MOODY'S
INVESTORS SERVICE

SECTOR IN-DEPTH
10 June 2021

Rate this Research

Contacts

Joseph Manoleas +1.415.274.1755
Analyst
joseph.manoleas@moodys.com

Eric Hoffmann +1.415.274.1702
Senior Vice President/Manager
eric.hoffmann@moodys.com

Leonard Jones +1.212.553.3806
MD-Public Finance
leonard.jones@moodys.com

Local Government – California

Municipalities will withstand credit risks posed by heightened wildfire threat

Environmental conditions in California (Aa2 stable) suggest the state's major economic centers are heavily exposed to damage from a potentially devastating 2021 wildfire season. Yet credit risks for local governments we rate are minimal considering generally strong liquidity, large tax bases, private insurance, and the levels of federal and state emergency aid following natural disasters. In a sign of municipalities' ability to withstand damage, no public finance issuer we rate in California or elsewhere in the US has defaulted because of a natural disaster since at least 1970.

» **Heightened physical risk from wildfires this year threatens local governments, including economic hubs.** Exceptionally hot and dry conditions increase the likelihood of a longer and more severe 2021 wildfire season. Most of California's major economic hubs, which collectively account for nearly 80% of state wages, are at "high" physical risk from wildfires, according to Moody's affiliate Four Twenty Seven (see Exhibit 1).

» **Enduring factors mitigate credit risks from wildfires.** Robust balance sheets, expansive tax bases and Federal Emergency Management Agency (FEMA) assistance in particular will continue to spur relatively quick recoveries in the aftermath of major wildfires. Private insurance also helps, though many insurance companies have dropped coverage which poses a longer-term challenge.

» **Additional state action aims to strengthen wildfire prevention and response**. Governor Gavin Newsom's proposed $100 billion "California Comeback Plan" budget includes $2 billion to bolster preparedness through improved forest management, increased community investments and more firefighters and equipment. The state has also taken steps to require homeowners to mitigate risks.

Exhibit 1
California's largest economic centers are at elevated physical risk for wildfire damage
Largest 10 counties by wages earned

County	Wages as a % of state total	Wildfire risk
Los Angeles County	22.50%	High
Santa Clara County	12.69%	High
Orange County	8.22%	High
San Francisco County	7.75%	Medium
San Diego County	7.60%	High
Alameda County	5.17%	High
San Mateo County	4.71%	High
Sacramento County	3.47%	Medium
San Bernardino County	3.18%	High
Riverside County	2.93%	Medium
Total 10 county wages as % of state wages	**78.22%**	

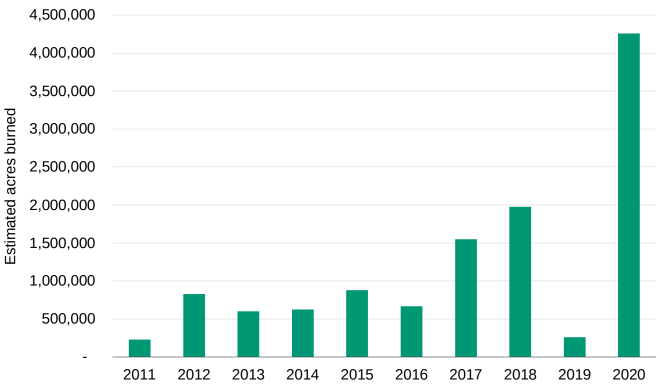
Wildfire risk classified by climate research firm Four Twenty Seven, a Moody's affiliate.
Sources: Four Twenty Seven and Bureau of Labor Statistics

Heightened physical risk from wildfires this year threatens local governments, including economic hubs

Drought conditions, below-average rainfall and hotter temperatures signal a more destructive wildfire season in 2021 than last year's record (see Exhibit 2), increasing the likelihood of local governments incurring physical damage. Of the 10 counties that collectively account for nearly 80% of the state's taxable income, seven are at “high”physical risk and the others at “medium” risk, according to Four Twenty Seven.

