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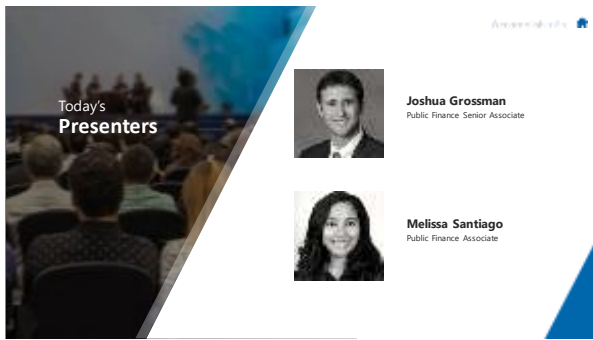
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Account ID: 1234

# #1: What is ESG?

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## The Basics of ESG

- **ESG = Environmental, Social, and Governance.**
- Generally, ESG factors are used to evaluate projects that have a broad social or environmental benefit.



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## ESG Investing versus "Traditional" Investing?

Traditional Investing v. Ethical Investing

- Under traditional investing models, if a project is expected to make **money**, generally, the profitability of the project makes it desirable.
- However, using ESG factors, investors seek to put their money into entities and projects that make money, and align with the investors' **values**.
- Thus, ESG seeks to **balance** the traditional investing model with the societal impact of the project itself.



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### ESG Muni Bonds

Accountability

- ESG muni bonds raise money to finance government projects that have a **positive environmental or social impact**.
- The government entity issues a non-binding verbal commitment to its investors to meet certain, pre-set social or environment goals.



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### So what do the ESG factors evaluate?

Accountability



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### The Factors: Environmental

Accountability

- Environmental criteria looks at how a project performs in relation to:
  1. Waste and pollution output
  2. Resource depletion
  3. Greenhouse gas emissions
  4. Deforestation
  5. Animal emissions
  6. Sustainable public transit
  7. Wastewater management
  8. Climate change; including the issuer's ability to withstand or mitigate the effects of fires, storms, and droughts, and the effects of same on their communities.
  9. ...and many other criteria!



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### The Factors: Social

Assessing ESG

• Social criteria looks at how a project performs in relation to:

1. Employee relations and diversity
2. Working conditions
3. Local communities
4. Public health and safety
5. Accessible education
6. Accessible (quality) healthcare
7. Accessible affordable housing
8. Accessible water supply



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### The Factors: Governance

Assessing ESG

• Governance criteria looks at how a project performs in relation to:

1. Tax strategy and financial practices
2. Executive remuneration
3. Donations and political lobbying
4. Corruption and bribery
5. Management diversity and structure
6. Long-term planning



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## #2: Issuing ESG Bonds

Assessing ESG

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### Why Investors Look to ESG

- According to investor initiative Principles of Responsible Investment ("PRI"), "retail investors and asset owners are increasingly interested in incorporating sustainability into their investment choices."
- Muni bonds are generally very safe and stable fixed-income investments.
- Combining ESG with making money is a "win-win" for certain investors!



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### Current State of the ESG Muni Bonds Market

- Current market for municipal bonds could be worth up to \$4 Trillion USD (Source: Bloomberg).
- In 2021, nearly \$50B worth of ESG bonds were issued, a twofold increase from the prior year.
- About 50% of municipal bonds labeled as having an ESG benefit in the last two years were verified by an outside company (up from just 35% in 2019).
- In 2021, nearly 75% of muni bonds issuers committed to offering investors continued ESG updates.
- In 2022, it is estimated that about \$62B worth of muni bonds will carry an ESG label.



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### How to attract ESG Investors?

- The PRI notes that, to attract investors, bond issuers should:
  - Offer ESG factor information that is tailored to the issuer's sector and geography, but allows investors to compare across the sector;
  - Offer information about the issuer's future strategies to identify and manage ESG risks;
  - Engage with investors to see what ESG factors they are most interested in; and
  - Keep a dedicated page on the issuer's website to effectively disseminate ESG-specific information to investors.



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### Things to Take Note of...

