Municipal Market Analytics

MN House of Representatives Capital Investment Committee Hearing

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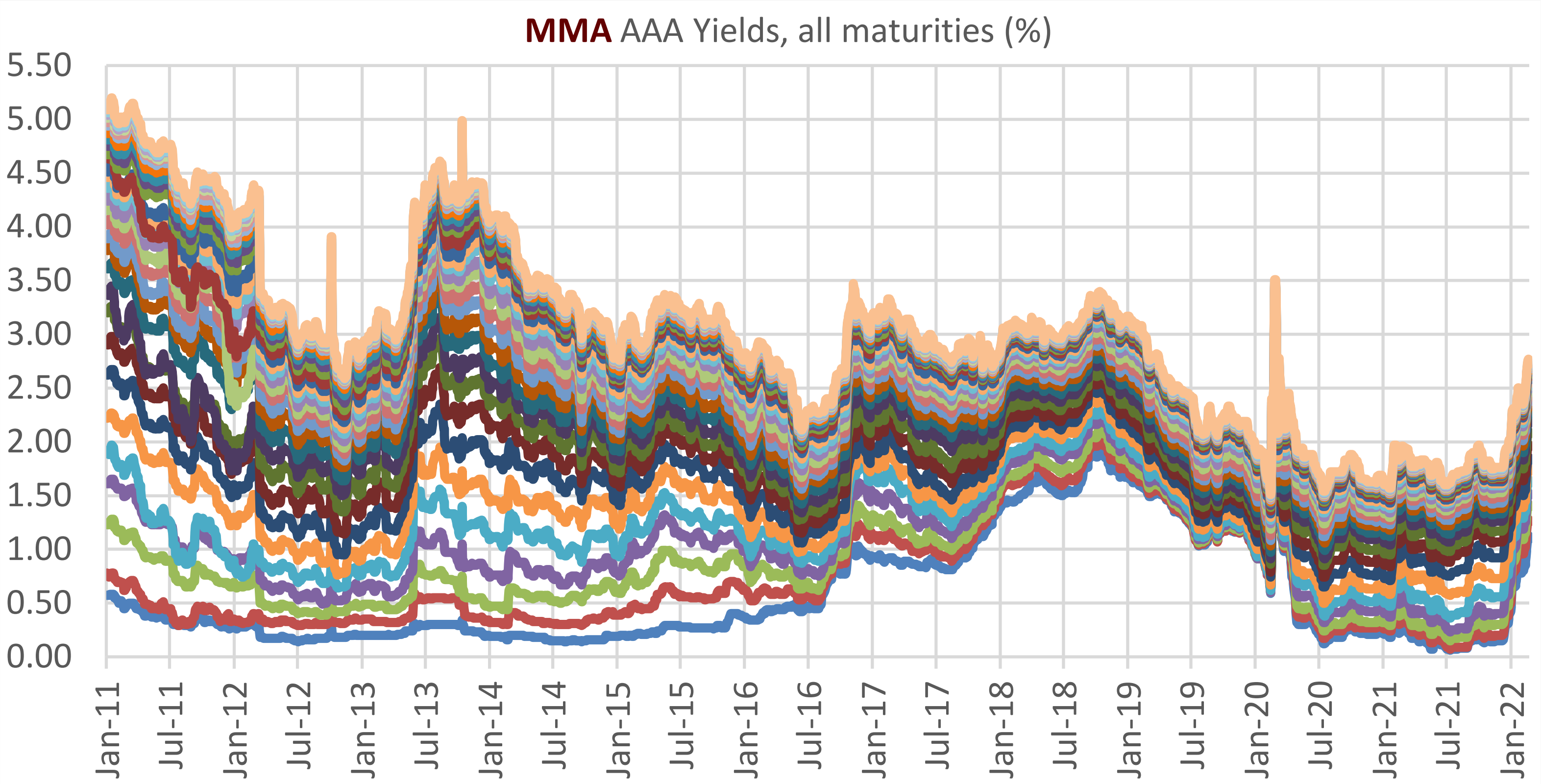