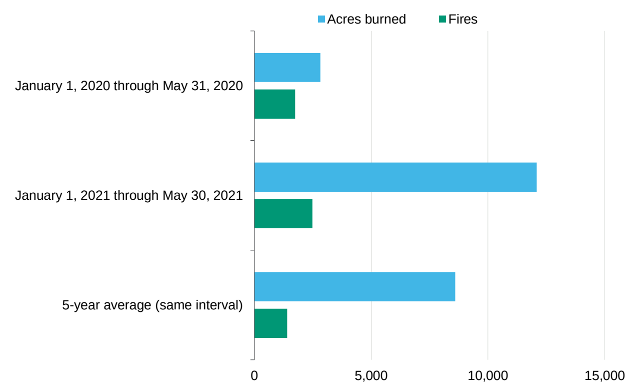
The acreage burned by wildfires soared in 2020 (see Exhibit 3) and there are signals of possibly greater trouble this year. Grasses, shrubs and forests are drying out because of a lack of precipitation while unseasonably warm spring temperatures have melted snowpack, essentially shrinking winter and expanding wildfire season. Because of a troubling combination of high winds, heat and low humidity, red flag fire warnings have already been declared this year across broad swathes of the state, which is unusually early and well before the traditional August and September peak of wildfire season. Heading into the summer months, the number of fires and acres burned from January 1 to May 30 this year are up compared to last year and relative to recent history (see Exhibit 3).

Exhibit 2
Wildfire destruction has increased over the past decade…



Source: Cal Fire

Exhibit 3
…and damage in early 2021 has surpassed last year at the same point



Source: Cal Fire

Enduring factors mitigate credit risks from wildfires

California local governments we rate generally benefit from several characteristics that limit credit risks from wildfires, which will remain strengths in the potentially catastrophic 2021 fire season. Liquidity remains strong, tax bases are large and FEMA has historically served as an important source of emergency support. Private insurance can also assist in the rebuilding and recovery process. In a sign of California municipalities' low credit risk, no Moody's-rated public finance credit in the US has defaulted because of a natural disaster since at least 1970.

Liquidity is particularly important because it helps a municipality pay for immediate recovery costs while waiting for FEMA reimbursement. Financial assistance under the agency's Public Assistance Program amounts to at least 75% of eligible expenses. State disaster assistance for local governments will likely fund a substantial portion of the remaining associated costs.

California cities, counties, school districts and community college districts all maintain fund balance and other liquidity positions that compare favorably to national levels. This fire season, municipalities will also benefit from an infusion of non-recurring coronavirus aid. While the relief money is generally restricted in nature, it can free up other resources to spend on wildfire preparedness and recovery.

Santa Cruz County (Aa3) serves as an example of an issuer that endured a major wildfire with minimal credit effects. The county reported 945 homes damaged or destroyed during an August 2020 fire, resulting in a county-estimated $220 million loss in its tax base (assessed value or AV). Like many California local governments, however, Santa Cruz County, benefits from a large property tax base. The loss amounted to a very modest 0.44% of total AV and the estimated property tax loss to the county's general fund was a modest $361,000 in fiscal year 2021 (end June 30, 2021). The county reported $23 million in immediate relief costs related to relocation, emergency shelter and debris removal and it expects to be reimbursed $16 million from FEMA. Although the county has historically maintained a below-average reserve position, the wildfire impact was manageable relative to the county's total general fund expenditures ($543 million) in fiscal 2020 and readily available liquidity ($165 million).

In similar scenarios, Santa Rosa City Schools (Aa3 negative issuer rating) suffered abrupt enrollment loss while Sonoma Valley Unified School District (Aa3 issuer rating) experienced more subdued year-over-year tax base growth following wildfires in 2017 through 2019, but overall creditworthiness was not materially affected.

The destruction of the Town of Paradise serves as an extreme example of a wildfire's negative credit implications. The 2018 Camp Fire destroyed about 90% of the town's 19,000 structures, including 11,000 homes. The town's AV declined to $788 million from $2.3 billion in one year. Following the fire, the state estimated the population of Paradise declined by 83%. Still, Paradise made its scheduled bond payments through insurance settlements and state backfill of lost property tax revenue. The town has since received a windfall from Pacific Gas & Electric Company to settle claims from the wildfire, which will help its financial recovery.

Private insurance coverage can also serve as an important tool in facilitating rebuilding communities after destructive wildfires. However, after several billions of dollars in reported losses over the past decade many insurance companies have dropped coverage for private homeowners and commercial entities in high-risk areas, forcing customers to buy high-cost insurance from a state-sponsored plan. Over the long term, an inability to access insurance coverage could influence decisions where and how to build in fire-prone communities and could lead to population and tax base declines.