- "Green Bond" = Environmentally Friendly Municipal Bond
  - Also can be titled "climate bonds," "social bonds," "sustainability bonds," etc.
- There are bonds that are not labeled as ESG, but nonetheless can meet certain ESG criteria.
- Some bond issuers may not want to incur the costs of having a third party verify and certify a bond as ESG.
- Some bonds that carry an ESG labels are not guaranteed to follow ESG standards.




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### Two Internationally Recognized Sets of Standards

- **International Capital Markets Association ("ICMA")**
  - First nationally and internationally accepted voluntary standard for green bond issuance.
  - ICMA has introduced both Green Bond Principles and Social Bond Principles
  - For an issuer to claim to have met these standards and to have their bond designated as ESG, the issuer must demonstrate observance of ICMA's four pillars:
    - (1) Use of Proceeds (2) Process for Project Evolution and Selection, (3) Management of Proceeds, and (4) Reporting
- **Climate Bond Initiative ("CBI")**
  - Another investor initiative, CBI differs from ICMA in that CBI's verified Climate Bonds must be reviewed and by an approved verifier who will review the issuer and the bond for conformation with ICMA Green Bond Principles.
  - Generally, CBI approval makes a Green Bond far more desirable to investors.




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### ICMA's Definitions

- **Green Bonds**
  - Proceeds or an equivalent amount will be exclusively applied to finance (or refinance), in part or in full, new and/or existing eligible Green projects and (2) the Project meets all four Pillars
- **Social Bonds**
  - Proceeds or an equivalent amount will be exclusively applied to finance (or refinance), in part or in full, new and/or existing eligible Social projects and (2) the Project meets all four Pillars
- **Sustainability Bonds**
  - Hybrid of Green and Social Bonds
- **Climate Bonds**
  - Green Bonds linked to climate change solutions via CBI's taxonomy
- **Sustainability-Linked Bonds**
  - Financial and/or structural characteristics vary depending on whether the issuer achieves Sustainability/ESG objectives




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### What Types of Projects are Considered "Green" under ICMA's standards?

1. **Renewable energy**
  - Including production, transmission, appliances, and end-products
2. **Energy efficiency**
  - Energy storage, district heating, smart grids and appliances, etc.
3. **Pollution prevention and control**
  - Soil remediation, waste reduction, greenhouse gas control, etc.
4. **Environmentally sustainable management of living natural resources and land use**
  - Environmentally sustainable fishery, agriculture, forestry, etc.
5. **Terrestrial and aquatic biodiversity conservation**
  - Protection of coastal, marine, and watershed environments.
6. **Clean transportation**
  - Electric, hybrid, public, rail, non-motorized, infrastructure for clean energy vehicles, etc.
7. **Sustainable water and wastewater management**
  - Wastewater treatment, flood mitigation, sustainable drinking water, etc.
8. **Green buildings**
  - Structures that meet local, national, or internationally recognized standards for environmental performance



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### According to the MSRB...

**Green Bond Principles (GBP)**

The proceeds from Green Bonds may be used to finance one or more of the non-exhaustive list of categories below:

- Clean transportation
- Climate change adaptation
- Eco-efficient and/or socially optimized products, production technologies and processes
- Energy efficiency
- Environmentally sustainable management of living natural resources and sea life
- Green buildings
- Pollution prevention and control
- Renewable energy
- Sustainable water and wastewater management
- Terrestrial and aquatic biodiversity conservation



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### What does ICMA consider a "Social" Project?

1. **Affordable basic infrastructure**
  - Clean drinking water, sewers, sanitation, transport, energy, etc.
2. **Access to essential services**
  - Healthcare, education and vocational training
3. **Affordable housing**
4. **Employment generation**
  - Designed to prevent or alleviate unemployment stemming from economic downturns
5. **Food security and sustainable food systems**
  - Physical, Social, and economic access to food that meets the dietary needs and requirements, reduction of food loss and waste, etc.



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## According to the MSRB...

