Community Finance Brief

Financing Resilience through Municipal Bonds

CSG

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The blessings of American prosperity have not, historically, been distributed equally. Of the many areas where this becomes hugely evident is when it comes to the resilience of our shared infrastructure, our homes and the related social fabric of our communities. Resilience has become a 'catch all' phrase as it pertains to impact investing as it transcends may areas: infrastructure, energy, water, agriculture/food systems, healthcare and financial systems. Yet, it is particularly difficult to pinpoint for government actors and their lenders based on some simple assumptions that must be defined in order to be properly engaged.

A thoughtful investment requires a vetting of assumptions around the present and future value of the object of an investment. Investing in resilience is almost entirely predicated on anticipating future risk/return while making present-day decisions. This poses significant policy and political challenges due to the complexities of present day calculations and the lack of immediate political rewards for doing so. Uncertain discount rates and future benefits versus present costs don't poll well. With this in mind, investing in communities that are overexposed to natural disasters and underinsured through municipal bonds offers a strategic approach to address both the immediate financial needs and long-term benefits. Competent and holistic resilience plans for communities require a multi-pronged approach but for the purposes of this *Brief* - we dive into why and how municipal bonds are critical to the capital stack.

Further, the outsized implications of climate risk for historically disinvested communities makes the role of government in their support all the more important. Government exists to protect all portions of our communities and, as such, have an extended obligation to engage these communities but also from a dollar and cents perspective, the future value of investing here plays larger dividends from a financial stability perspective as well as on a so-called social rate of return.

Quick Takes

Investing 'in resilience' in the amount of $1.8 trillion globally between 2020 and 2030 could generate $7.1 trillion in total net benefits
– *Global Center on Adaptation*

Damage from global natural disasters totaled $380 billion in economic losses driven by earthquakes and severe convective storms in the U.S. and Europe
– Aon

Federal Emergency Management Agency's disaster relief fund is on pace to run out of funds in August this year.
– *FEMA Deputy Administrator Erik Hooks*

Issuance of municipal bonds is predicted to be just north of $400 billion in 2024, up from the $330 billion issued in 2023.
– *CSG*, *The Bond Buyer*

THE CASE FOR MUNI BONDS

Municipal bonds offer a robust foundation for state and local governments to build resilience against future risks due to several key advantages. A case for the asset class:

1. Securitizing Present Risk and Future Dividends

- Present risk management: municipal bonds allow governments to securitize the present risk of not adapting to future challenges by providing immediate capital to invest in necessary infrastructure. This upfront funding is crucial for initiating resilience projects that can mitigate long-term risks.

- Future value realization: The future benefits of resilience investments, such as reduced disaster recovery costs and enhanced community stability, correlate well with the financial structure of municipal bonds. These bonds essentially pass the dividends of future value back to the present, ensuring that today's investments yield significant returns over time.

