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Texas Drought Forces Small Town to Default on Water System Debt.

- **Clyde, Texas, missed its Aug. 1 municipal bond payment**
- **The action caused S&P to drop debt rating from A- to D**

A persistent drought in Texas is hurting the finances of a small town, making it unable to pay bondholders in a rare instance of climate-related default.

The city of Clyde, located roughly halfway between Dallas and Midland, informed investors it couldn't make a debt payment due in August, according to a securities filing. Instead, its bond insurers — Assured Guaranty and Build America Mutual — were asked to cover the payment, illustrating the financial strain facing the city.

“Such draw is unscheduled and reflects financial difficulties of the issuer, including without limitation financial difficulties resulting from increased costs related to operations and maintenance of the issuer's waterworks and sewer system,” the filing dated Aug. 15 read. The bonds were sold to support the city's water and wastewater system.

That caused S&P Global Ratings to drop the grade on the bonds to D from A-, a whopping 15-notch downgrade, according to a report from the company late Friday. It also cost the city its A- credit rating, as S&P downgraded Clyde's general-obligation debt to B, which is below investment-grade.

Analysts led by Misty Newland wrote that “a lack of willingness to pay an unconditional debt obligation results in a rating cap.”

Clyde is a commuter community near Abilene, and is home to about 4,000 residents. Roughly one-third of Callahan County, where it's located, is facing a moderate drought. The city has been implementing a drought-contingency plan for several years, which includes double-digit water reductions. Following the restrictions, the town's water sales decreased — which hit revenues.

On Aug. 1, the day the bond payment was due — Clyde issued a “water emergency” notice, outlining “severe water shortage” conditions with the intention of reducing usage by 30%.

Local government bond defaults are incredibly rare, with those caused by climate-related events all but unprecedented. While bondholders will be made whole because the debt is insured, Clyde's financial challenges are a stark reminder that the \$4 trillion municipal bond market isn't without risk and extreme weather can pose a threat.

Texas is the epicenter of such weather events in the US, and has faced multiple disasters this year. Hurricane Beryl knocked out power in Houston for days in July. A May derecho punched windows out of skyscrapers in the city and a storm that month dropped hailstones the size of DVDs near Lubbock. The largest wildfire in state history burned more than 1 million acres in the panhandle in February and March.

Currently, more than 30% of Texas is experiencing drought conditions, according to the US Drought Monitor. The most extreme issues are in western part of the state, but almost all of North Texas is facing dryness. Governor Greg Abbott has issued a drought disaster proclamation for the state.

To help reduce water usage, officials in Clyde have prohibited the use of water for cleaning sidewalks and driveways. Only new lawns at residents' homes can be watered, not existing ones.

The drought has affected life in other ways. Some residents were unhappy that a splash pad — which is a playground of sprinklers used by children — wasn't working, according to local news station KTXS.com.

"Would you rather have your splash pad running so your kid can spend two hours a day in the water there, or do you wanna be able to bathe your kid with water at your house?," the mayor told KTXS.com.

Michael Stanton, head of strategy and communications at Build America Mutual, said in an emailed statement that the company's insurance protected investors. "Although this is a small exposure, our team is in contact with city officials and their professional advisors and will continue to represent bondholders' interests in those discussions," the statement read.

Robert Tucker, senior managing director of investor relations and communications at Assured Guaranty, said in a statement that bondholders would be protected. "The type of situation Clyde, Texas, encountered - unexpected conditions leading to the non-payment of debt service - is exactly what our bond insurance is designed for," he said.

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