

LOS ANGELES WILDFIRES

Our thoughts are with our clients, business partners, and all individuals whom the Los Angeles area wildfires have impacted. Please note that this commentary is written strictly from a credit perspective and is not intended to minimize the devastating impact of this natural disaster on people and property.

THE SCOPE OF THE SOUTHERN CALIFORNIA WILDFIRES

Natural disasters and other tragic events are, first and foremost, extremely painful at a human level, yet they also introduce challenges that we, as an investment advisor, must evaluate. The ongoing California wildfires have already at least temporarily displaced nearly 200,000 residents and destroyed thousands of homes and buildings. While it is still too early to calculate the ultimate economic cost, these wildfires are expected to be the costliest in US history.

The Costliest US Wildfires in US History

Rank	Year	Year	State	Name	Dollar Loss (\$B)	Inflation-Adjusted Dollar Loss (\$B)	Structures Destroyed	Acres Burned
1	November	2018	CA	Camp Fire	10.0	12.4	18,804	153,336
2	October	2017	CA	Tubbs Fire	8.7	11.0	5,636	36,807
3	August	2023	HI	Lahaina	6.0	6.2	3,000	2,170
4	November	2018	CA	Woolsey Fire	4.2	5.2	1,643	96,949
5	October	1991	CA	Tunnel/Oakland Hills	1.7	3.9	2,900	1,600
6	October	2017	CA	Atlas Fire	3.0	3.8	783	51,624
7	September	2020	CA	Glass Fire	3.0	3.5	1,555	67,484
8	December	2017	CA	Thomas	2.5	3.2	1,063	281,893
9	August	2020	CA	CZU Lightning Complex Fire	2.5	3.0	1,490	86,509
10	October	2007	CA	The Southern California Firestorm	1.8	2.7	3,108	518,000

Source: National Fire Protection Association

OUR EXPOSURE TO LOCAL BOND ISSUERS

Given the size of our client base in California and the State's prominence in the tax-exempt markets, Appleton has significant bond holdings issued by Los Angeles area-domiciled state and municipal entities.

API Client Exposure (as of 1/10/25)	Market Value
All California Issuers	\$2,354.9 million
Municipal Issuers in LA County	\$661.7 million
Issuers With Direct or Nearly Direct Exposure*	\$526.3 million

*Primarily Los Angeles City or County Entities

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APPLETON HOLDINGS BY ISSUER

The list below is comprised of municipal issuers owned on behalf of clients that we believe have revenue or service area exposure to the wildfires. This exposure is subject to change.¹

Issuer/Obligor	Holdings Sector	API Internal Rating
California Institute of Technology	HIGHER ED	AA-
Cedars-Sinai Medical Center CA	HLTHCARE	A+
J. Paul Getty Trust CA	NONPROF	AAA
Los Angeles CA	LOCAL GO	AA+
Los Angeles CA Community College District	LOCAL GO	AA
Los Angeles CA COP	LOC AGY LSE	AA
Los Angeles CA Department of Water and Power (Power Revenue)	WTR & SWR	AA-
Los Angeles CA Department of Water and Power (Water System)	WTR & SWR	AA
Los Angeles CA Metropolitan Transportation Authority Sales Tax Measure R Sr	SPEC TAX	AAA
Los Angeles CA Metropolitan Transportation Authority Sales Tax Measure R Sub	SPEC TAX	AAA
Los Angeles CA Metropolitan Transportation Authority Sales Tax Prop A	SPEC TAX	AAA
Los Angeles CA Metropolitan Transportation Authority Sales Tax Prop C	SPEC TAX	AA+
Los Angeles CA Metropolitan Transportation Authority Union Station Gateway	SPEC TAX	N/R
Los Angeles CA Solid Waste System	WTR & SWR	AA-
Los Angeles CA Unified School District	LOCAL GO	AA-
Los Angeles CA Unified School District COP	LOC AGY LSE	AA-
Los Angeles CA Wastewater Sr.	WTR & SWR	AA+
Los Angeles CA Wastewater Sub	WTR & SWR	AA+
Los Angeles County CA	LOC AGY LSE	AA+
Los Angeles County CA Public Works Financing Authority	LOC AGY LSE	AA+
Pasadena CA Area Community College District	LOCAL GO	AA+
Pasadena CA Unified School District	LOCAL GO	AA-
Pepperdine University CA	HIGHR ED	AA-
Santa Clarita CA Community College District	LOCAL GO	AA-
Santa Clarita Valley Water Agency CA Subordinate	WTR & SWR	AA+
Santa Monica CA Community College District	LOCAL GO	AA
Santa Monica-Malibu CA Unified School District	LOCAL GO	AA+
So. California Public Power Auth Transmission Project Rev. Sub Lien	PUB POWER	AA-
So. California Public Power Auth Transmission Renewal Project	PUB POWER	AA-

INITIAL THOUGHTS CONCERNING CREDIT IMPLICATIONS

Greater Los Angeles is an enormous, economically vibrant metropolitan area that encapsulates many large and financially strong tax-exempt bond issuers. While it is too early to draw definitive credit conclusions, municipalities in the region will certainly face short-term financial and management challenges, some more severe than others. At this stage, the authorities' focus appropriately remains on evacuation, containment, the provision of essential utilities, and then rebuilding of infrastructure.