2. Community Engagement and Confidence

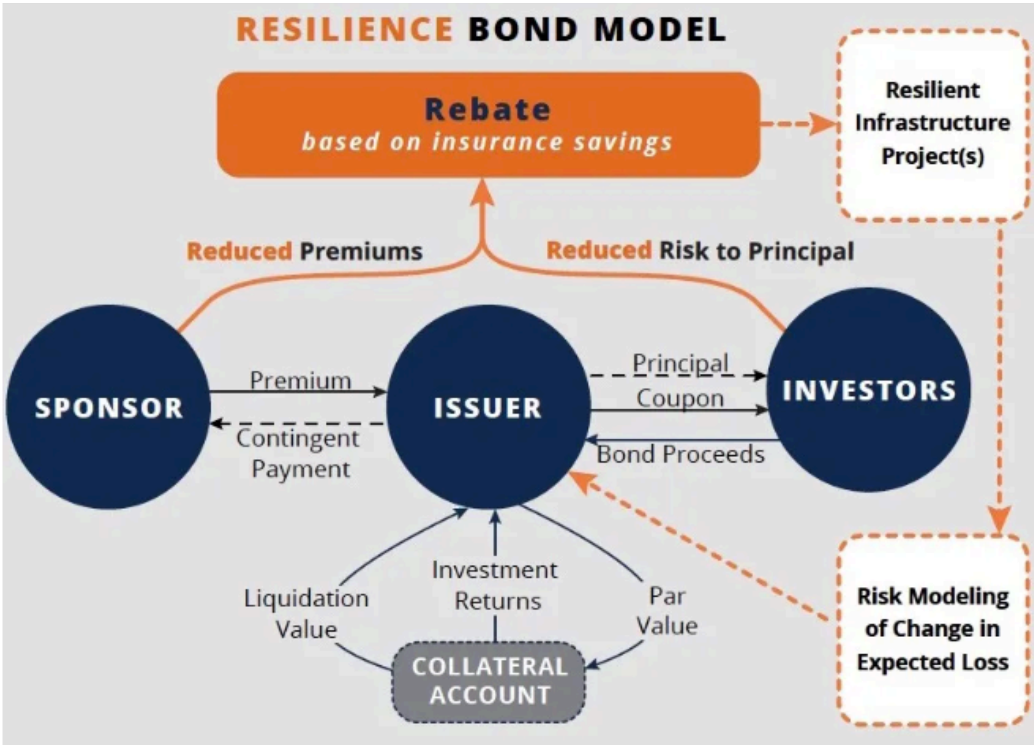
- Government commitment: The issuance of municipal bonds specifically for resilience projects sends a strong message to the community that the government is committed to addressing future risks. This can enhance public confidence and support for government initiatives, fostering a sense of proactive governance.
- Community involvement: By engaging the public in resilience financing, local governments can encourage community participation and awareness. This involvement is critical for the success of resilience projects, as it aligns public interest with governmental action as is described in this international example.

3. Legal Obligation and Accountability

- Bond covenants: Municipal bonds create a legal obligation for governments to use the proceeds for specified resilience projects if they chose to so. This would ensure that funds are allocated and utilized effectively, providing accountability and transparency in the use of public resources.
- Structured implementation: The legal framework of municipal bonds requires detailed planning and execution of resilience projects, which helps in maintaining a

"Accelerating climate change adaptation is desirable from multiple perspective. The human imperative its to address existing climate-related inquiries, as the criss disproportionally impacts vulnerable countries. The environmental challenge is to protect the ecosphere. In addition to the human and environmental imperatives, there is also a strong economic rationale. The Global Commission on Adaptation found that the overall rate of retune on investments in improved resilience is very high, with benefit-cost ratios ranging from 2:1 to 10:1. Specifically, the research shows that investing $1.8 trilling globally from 2020 to 2030 could generate $7.1 trillion in total net benefits." - **Global Center on Adaptation.**

structured approach to tackling climate risks and other challenges. This legal obligation can prevent the diversion of funds and ensure that resilience remains a priority.



4. Economic Sense and Cost Efficiency

- Low cost of capital: Municipal bonds offer a relatively low cost of capital, making them an economically sensible option for financing large-scale resilience projects. The interest rates on municipal bonds are often lower compared to other forms of borrowing, reducing the financial burden on governments.
- Cost of inaction: The increasing cost of not engaging in resilience projects—due to more frequent and severe climate events, infrastructure failures, and economic disruptions—far outweighs the cost of borrowing through municipal bonds. Investing in resilience now can save substantial amounts in future disaster recovery and economic losses.

RESILIENCE ACTION PLANS

The global increase in climate action among cities and regions around the world, by which the United Nations pegs the figure of engagement at six times higher in 2023 than in 2015, is welcome. The engagement in the U.S., like many things, has become politicized. While we see climate action plans as essential for cities, counties and state to systemically address the impacts of climate change - a roadmap for mitigating increased climate volatility in the form of a resilience plan could be a more results-oriented approach that focuses on *financing* resilience as the front-line action for policy-makers.

