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At Pimco, Climate Change Is Happening Sooner Rather Than Later.

- **Muni analysts treat climate change as more a near-term threat**
- **Traditional credit factors are seen through 'different lens'**

The typical municipal-bond analyst already wields an array of jargony acronyms befitting the niche market: GO, COP, POS. Now comes WUI.

That's wildland urban interface, a term once confined to firefighters and academics. But since 2017, when some of the most destructive fires in California history burned entire neighborhoods, analysts for bond giant Pacific Investment Management Co. have increasingly focused on whether muni-bond sellers reside in that kind of environment, where people live near brush and trees and are at a greater danger from fire.

"When we make investments in California, we take a birds-eye view of where these communities are located," said Sean McCarthy, Pimco's head of municipal credit research, in an interview. "It's not just the warming climate — there are more homes in harm's way, there are more human ignition sources."

That's just one of the ways the firm is assessing the impact of climate change, which for its analysts has moved from a long-term threat to one that could impact local governments within three to five years. They look at traditional metrics such as the size and diversity of the tax base with a "different lens" and evaluate how resilient they would be if there's a fire or other natural disaster, he said.

"It's front and center more on the individual analyst's mind when they're doing their ratings process," said McCarthy, whose firm holds about $50 billion of municipal bonds. "We are more acutely concerned about some of these longer-term risks falling within the shorter-term ratings horizon than we were in the past."

Investment and rating companies are seeking to reassure investors in the $3.8 trillion municipal-bond market that they're accounting for climate change when they evaluate issuers given how state and local government bond sellers are on the front lines. Climate scientists predict hurricanes will intensify and rainfall will increase in a warming globe. In California, the biggest municipal-bond issuer, 10 of the 20 most destructive wildfires have occurred since 2015.

Pimco analysts use an internal tool that pulls up dozens of different financial metrics by zip code. If a jurisdiction is within an elevated risk area, they consider offsetting factors such as support from state and local governments. (For instance, California lawmakers backfilled lost local property-tax revenue due to wildfires in this year's state budget.)

"A geographically desirable city, such as Malibu, California — which has strong credit factors and occupies prime oceanfront property — will likely show relative resilience after severe wildfires, with residents more willing and able to return to rebuild," Pimco analysts wrote in a report this month.

How essential the project being financed also gets scrutinized. A local government at risk from wildfires is more likely to continue making debt payments on a hospital than an arena, for instance. And important considerations some may overlook, McCarthy said, are technicalities of the deal, such as the ability of an issuer to redeem the bonds before maturity.

A lower internal rating doesn't necessarily mean Pimco would avoid buying the bond altogether, but "we should be compensated with greater risk premiums," he said.

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