



U.S. Municipal Bond Market

The Coming Climate Change Reallocation

**“This is Going to Change the Municipal Bond Market,”
said Blackrock CEO Larry Fink**

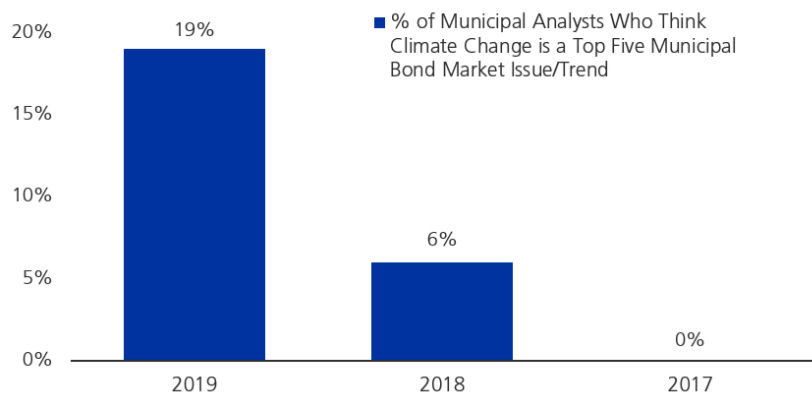
The largest money manager in the world recently made sustainability a central tenet of his firm’s investment thesis and predicted a coming major reallocation of capital due to the impact of client change. Blackrock CEO Larry Fink also said:

“I do believe this is going to change the municipal bond market. Areas that are more impacted by climate change [are] going to have a harder time financing their debt if they do not focus on the impact of climate change in their district, in their region, or in their cities.”

And we agree.

Both the reallocation of capital and the impact to municipal bonds is going to happen over time—most likely years not months. Select investors are considering climate-change related pressures during their decision-making now, but the practice is not widespread. A June 2019 working paper concluded that only 26% of institutional investors (not municipal specific) incorporated climate change-related risks into their investment analysis.¹ However, the importance of climate change has increased among municipal bond analysts year over year. In a 2019 survey, 19% of municipal analysts responded that climate change is one of the most important issues/trends/factors facing the municipal bond market right now,² compared to only 6% in a 2018 survey. We will conduct that survey again in April 2020, and we expect climate change’s position will increase again. The pace investors take in transitioning to a thesis similar to Blackrock’s will likely quicken as investors are presented with convincing data and analysis of the threat.

Municipal Analysts See an Increased, but Still Relatively Minor Risk from Climate Change



Source: Smith’s Research and Gradings and PNC Municipal Bond Analyst Surveys conducted by Tom Kozlik.

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The Data

The available data to assess the impact of climate change in the municipal bond market is maturing. risQ, a climate-risk analytics start-up, is teaming up with Intercontinental Exchange's ICE Data Services to provide risk management numbers on a CUSIP by CUSIP basis.³ risQ has compiled data on cities, counties, utilities, school districts, and hospitals. The effort is soon expected to compile data on continuing care retirement communities, higher-education issuers, and charter schools.⁴ Rating agencies are assigning value to climate change-related information as well. This summer, Moody's took a controlling stake in Four Twenty Seven, a provider of physical climate risk data.⁵

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The Impact of Climate Change Conditions to Evolve in Municipals

Municipal market investors are likely to develop more stringent disclosure requirements related to climate change. Soon, we expect that investors will no longer be satisfied with selective voluntary disclosure as being sufficient. Using the above data, and/or similar statistics, investors are likely to compile climate change-related investment criteria across all sectors and areas of the country, allowing them to illustrate specific risk and rank exposure. Over time we expect that if issuers are not disclosing the necessary or required information, pricing results could be viewed negatively. This process is not likely to start out as outright rejections of certain or riskier credits, but it could evolve to that point.

U.S. State and Local Government Climate Change Preparations

State and local governments are taking notice of the importance of climate change risk. A Moody's survey published at the beginning of 2019 reported that 82% of cities who responded anticipated having climate-related plans in place by the end of 2019.⁶ The city of Miami began construction on its Miami Forever Bond project that is expected to protect areas of the city against rising seas levels and flooding. Voters approved the \$400 million program in November 2017.⁷ Meanwhile, the state of California is considering over \$4 billion of climate change bonds that would be used to reduce wildfire risk, protect farmland and water sources from climate-related risks, and help coastal communities prepare for rising sea levels.⁸ Investors and other market participants will surely be watching to see how the issuer reaction, or lack of a reaction, differentiates the municipal landscape.

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Additional Sources and Other Information

- [Climate risk and response: Physical hazards and socioeconomic impacts](#); McKinsey Global Institute; Jan 2020.
- [Sustainability as Blackrock's new standard for investing](#); Blackrock Letter to Clients; Jan 14, 2020.
- [A fundamental reshaping of finance](#); Larry Fink Letter to CEOs; Jan 14, 2020.
- For the Sorkin interview of Larry Fink, please see Pippa Stevens; [Here's how the world's largest money manager is overhauling its strategy because of climate change](#); CNBC; Jan 14, 2020.
- [Taking the heat: Making cities resilient to climate change](#); Goldman Sachs; Sept 2019.
- [Climate risk: Regulators sharpen their focus – helping insurers navigate the climate risk landscape](#); Deloitte Center for Financial Services; 2019.
- [Climate change risks present challenges for housing-related sectors](#); Moody's; April 19, 2019 (subscription required).
- Wallace-Wells, David; *The Uninhabitable Earth – Life After Warming*; Tim Duggan Books; 2019. Thanks to Tom Doe for the book recommendation.
- [Despite climate risk and hurricane damage, Florida and Texas maintain strong credit quality](#); Moody's; Feb 8, 2018 (subscription required).

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¹ Bershidsky, Leonid; [Moody's Catches on to Climate Risk Mispricing](#); Bloomberg; July 25, 2019.

² See the [Municipal Bond Analyst Survey, April 2019](#) by Tom Kozlik at Smith's Research and Gradings, compared to the [Municipal Bond Analyst Surveys from April 2017 and 2018](#), all conducted by Tom Kozlik.

³ Funk, Lynne; [risQ, ICE partner on climate change analysis for muni market](#); The Bond Buyer; Jan 9, 2020.

⁴ *ibid.*

⁵ [Moody's acquires majority stake in Four Twenty Seven, Inc., a leader in climate data and risk analysis](#); Moody's Investor Relations; July 24, 2019.

⁶ [Cities heightened focus on mitigating climate risk is a credit positive](#); Moody's; Jan 17, 2019. Subscription required.

⁷ [Miami Forever Bond Project to mitigate effects of sea level rise](#); Miamigov.com; March 1, 2019.

⁸ Beam, Adam; [California eyes climate bond to prepare for disasters](#); Associated Press; Jan 5, 2020.

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