Despite the loss of life and devastating property damage, we feel that most public finance credits will not incur long-term credit deterioration. Appleton's Municipal Research team is not recommending selling any CA-based bond holdings for credit reasons at this time.

While there may be a need to draw on reserves to address significant operational disruptions, federal reimbursements, state grants, and private insurance will likely cover a large portion of the rebuilding costs. Funding of this nature has historically quickly materialized and, in time, provided an economic boost as rebuilding commences.

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Furthermore, our investment process emphasizes large, well-established issuers, most of which have diverse revenue streams, sizeable financial reserves, and ready access to financial liquidity. Areas that have historically attracted wealth and businesses have done so for a reason – they are typically supported by healthy economies. These characteristics better enable bond issuers to manage the costs and operational disruption created by unfortunate events of this nature.

Local General Obligation credits support essential governmental services, which in turn attract fiscal support during times of stress. In California, the State has historically backfilled property taxes lost by municipalities in areas devastated by fire and provided resources to ensure that per pupil state funding for school districts remains at the pre-disaster level for years after a natural disaster. Although our credit analysis is not dependent on this, we expect there to be similar extraordinary support in this situation.

Appleton’s impacted revenue bond exposure is limited to utilities, higher education, and healthcare. Although we also invest in revenue bond sectors such as airports, toll roads, and ports, our holdings in these sectors to date have not been impacted by the wildfires.

In analyzing revenue bond credits, we look for revenue and geographic diversity. While a given local operation may be forced to close, an entity with a larger footprint can rely on the revenue generation of its other operations to weather short-term disruption. **Our focus on larger operations helps to reduce the risks to which smaller entities are subject.** Balance sheet strength is also critical as it helps manage operational challenges while facilitating a rebuilding process.

Utilities face the risk of wildfire liabilities, specifically due to California’s “inverse condemnation” laws. We are not currently aware of any evidence that points blame at a specific municipal electric utility for the fires, but it is a possibility that has our attention. Even if such liability were to be incurred, **the municipal utilities in which we invest have the ability to increase rates without regulatory approval, as well as significant balance sheet and external liquidity sources.** Due in part to the essential nature of their services, State support and/or authorization to issue securitization bonds could materialize if there was severe financial strain.

CALIFORNIA GENERAL OBLIGATION BONDS¹

Client Exposure:	\$415.8 million
API:	AA-/stable
Moody’s:	Aa2/stable
S&P:	AA-/stable

We are changing our outlook on California's GO Bonds to "stable" from "positive." Due to the impact of the Los Angeles area wildfires, the IRS has extended the tax filing and payment date of federal personal and commercial income taxes to October 15th for those affected. We expect the State of California to follow suit. The extension disrupts the State's ability to accurately track tax revenues and to budget accordingly, and this change also extends payment from one fiscal year to the next (FY24 ends June 30th, FY25 begins on July 1st), introducing additional complexities.

Our “AA-” rating reflects the State’s healthy fiscal profile, substantial reserves (\$22.1 billion projected as of 6/30/25), and manageable long-term liabilities.

From a purely economic standpoint, despite the tragic nature of the Los Angeles area wildfires, we anticipate short-term economic disruption to be followed by growth from a robust rebuilding effort. Metro Los Angeles is California’s largest economic region and, as a going concern, will be able to manage through the economic slowdown. **Our change in credit outlook to "stable" is a function of the tax filing and payment extension and should not be seen as a negative reflection of our long-term credit confidence in California’s GO bonds.**

MORE VULNERABLE SECTORS

Inevitably, certain issuers will be more acutely impacted by events such as the L.A. wildfires, often due to reliance on a narrow tax base, single-site facility operations, and modest financial resources. **Issuers with such characteristics include redevelopment agencies, charter schools, senior living, and student housing.** Appleton has long avoided exposure to these sectors due to perceived business risks, and the current situation only reinforces our reluctance to take on natural disaster-related tail risks.

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TRADING ENVIRONMENT

Trading has been active in some of the impacted bond issues since the onset of the wildfires, although spreads have, for the most part, only widened modestly. Secondary market trading volume in Los Angeles area credits was significantly higher on Monday, January 13th, up to 10 times a typical business day. Los Angeles Department of Water and Power bonds alone had ~\$226 million in attempted sales via Bids Wanted listings compared to early last week. The pricing of most other Los Angeles area credits is generally trading about 10-15 bps cheaper than pre-fire levels. A notable outlier is the Los Angeles Department of Water & Power System, where we have seen trades nearly 70 bps wider than pre-fire levels.

We are monitoring developments closely and will adjust client portfolios if we believe it would be in the interests of clients to do so. We are hopeful that the Los Angeles area wildfires are contained as soon as possible and are keeping all those impacted in our thoughts. We encourage financial advisors to reach out to discuss specific questions or concerns.

1. As of January 10, 2025. Bond holdings are subject to change at any time.

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