

Bond Case Briefs

Municipal Finance Law Since 1971

Fitch: CA Weather Events Underscore Climate Risks to Local Govts, Utilities

Fitch Ratings-Austin/San Francisco/New York-26 January 2023: Recent extreme weather events in California underscore the state's challenges in addressing storms, drought, wildfires and widely fluctuating temperatures, Fitch Ratings says. Mitigating climate risk is an important part of the state's current fiscal 2023 budget, which provided \$54 billion over five years in climate-related spending that will help local governments, utilities and other entities reduce greenhouse gas emissions and build resilience to environmental risks. These funds will also supplement municipal governments' resources and help preserve general fund flexibility.

To date, state and federal disaster relief funds have largely mitigated the financial impact of weather-related events on Fitch-rated local governments. However, local government credit quality could be affected if there are reductions in state and federal disaster support, and local resources are insufficient to address adverse effects.

The state now projects fiscal 2023 general fund revenues, prior to transfers, will be \$12 billion (5.5%) lower than the June 2022 enacted budget estimate with general fund revenues forecast to be essentially flat to fiscal 2023 at \$209.7 billion in fiscal 2024, \$24 billion (10.2%) lower than the June 2022 estimate. One of the balancing solutions proposed by Governor Newsom in his recently released FY 23-24 budget would reduce the five-year climate spending to approximately \$48 billion.

The fiscal 2022 and 2023 budgets committed \$649 million to combat extreme heat and \$1.9 billion for community resilience investments over multiple years to promote climate resilience in low-income and underrepresented communities. These funds may help local communities and governments reduce general fund spending or debt financing to address weather and climate issues. While lower, the most recent budget plan maintains \$444 million (68%) of extreme heat funding and \$1.6 billion (85%) of community resilience funding.

Recent rainstorms that have destroyed property and left thousands without power, primarily along California's coast and Sacramento valley, illustrate the impact that extreme weather events have on the state. Counties, cities and utilities that saw damage from the storms are expected to face significant clean up and rebuilding costs; however, affected entities are highly rated and have financial resources, including federal and state disaster aid, to address repairs. The Federal Emergency Management Agency (FEMA) is making federal disaster assistance available to supplement local and state resources, including funding, equipment and personnel. The state's fiscal 2021 and 2022 budgets committed a total of \$1.3 billion for coastal resilience, which may be available to help these communities prepare for and mitigate future flood events.

The fiscal 2023 budget also funded programs that provided support to the electric grid during the September 2022 extreme heat event. The California Independent System Operator (ISO) declared an Energy Emergency Alert amid record breaking temperatures and energy usage across the state, asking residents and businesses to reduce their electricity use to avoid blackouts. Droughts reduced hydro generation, straining the ability of the energy grid to meet demand and thrusting reliance

back on fossil fuels for energy generation. In turn, purchased power prices, already elevated from higher natural gas prices, spiked further due to scarcity, increasing costs for electric utilities.

Utilities with pass through fuel adjustment cost mechanisms in their rate structures that allow rates to be adjusted in response to mid-year power cost increases are better positioned to manage the financial burden of grid strain and recoup higher power costs. Conversely, increased costs may pressure the financial margins of utilities without automatic adjustment mechanisms if rate increases are not approved.