**Social Bond Principles (SBP)**

The projects from Social Bonds may be used to finance one or more of the non-exhaustive list of categories below:

- Affordable basic infrastructure (e.g. clean drinking water, sewers, sanitation, disaster relief)
- Access to essential services (e.g. health, education and vocational training, healthcare, housing and financial services)
- Affordable housing
- Employment generation, and programs designed to prevent and/or reduce unemployment stemming from seasonality, crop, marketing through the purchase effect of food, farming and processing
- Food security and sustainable food systems (e.g. organic, local, fair trade, access to safe, healthy, and sufficient food that meets dietary needs and requirements, resilient agricultural practices, reduction in food loss and waste, and expansion of small-scale producers)
- Socioeconomic development and empowerment (e.g. financial access to and control over assets, services, resources, and opportunities, equitable participation and integration into the market and society, including protection of income recipients)

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## Who is Served by a "Social" Project?

"Social" Projects that seek ESG designation on the muni bond should tie back to supporting target populations:

1. Those living below the poverty line
2. Excluded and/or marginalized populations and communities
3. Vulnerable youth, aging populations, and those living with disabilities
4. Migrants, displaced persons/populations, and vulnerable groups
5. Unemployed, underserved, underrepresented, or uneducated




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## So, How to Verify All of This?

- While some issuers will choose to self-label their bonds as "Green" or "Social," the only real verification that occurs is if the issuer lists the criteria the issuer choose.
- In the case of a Green bond, the issuer may state that the project intends to obtain certification as Leadership in Energy and Environmental Design (LEED) from the U.S. Green Building Council.
- However, the issuer is under no obligation to disclose if the project actually received LEED certification.
- Third-party review **is for more preferable** from an investor's point of view.
- Several auditors and verifiers (climate, environmental, social, and governance institutions) offer independent opinions on the issuer's project or program.
- These independent assessments help offer investors' greater peace of mind that the bonds are securing projects that are consistent with generally agreed-upon standards.
- Once a bond issuer has drafted their official statement, a verification entity can verify the ESG factors associated with the bond (and attach the verification statement to the offering statement).




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## Verification Entities

A number of entities exist that provide scoring for various ESG criteria. Some of these entities are:

1. Fitch Ratings, Inc.
2. Knoll Bond Rating Agency, Inc.
3. Moody's Investors Service, Inc.
4. S&P Global Ratings



Answers 1 of 1

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## EMMA

Issuer	ESG Rating	ESG Score	ESG Disclosure
City of New York	AA	85	City of New York
City of Los Angeles	AA	85	City of Los Angeles
City of San Francisco	AA	85	City of San Francisco
City of Seattle	AA	85	City of Seattle
City of Portland	AA	85	City of Portland

Municipal Securities Rulemaking Board's EMMA website is the official repository for issuer's disclosures.

Here is a screenshot of a few ESG bonds listed on EMMA

Answers 1 of 1

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Figure 1. Sample Official Statements for ESG-Labeled Bonds



Source: Municipal Securities Rulemaking Board

Answers 1 of 1

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Source: Municipal Securities Rulemaking Board

Sample Official Statement for ESG Climate Bonds issued by the Metropolitan Sewerage District.

Source: Municipal Securities Rulemaking Board

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Source: Bloomberg

**Effort to Go Green**  
State and local governments put effort behind ESG push

% of ESG bonds with outside verification

Year	% of ESG bonds with outside verification
2019	15
2020	25
2021	45

% of ESG bonds with ongoing reporting

Year	% of ESG bonds with ongoing reporting
2019	10
2020	20
2021	40

Source: Bloomberg  
Blue: Long-term bond sales with green, social or sustainability inclusion.

Municipalities are increasingly issuing ESG-labeled bonds, and getting those bonds verified/certified as ESG-compliant

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Source: Bloomberg

# #3: What are the Downsides of Municipal Bonds & ESG?

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## Negative Aspects (of ESG in General)

- Not regulated (yet).
- Firms use different standards and rating for evaluating ESG factors.
- Thus, scores for the same project or entity can vary widely depending on criteria evaluators use.
- Many factors impact ESG scores, including the supply chains, management structure, and employees of an entity.
- Some ESG data is "self-advertised."
  - Some governments view ESG disclosures as burdensome and costly, and thus, do not invest the time or effort to issue ESG-labeled bonds, or, get their bonds verified/certified.
- Strict ESG criteria can limit the diversification of your portfolio.
- ESG funds and high-ranking stocks can garner a big premium.
- ESG funds charge larger fees than traditional funds.
- Larger criticism: Some believe that the job of an investor is only to get the greatest return on their money, even if that means putting their money into entities that have poor social and environmental optics

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## General Municipal Bond Risks

Some municipal bond investor risks are shared with other types of bonds:

1. **Default:** the chance that the bond issuer will not be able to make payments to their investors, or be able to pay out the principal at maturity.
2. **Interest Rates:** the chance that rising interest rates devalue a bond sold before maturity.
3. **Inflation Risk:** the chance that rising inflation will lower the purchasing power of a still-maturing bond.