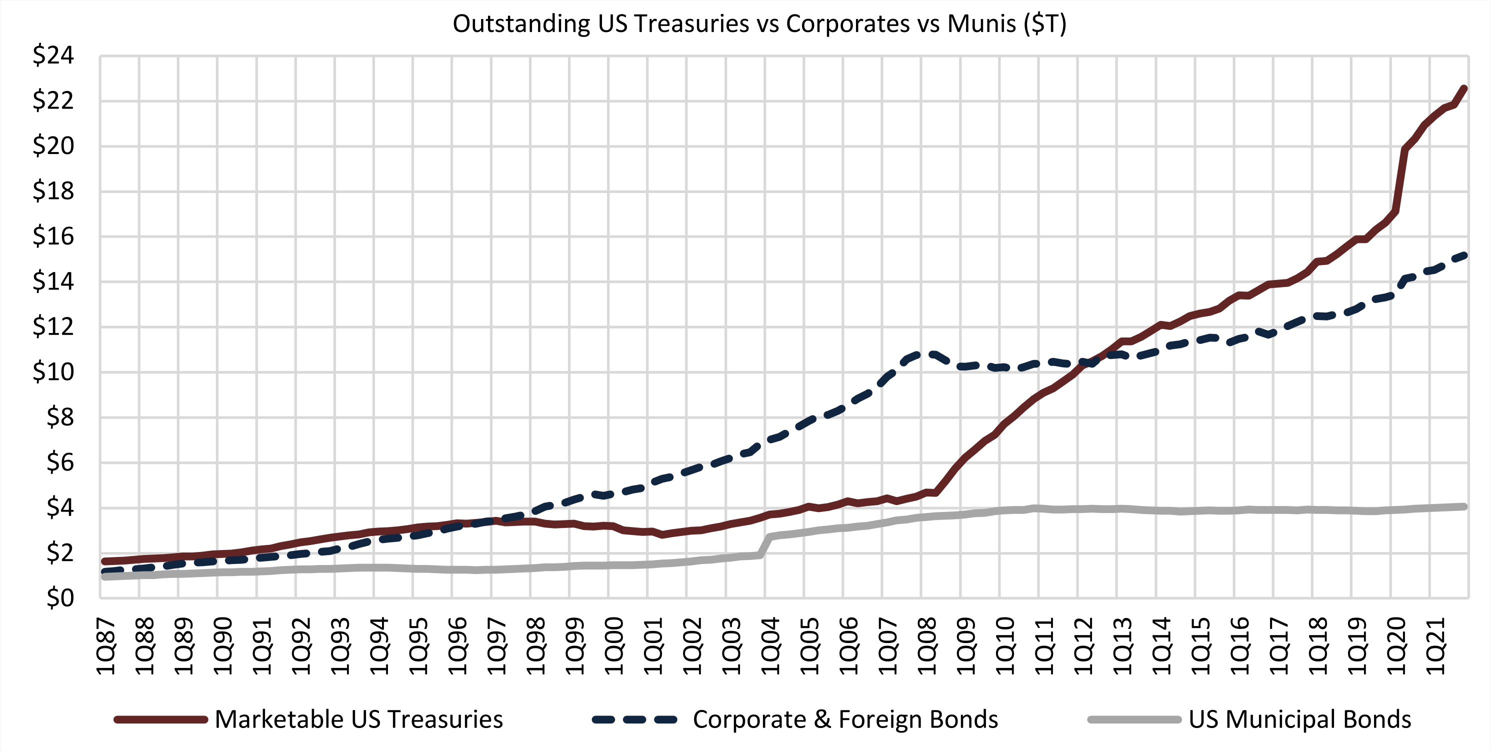
Despite rising bond yields in 2022, tax-exempt borrowing rates are still low (and tightly clustered) by historical standards