Congress has shown a willingness to keep FEMA aid widely available to help states and municipalities recover from natural disasters, and the Biden administration recently appropriated an additional $1 billion from the agency for states, local governments and other entities to invest in pre-disaster mitigation.

However, FEMA has taken a significant step to shift some disaster recovery costs from the agency to state and local governments. A proposed FEMA rule would raise the damage threshold to receive aid as part of its Public Assistance Program (see Exhibit 4). For major wildfires in California, however, the proposed FEMA changes are unlikely to pose any material, new hurdle to assistance.

Exhibit 4

Proposed changes to FEMA's Public Assistance Program would increase threshold for the agency's intervention

	Current FEMA rule	Proposed FEMA rule
Minimum threshold	At least $1.0 million in damages	At least $1.5 million in damages, increasing this threshold by CPI-U annually
Estimated cost of assistance	Damages must be at or exceed $1.50 per capita (increasing annually by inflation)*	Damages must be at or exceed $2.32 per capita, via an annual inflation and state revenue adjustment and using annual population estimates going forward**

*$1.50 is the FY 2019 per capita indicator, based on the $1 baseline in place since 1986, increasing by inflation since 1999.
**The new rate would account for inflation and adjustments for state total taxable resources from 1986 to 1999, increasing the threshold by inflation for 1999 through 2019 and annually thereafter.
CPI-U stands for consumer price index for all urban consumers.
Source: Federal Emergency Management Agency Proposed Rule, 85 FR 80745

Additional state action aims to strengthen wildfire preparedness and response

With wildfires becoming an increasing threat, the state has recently taken a number of steps to prevent and fight the disasters, both monetarily and otherwise.

With its revenue projected to remain robust despite the pandemic, the governor in May proposed an 8.5% increase in the California Department of Forestry and Fire Prevention's fiscal 2022 funding. The increase versus his earlier, January proposal would keep funding on par with the unusually high level for fiscal 2021. Additionally, the governor's $100 billion “California Comeback Plan” includes

$2 billion for an array of wildfire prevention and response measures such as hiring more firefighters, dead tree removal and forest management. In late 2020, the state entered into a memoranda of understanding (MOU) with the US Forest Service, which owns over half of the forestland in the state, to thin dense forest, use prescribed burns and harvest timber on 500,000 acres annually through 2025. The MOU also provides various resources and incentives for private landowners to clear and maintain particularly fire-prone forests.

Also, passed in late 2019, California Assembly Bill 38 strengthens homeowner obligations to mitigate the effects of wildfires. Starting July 1, 2021 the law requires sellers of property in a state-designated “high or very high fire hazard severity zone” to disclose certain vulnerabilities to damage involving landscaping, windows, roofing and other potential areas of exposure. It also calls for a California Wildfire Mitigation Financial Assistance Program to assist property owners with structural hardening, retrofitting and vegetation management.

Moody's related publications

Sector In-Depth

» Regulated Electric & Gas Utilities – US: Recent California wildfires do not imperil the credit quality of investor-owned utilities, September 22, 2020

» Property & Casualty Insurance - US: P&C insurers face mounting losses from California wildfires, August 25, 2020

» Public Power Utilities - US: Rising wildfire risks manageable for CA publicly owned electric utilities, except in extreme scenarios, May 27, 2020

» Electric & Gas Utilities – US: California utilities struggle with inverse condemnation exposure, April 15, 2019

» Public Power Utilities - US: FAQ: California public power utilities are not immune to wildfire risks, April 9, 2019

» Local Government - US: Cities' heightened focus on mitigating climate risk is credit positive, January 17, 2019

Sector Comment

» Local Government – California: Wildfires amid pandemic compound social and economic risks, but unlikely to hurt credit quality, August 26, 2020

» Regulated Electric Utilities – North America: Bill proposing fines for power shutoffs is credit negative for California utilities, January 31, 2020

Methodology

» General Principles for Assessing Environmental, Social and Governance Risks Methodology, April 26, 2021

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

REPORT NUMBER 1284994

MOODY'S
INVESTORS SERVICE