A key item here that differentiates itself is a focus on the financing elements. If a government would to begin by inquiring on the 'how do we pay for this' and 'who should pay for this' questions, the roll-out of actionable items would be more concrete. The situation of a project having received considerable policy-oriented endorsements and subsidies in pre-development but having never secured financing to move on with construction is an example that does not happen within a resilience actin plan (RAP) based approach.

Starting with a municipal bond foundation innately links policy and finance but the concept of securitizing the future value of adaptation projects offers a myriad of benefits from a financing perspective but is also **forces the community to quantify the cost of not adapting**. This is imperative to fully embracing the long-term upside of resilience.

Municipal bonds for resilience also lays a foundation for these policies to be focused on equity. Ensuring that the financial burdens and benefits are fairly distributed across different segments of the population is critical. Whether tax-backed or through another obligation, the use of a muni bond indicates community benefit rather than the promotion of a particular interest. The challenges of executing on this is evident, but starting with a bond like this offers an outcome that is more likely in the community benefit.

Beyond the structure of the bond itself, a competent RAP would lay out a more involved capital stack to encourage other types of investors. Cities can structure resilience bonds to include first-loss capital, where certain investors agree to absorb initial losses, thereby protecting other investors. This structure can make resilience bonds more attractive by lowering the overall investment risk.

By incorporating first-loss capital into a broader capital stack, cities can leverage additional funding sources, such as grants, public-private partnerships, and philanthropic contributions, to finance comprehensive resilience programs in vulnerable communities.

In summation, RAPs offer:

- Long-Term commitment: a focus on resilience and financing demonstrate a long-term commitment from state and local governments, fostering trust and support among stakeholders.
- Policy integration: These plans should integrate resilience financing strategies into broader policy frameworks, ensuring alignment with economic development, land use planning, and social equity goals.
- Cost-effective solutions: Investing in resilience through municipal bonds and other financial instruments can be cost-effective in the long run, reducing the economic burden of disaster recovery and enhancing community stability.
- Social equity: Targeted resilience investments can address vulnerabilities in marginalized communities, promoting social equity and ensuring that the benefits of resilience are widely distributed.

TRANSILIENCE:

RAPs should take advantage of the existing climate zeitgeist and promote *transilience:* combining the transition to zero along with adapting to increased climate volatility through resilience efforts. By integrating both migration and adaptation, a comprehensive policy develops.

Climate action in this method addresses immediate and long-term goals while encouraging broader stakeholder engagement by demonstration multiple benefits. The policy objectives around sustainable development also become clear when engaging in all efforts. Resilient and low-carbon infrastructure go hand-in-hand.

Further, state and local governments should ride the Greenhouse Gas Reduction Fund (GGRF) wave (while they can) and engage in transilience. There are currently large and unprecedented tax-credits that can be transferred as cash to local governments for engaging in transition efforts that can also be geared more broadly within a resilience framework. Once again - the focus on financing projects as a policy objective can help develop more long-term solvency through programs that are born out of the transition to zero movement worldwide.

Insurance companies can also leverage the the emerging state-level green banks to engage with the GGRF and other funding sources to support resilience initiatives. These green banks can serve as intermediaries, channeling funds into projects that bolster community resilience, reduce greenhouse gas emissions, and promote sustainable development.

RESILIENCE IN THE ABSTRACT AND IN THE FLESH

State and local governments can substantially improve their resilience financing strategies by embracing a financing-first approach that could very well lean heavily on municipal bonds. They should also consider wrapping these efforts up with transition to net zero efforts as they compliment each other from a policy perspective and there are novel financing structure and subsidies currently in place to support such efforts.

For the balance of the Summer and ahead of a series of workshops regarding resilience and public-private partnerships, **CFB** will cover theoretical models for resilience along with examples of how various communities are engaging in novel ideas now.

Broad areas of interest in the form of 'how':

- How to you structure resilience muni bond? (**see figure, page 3**)
- How can insurance companies change the way they invest in muni bonds to allow them to support communities whilst also offering affordable insurance in these same communities?
- How can bond banks level-up resilience efforts?
- How can data help these efforts?