This reflects, mostly, scarcity; state and local borrowers haven't borrowed very much for new projects in recent years



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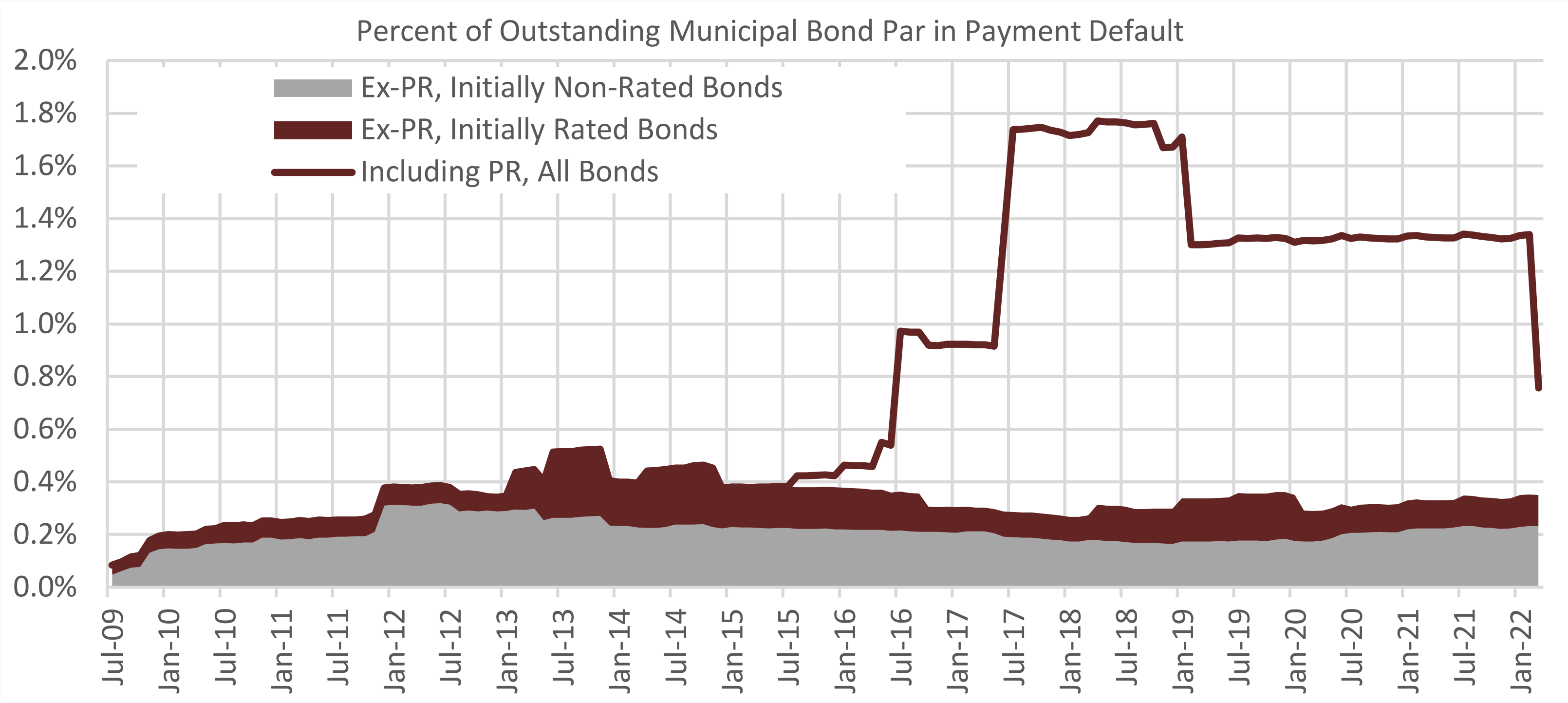
And because the municipal default rate is extremely low, even considering Puerto Rico's defaults



Scarcity & confidence encourage investors to absorb issuers' climate risk

- Despite the rhetoric from large investors that climate change is a critical element of their investment policies, there is little to no evidence that a climate penalty has been applied to borrowers (issuers) who have measurably high climate risks
- Instead, investors have utilized idiosyncratic risk management tools (highly diversified funds, high yield strategies, ultra-high net worth investors, ETFs) to digest the risk of climate-affected credits defaulting
- These strategies, and market function in general, would be in jeopardy if climate change risks become systemic (i.e., disrupting a material number of debt service payments at the same time in the same way)

Distributed data likely to create change

- Borrower disclosure of risks has been non-systematic; will likely improve, likely through regulatory (i.e., SEC enforcement) action
- The Government Finance Officers Association (GFOA) has taken a step to open dialogue with investors, bankers and regulators regarding disclosure of climate risks; climate data can be utilized in the proper planning of projects to benefit stakeholders, including investors
- Still, the best and most robust data are likely to come from third parties, limiting issuers' control over the information investors use to make allocation decisions
- Improvement and change in third-party data sources are unpredictable and could be rapid, with immediate downstream effects on pricing, etc.
- **Issuers must not only understand general climate risks in their portfolio but also how third-party data sources are changing**

Climate perils do not often include migration or political risks

- Industry and borrowers tend to focus on immediate, granular physical perils: Avalanche; Coastal Flooding; Cold Wave; Drought; Earthquake; Hail; Heat Wave; Hurricane; Ice Storm; Landslide; Lightning; etc.
- However, people and companies can move: Puerto Rico is an example of material risk from migration that could accelerate if things get worse
- Migration can also be at least a near-term positive; consistent domestic migration to TX & FL provides resources for adaptation/mitigation
- Political risks can outweigh all the above; state legislatures failing to be proactive could wind up overspending on recovery or remediation of one geographic area, at the expense of regular or emergency spending in all other geographic areas
- Areas of regional economic importance may not carry as much political importance in a state government, allowing an inefficient state response in general