risk for municipal bonds, especially long, when you talk about communities that are more prone to hurricanes, flooding, wildfires, and those rising insurance costs,” said Eric Diton, president and managing director at The Wealth Alliance.

Disaster prone areas

Diton cited California and the West Coast of Florida as parts of the country exposed to higher risks from natural disasters.

“Those are areas where you’ve really got to think about: Am I getting compensated sufficiently for the risk that I’m taking, that specific credit risk that I’m taking in those regions?”

The disasters themselves are difficult to predict and price, so investors get frustrated with issuers that fail to disclose how they are preparing for such events.

“The municipal market has been slow to price in these risks versus other fixed income asset classes,” Nuveen’s head of municipal bonds Dan Close said. “And I think that’s starting to change.”

Investors are paying more attention to signs that a bond issuer will be able to honor its debt in the aftermath of a major natural disaster. That keeps environmental, social and governance criteria relevant for bond buyers.

Factoring in climate

“[T]he way we think about incorporating this sort of risk is by reflecting climate exposure and readiness in our internal credit assessment, which includes a comprehensive ESG analysis,” said Aanya Mehta, muni credit analyst at Conning.

The idea is to weigh climate risk against, say, a water utility’s long-term resilience plan and other indications of preparedness, in order to determine the issuer’s creditworthiness, she said.

As an example of natural events’ potential impact on a munis portfolio, Conning researchers estimated that Louisiana alone sustained $300 billion in catastrophe damages between 1980 and 2024, with 31% of that total accumulating in just the last five years.

In addition, a 10-year bond issued by the Los Angeles Department of Water and Power during the January 2025 wildfires paid a yield of 3.67%, up from 2.62% a month earlier, according to Nuveen data. That means early investors saw the price on their bonds decline.

The impact can go beyond costs directly linked to natural disasters, as rising insurance premiums weigh on household and business budgets. As a result, population growth is repressed, curbing tax revenue and potentially squeezing credit quality.

While professional investors try to stay away from the scientific debate around the root cause of natural disasters and how to deal with them, they expect borrowers to be transparent about their preparedness, especially in areas more exposed to these events.

“At the end of the day, part of the process of buying a credit is determining what the interest rate should be, what is the credit risk, and how much should we be paying for this bond, and [climate risk] has to be part of the calculus,” said Jennifer Johnston, senior vice-president and director of research, Municipal Bonds at Franklin Templeton Fixed Income.

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