



## U.S. State and Local Government Watching ESG in California, 2019

### Rising Importance of ESG Factors

#### Focus on the Environmental, Governance in California

Environmental, Social, and Governance (ESG) related factors have become more relevant to investors in recent years. When considering ESG factors, investors are attempting to carve out and even shape missions that drive a positive environmental or social impact. Investors are expressing an increased interest in participating in financings that could be described as socially responsible investing. The new focus also acknowledges environmental changes that are increasingly evident in the United States, including escalations in extreme weather. For example, the annual average temperature in the United States has increased by 1.8 degrees Fahrenheit from 1901 to 2016 and is forecast to increase another 2.5 degrees, according to the [U.S. Global Change Research Program](#). We are going to focus on the “Environmental” and a little of the “Governance” parts of ESG as it relates to recent events in California.

#### California Wildfires

Dry and windy conditions are more prevalent in the spring through late fall in many California regions. While there has been an uptick in California wildfire activity starting in 2017 to date, [California Department of Forestry and Fire Protection](#) data shows a history of sporadic wildfire experience going back to when they began collecting data in 1932. The time periods in which the largest, deadliest and most destructive California wildfires have occurred are all over the map, with [the two largest California wildfires occurring in December 2017 and July 2018](#).

In recent years, California has battled significant wildfires, as many have surely read or even observed. The reason the fires begin are most often due to human error. In some cases, [electrical malfunctions](#) have been to blame. But the environmental element is rooted in the idea that temperatures are rising and moisture is falling. The rising temperatures and reduced amount of precipitation have been contributing factors to the fires quickly spreading and overall magnitude of the blazes relative to past wildfires in California, [according to scientists](#).

So far, there has only been a small to minimal amount of municipal market issuer related credit impact as a result of the California wildfires. This outcome could very well change as financial losses and lost economic output due to the fires and from the power outages mount. In July, the Governor created a Wildfire Fund that the state’s investor-owned utilities could access to cover future liability claims.<sup>1</sup> In January 2019, Pacific Gas and Electric Company (PG&E), California’s largest investor-owned utility declared bankruptcy, mainly due to potential claims from past wildfires. Another recent example of harm occurred in 2018. Paradise, CA suffered a [90% loss of population](#) as a result of a 2018 wildfire. It is speculated that drought was a contributing factor in Paradise as the town [typically receives five inches of rain in the summer but only received one seventh of an inch from May to Nov. 2018](#). Such events are so far much more the exception than the rule. At this time we are unable to speculate about whether we expect this relationship to change anytime soon, however.

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### California Governor Newsom Declares State of Emergency

What is happening so far in 2019? So far state and federal resources are being mobilized as [California Governor Newsom declared a State of Emergency](#) for Sonoma and Los Angeles counties at the end of last week in response to the impact of the Kincade and Tick fires. Governor Newsom also announced [California secured Fire Management Assistant grants](#) that allow state and local governments to recoup eligible costs.

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### FEMA Disaster Declarations

There were 10 wildfire [disaster declarations](#) by the Federal Emergency Management Agency (FEMA) in California in 2018, and two in 2017. So far in 2019 FEMA has only named six disaster declarations in California: One for a July earthquake and five for severe storms and flooding that occurred between March and May. To this point in 2019, there have been zero California disaster declarations for fire-related events. As noted however, [FEMA has award Fire Management Assistance grants](#) in October for the Getty, Tick, Kincade, and Saddleridge fires. On [FEMA's website](#) the first item reads:

California Wildfires: FEMA is monitoring the wildfire activity in California and coordinating with state officials.

### Recent Power Outages

Hundreds of thousands in California have been experiencing power outages as [electric companies try to reduce the risk of wildfires in the face of rising winds](#). This is another factor that could potentially impact credit. But we are not yet seeing that it has had an impact that is likely to move the needle on state and local government or municipal claims' paying ability above events that have already occurred. Moody's Analytics data estimates power outages cost PG&E customers \$400-\$600 million in lost economic output.<sup>2</sup> And a Moody's Investor Service report notes this should be put into the context of the \$3.1 trillion GDP of the state of California.<sup>3</sup> However, it is important to monitor how this potential lost output number mounts, as we noted above, and whether or not there ends up being any specific concentration on a single local government or entity.

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### In Summary

It does not appear that the 2019 wildfire experience in California is quite at the level experienced in 2017 or 2018. However, weather patterns can shift quickly, and it is something we are watching. The power outages Californians have been experiencing have been more than a nuisance for sure and they are certainly impacting business activity. Just how much business activity is being impacted is not yet known and whether or not it impacts economic output and population statistics is also not known. But, we will be watching closely to attain the answers so we can get a better credit picture going forward.

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<sup>1</sup> California (State of); Wildfire fund will reduce likelihood of utility bankruptcies and market uncertainty, a credit positive for the state; Moody's Investor Service; July 25, 2019.

<sup>2</sup> Lights Out in California; Moody's Analytics; Oct. 11, 2019.

<sup>3</sup> Public safety power shutoffs highlight links between environmental and social risks; Moody's Investor Service; Oct. 28, 2019.

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