Invesco

Investment Insights

Municipal Credit Update: 2025 Los Angeles Metro-Area Wildfires

Mark Paris
Chief Investment Officer,
Invesco Municipal Bond team

Tim Spitz
Head of Municipal Business
Strategy & Development

Mark Gilley
Head of Municipal Credit Research

Shaun Peters
Senior Credit Analyst, Municipals

Overview

- The wildfires in LA have destroyed more that 12,000 structures and caused upwards of $250 billion in economic losses.
- It is still early days, and the only way to assess credit impacts is to look at previous natural disasters, as well as the financial strength of the credit issuers before the fires began.
- We believe state and federal aid will be instrumental in rebuilding the region in the years to come.
- While we expect near-term volatility from headline risk, we do not believe the wildfires will lead to widespread negative credit actions over the long term.

We are deeply saddened by the wildfires in the Los Angeles area, and we sincerely hope all of our shareholders, clients, friends and colleagues in the area are safe as are their families and loved ones.

While we all wait and hope for the best possible outcomes to occur, investors are asking how the events could potentially affect their municipal bond holdings. As the situation continues to develop, we'd like to provide some historical context and our thoughts on municipal credits in the surrounding Los Angeles area.

Background

Since January 7, 2025, a series of devastating wildfires have ravaged the Los Angeles metropolitan area and surrounding regions. These fires, fueled by severe drought conditions and powerful Santa Ana winds, have burned over 40,000 acres and resulted in significant destruction. The two largest fires, the Palisades Fire in Pacific Palisades and the Eaton Fire in Altadena, have caused the most damage, destroying or damaging more than 12,000 structures and forcing over 200,000 people to evacuate.[1] Tragically, at least 28 people have lost their lives, and many more have been injured or are missing.[2]

Los Angeles County and its place in California

The county (Aa1/AAA/AAA)[3] is very large (4,059 square miles)[4] and as of January 14, 2025, the collective area burned by the three major fires represents just 1.5% of its total land area. We believe the county's size and importance to the state and national economy increases the likelihood of political support from both federal and state aid. Supporting our belief is Governor Newsom's proposal that the state legislature expedite $2.5 billion (bn) in emergency response funding for areas affected by the fires.[1]

What we know about the losses at this point

As of January 16, AccuWeather has projected economic losses to be in the range of $250bn to $275bn, with insured losses predicted to be as much as $30bn.[5] This is in contrast to the 2018 Camp Fire in Butte County which previously held the record for the highest insured loss wildfires in California's history at $12.5bn.[6] These estimated losses place the current wildfires in a more comparable position to Hurricane Katrina, which incurred inflation-adjusted damages of $200bn.[7]

Not a Deposit | Not FDIC Insured | Not Guaranteed by the Bank | May Lose Value | Not Insured by any Federal Government Agency

The 2018 Camp Fire in Butte County and its aftermath

The 2018 wildfires in northern California impacted more than150,000 acres and more than 18,000 structures, destroying more than 90% of the buildings in the town of Paradise.[7] S&P identified 10 school districts as downgrade candidates; however, nine of those credit ratings ended up being maintained or upgraded. The tenth school district—Paradise Unified School District, which lost most of its facilities in the Camp Fire—was downgraded one notch to A- in February 2019. Paradise USD is still rated A- today.[7]

Hurricane Katrina and New Orleans' municipal credits

The effects of natural disasters do not affect all municipalities in the same way, rather, the impact on credit quality and market performance tends to be very idiosyncratic. Looking back at Hurricane Katrina in 2005 and its impact on New Orleans as a guide, spreads widened significantly following the storm and the city's credit rating was downgraded four notches from BBB+ to BB. It returned to BBB+ in 2013, with no default occurring.[7] Following the hurricane, Moody's identified 51 credits in Louisiana and Mississippi that were at risk of a downgrade. The agency ultimately downgraded 29 of those credits in December 2005, citing anticipated declines in tax base values and population or enrollment losses.[7] The majority of the downgraded credits were small, local issuers. Encouragingly, none of those credits were further downgraded the following year; while the remainder of the 51 credits were unchanged (with one having been upgraded).[7]

LA compared to New Orleans and Butte County

The scale of destruction in the LA wildfires is likely to be much less than the 90% loss that Paradise, CA suffered in 2018. However, the economic loss is almost certain to be magnitudes greater—closer to that of New Orleans' losses after hurricane Katrina. Unlike the credits affected by Katrina, the municipal credits likely to be affected by the 2025 wildfires are higher in quality. The issuers tend to have a larger regional footprint, with a greater base of revenues. No defaults occurred as a direct result of Hurricane Katrina, and the issuers in the LA area will generally begin the long rebuilding process on stronger financial footing than similar credits New Orleans had.