A municipal bond-*specific* risk is that the investor's tax liability will drop (typically when an individual investor retires and enter a lower tax bracket).

- Thus, if the muni bond was purchased before retirement, the tax benefits discussed earlier may not be as significant.



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## Specific Challenges for Municipal ESG Bonds

- Assessing factors relevant to municipalities is more difficult than a standard entity (like a corporation), as many municipalities benefit from federal or state support.
- Risks vary, as some municipalities resemble sovereign borrowers and some function like corporate issuers (see chart).
- Data on municipalities is inconsistent; environmental factors suffer from not enough information, whereas governance and social factors may have too much (unsubstantiated) information.
- Some issuers self-advertise their ESG factors, and some lack the resources to effectively verify their data, or do not put in the effort to accurately disclose.



Source: Principles for Responsible Investment, 2021

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### Single Largest Concern?

Answers only

**"Greenwashing."** This is the risk that the proceeds of the sale of a bond that is marketed to investors as a green, social, sustainable, or climate bond will not achieve the ESG goals described (intentionally or unintentionally).

- Since there is no universally accepted definition of what constitutes a green, social, sustainable, or climate bond, reasonable minds may differ as to when a project has met its environmental "goal."
- There is potential for reputational harm to the bond issuer or their investors if the issuance does not live up to the stated goals.

**Best way to mitigate:** a full and exhaustive review of the ESG disclosure regarding the project, its adherence to any recognized standards, and any/all third-party verifications.



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### What One Industry Experts Is Saying...

Answers only

- "I could care less if someone slaps a green label on a bond, what we care about is the ongoing commitment to an eventual impact... We haven't been willing to pay more because we haven't been receiving the information that we're looking for..."
- "Building portfolios that align with investors' values will continue to be a priority, as ESG investing is personal. Looking ahead, I do expect buyers to pay a premium, or 'greenium,' for additional quality labeled issuance..."

Alexa Gordon, Head of ESG of Municipal Fixed Income, Goldman Sachs Asset Management, LP



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### Is Verification a "Must"???

Answers only

- **Main Takeaway:** Investors don't just want to see labels that claim to make a project "ESG" friendly, they want to see verification from a third-party entity and, ideally, receive continued updates from the issuer on the project's status as remaining ESG-compliant.
- Thus, the real value in issuing ESG bonds is to have your bonds properly verified; otherwise, many large institutional investors may not be interested.



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**Conclusion**

- Many investors (especially institutions seeing a changeover to younger management) are seeking to invest in companies, entities, and municipalities that are embarking on projects that match the investors' views on what is environmentally and socially responsible.
- ESG-labeled bonds are growing in popularity, especially bonds that are verified as ESG-compliant by a third-party.
- ESG has many critics and there are a variety of perspectives on whether values-based investing is a good model.

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**Questions?**

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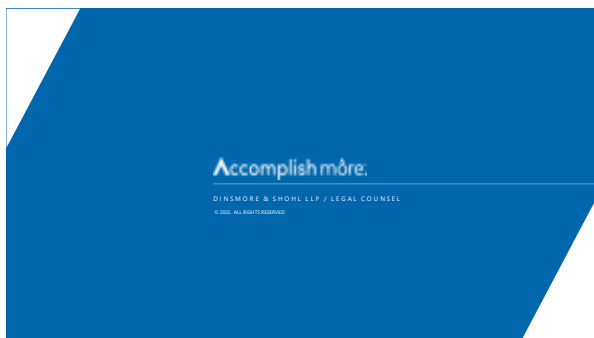
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