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Cities Prepare for Climate Risk. Bond Prices May Not Reflect It.

An analysis covering 620 municipalities shows there's plenty of room for improvement.

Climate change is no longer the problem of the future—some 70% of cities worldwide are already experiencing its effects. The good news is that many of them are doing what they can to prepare, according to an analysis of global disclosures by the nonprofit CDP.

There's a direct connection between identifying climate-related threats and taking steps to reduce them, according to Kyra Appleby, global director of CDP's program on cities, states and regions. Climate change "is affecting cities now," she said. That reality is not, however, always reflected in local real estate and municipal bond markets.

The three U.S. cities identified by CDP as having the highest climate hazard scores (St. Louis, Boynton Beach, Fla., and Lakewood, Col.) have about $218 million in outstanding municipal bonds, including utility debt sold by Boynton Beach.

The hazards outlined by CDP aren't reflected in the prices of state- and local-government securities, which continue to hover near record-low yields. "These risks will undermine your tax base. They'll undermine your economy, and ultimately they will undermine the ability to pay back the debt, which is what investors really care about," said Eric Glass, a portfolio manager for fixed income impact strategies at AllianceBernstein. "They are material risks, and I don't think investors are entering this into their credit analysis."

CDP asks companies and sub-national governments to submit reports every year explaining the specific concerns they have about climate change and what they're able to do about them. At least 620 cities filled out those surveys for 2018, which the British nonprofit scored by type and quantity of threat, in its eighth annual assessment. Fewer than half of those cities have conducted citywide climate vulnerability assessments, which Appleby linked to increased action to lessen risk.

More than 40% of the hazards that cities reported last year are likely to occur in the relatively short-term, according to the group's seven-page analysis, well-within that 30-year time-frame of a typical muni bond. That's an improvement compared with trends before the 2015 Paris Agreement, Appleby said, but still insufficient. Climate threats are going to keep increasing, particularly after mid-century, according to the UN's Intergovernmental Panel on Climate Change, which means, theoretically, that cities should report more threats in the future, not fewer.

"What cities are reporting doesn't line up with what the science tells us the future will be like," Appleby said.

St. Louis, for example, is planning for drought when it's also at risk of flash floods, which can bring water-borne diseases. The city was struck with outbreaks of Legionnaires' and cryptosporidium in 2014 and 2015. Heavy rain and ever-higher tides threaten low-lying businesses in Boynton Beach. In its 2018 survey, the city noted local snorkeling and scuba trips could diminish as more coral reefs die. Lakewood is staring down the barrel of extreme heat, heavy snow, drought, forest-fires and greater insect infestation.

Banks and other businesses are preparing for future threats as well. The Federal Reserve Bank of San Francisco last week published an 18-chapter volume dedicated to climate risks in low- and moderate-income U.S. communities. The report calls for an entirely new system for financing resilient infrastructure.

“Historically, cities have taken the approach of willful ignorance because actual notice of a problem often legally required them to do something about it,” said Jesse Keenan, a climate risk and adaptation specialist at Harvard University and the editor of the new Federal Reserve volume. “Some cities are actively disclosing the risks and uncertainties with the hopes that they can dictate the terms of how they will invest in the adaptation.”

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