Public utilities in the surrounding areas

Los Angeles Department of Water & Power (LADWP), Burbank Water & Power, Glendale Water & Power and Pasadena Water & Power are the largest public utilities in the area. These issuers have a combined $19.5bn of municipal debt outstanding ($18.3bn tax-exempt/$1.2bn taxable), most of which is not insured.[8] S&P downgraded LADWP issuers two notches from AA+ to AA- (Water) and from AA- to A (Power) on January 14 and kept the names on Watch Negative. Ratings on Southern California Public Power Authority's bonds were also downgraded. Language in the S&P report suggests other systems could be downgraded in the coming days and months.[9]

Default risk

Based on the historical data above and the strong financial footing of issuers prior to the fires, we do not expect a string of defaults in municipal credits resulting from the fires. We've seen credit spreads widen in a lot of names in and around the LA area and believe there will continue to be downgrades. Affected issuers will likely experience a short-term decrease in economic activity and increased financial pressure to fund the immediate recovery efforts. In the medium- to long-term, state and federal aid will likely bolster finances, as will increased sales tax revenues from the rebuilding efforts until the property tax base can recover. LA County is a very affluent area of the country, and it is not uncommon for 50-70% of property values to come from the underlying land.[8] Despite the devastating effects of the fires, the land remains valuable which may deter many from walking away from properties.

Our outlook

At this time, the Eaton and Palisades fires are mostly contained, but they are still burning.[10] The Los Angeles area's drought persists, and the Santa Ana winds are still a factor. The situation in LA County is constantly evolving and highly complex. We believe the ratings downgrades were hastily done, before any real credit ramifications could be ascertained. Our credit analysts and portfolio managers continue to monitor our holdings for potential negative credit impacts. For now, we believe the affected issuers' strong financial footing before the wildfires, as well as state and federal aid, will be sufficient to prevent wide-ranging negative credit impacts over the long term.

Spread is the difference between yields on differing debt instruments, calculated by deducting the yield of one instrument from another.

A credit rating is an assessment provided by a nationally recognized statistical rating organization (NRSRO) of the creditworthiness of an issuer with respect to debt obligations, including specific securities, money market instruments or other debts. Ratings are measured on a scale that generally ranges from AAA (highest) to D (lowest); ratings are subject to change without notice. NR indicates the debtor was not rated and should not be interpreted as indicating low quality. For more information on rating methodologies, please visit the following NRSRO websites: www.standardandpoors.com and select 'Understanding Credit Ratings' under Rating Resources 'About Ratings' on the homepage.; https://ratings.moodys.io/ratings and select 'Understanding Ratings' on the homepage.; www.fitchratings.com and select 'Ratings Definitions Criteria' under 'Resources' on the homepage. Then select 'Rating Definitions' under 'Resources' on the 'Contents' menu.

Sources:

1. Bond Buyer, as of January 17, 2025
2. LA County Medical Examiner, as of January 21, 2025
3. Moody's, S&P, Fitch as of June 2024
4. US Census Bureau, 2020 Census Redistricting Data, retrieved January 22, 2025
5. American Property Casualty Insurance Association as of January 15, 2025
6. DBRS Morningstar as of January 15, 2025
7. JPM Economic Research: The LA wildfires, published January 14, 2025
8. Invesco, as of January 21, 2025
9. S&P as of January 14, 2025
10. California Department of Forestry and Fire Protection, as of January 22, 2025

About risk

Municipal securities are subject to the risk that legislative or economic conditions could affect an issuer's ability to make payments of principal and/or interest.

Junk bonds involve greater risk of default or price changes due to changes in the issuer's credit quality.

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested. The values of junk bonds fluctuate more than those of high-quality bonds and can decline significantly over short time periods.

All fixed income securities are subject to two types of risk: credit risk and interest rate risk. Credit risk refers to the possibility that the issuer of a security will be unable to make interest payments and/ or repay the principal on its debt. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa.

Municipal bonds are issued by state and local government agencies to finance public projects and services. They typically pay interest that is tax-free in their state of issuance. Because of their tax benefits, municipal bonds usually offer lower pre-tax yields than similar taxable bonds.

All data as of January 21, 2025, unless otherwise stated.

All data provided by Invesco unless otherwise noted.

The opinions expressed are those of the author, are based on current market conditions and are subject to change without notice. These opinions may differ from those of other Invesco investment professionals.

Invesco does not provide tax advice. The tax information contained herein is general and is not exhaustive by nature. It is not intended or written to be used, and it cannot be used by any taxpayer, for the purpose of avoiding tax penalties that may be imposed on the taxpayer under US federal tax laws. Federal and state tax laws are complex and constantly changing. Investors should always consult their own legal or tax professional for information concerning their individual situation.

This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions.

Past performance does not guarantee future results. An investment cannot be made into an index.

Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions, there can be no assurance that actual results will not differ materially from expectations.

There is no guarantee the outlooks mentioned will come to pass.