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Why ESG Bonds and Green Bonds May Help Colleges and Universities with Their Sustainability Plans: McNeese

As colleges and universities develop and implement sustainability plans to reduce their carbon footprint, there remains the question as to how to fund these sustainability plans. Some colleges and universities look to federal and state grants for a portion of this funding and some look to donors. In addition to these options, there is a new development in the debt market which could also lead to lower interest rates for issuers as a result of increased demand: ESG bonds and Green bonds.

Universities such as Stanford University used ESG Bonds to fund projects that support the emission-reduction goals set forth in its sustainability initiative. Oberlin College used Green Bonds to convert its energy system to geothermal power. During the financing Oberlin College priced bonds with and without the Green label and found that the Green Bonds provided a better price. The ability to borrow money at lower interest rates means colleges and universities may be able supplement any donor funds and/or federal funds received with additional funding sources.

ESG bonds and Green bonds are increasingly attractive to investors as the concept and practice of socially responsible investing is recognized as valuable in the bond markets. Currently, these types of socially responsible bonds only make up approximately 2% of the municipal bond market, but the demand is increasing from investors. In the past decade, issuance of ESG bonds and Green bonds has increased substantially — but so has demand.

The term ESG bonds stands for Environmental, Social and Governance bonds. They are a type of debt instrument in which an issuer has identified certain environmental, social or governance criteria for the use of the bond proceeds. In general, colleges and universities have been developing and providing environmentally friendly and socially responsible projects, so the ability to borrow at a lower interest rate to continue to provide these services is a big benefit.

Colleges and universities may issue these ESG bonds for a wide variety of types of projects. Many issuers appreciate the flexibility that this type of offering provides. Examples of projects funded with ESG bonds by colleges and universities are include renewable energy, smart buildings, and expanded research facilities. These types of projects may be partially funded with federal and state funds pledged for sustainable infrastructure and the remaining funding may come from ESG bonds.

In addition to the environmental components, ESG bond financings may focus on social or governance projects. Examples of social projects include a college or university's plan for safety management, workplace diversity initiatives, and health and safety of employees or citizens. Examples of governance projects include the everyday operations of a college or university, ensuring financial transparency, and establishing internal policies and procedures.

The term "Green bonds" means a type of debt instrument used to support environmental- and climate-focused projects. Green bonds may be used to raise funds for specific environmental and climate projects in areas such as energy (projects such as wind or solar) and buildings (projects such as efficient buildings and low carbon materials).

In order to issue either ESG bonds or Green bonds, the issuer's counsel and the underwriter's counsel will work with ESG specialists to determine and draft the framework of the criteria used by the issuer as the basis for this designation. The counsel will work together to evaluate the request for either general funding or project-specific funding and then determine which type of bonds best fit the required funding request. The issuer's counsel and the underwriter's counsel may also work with the ESG specialist to determine if there will be a continued reporting obligation on behalf of the issuer following the issuance of the bonds.

In response to questions regarding the qualifications as either an ESG bond or a Green bond, the International Capital Market Association (ICMA) published "Social Bond Principles" and "Green Bond Principles" to provide issuers with guidance on criteria for these issuances (www.icmagroup.org). While the Securities and Exchange Commission (SEC) is considering establishing a standard set of principles regarding ESG bonds and Green bonds, no other standards exists except for the voluntary guidelines described in the Social Bond Principles and the Green Bond Principles. As these guidelines are voluntary, issuers do not need to follow them. However, they are generally accepted as a framework to evaluate the socially responsible principles of these bonds.

The "Social Bond Principles" and "Green Bond Principles" guidance is based on four main components: (1) use of proceeds; (2) process for project evaluation and selection; (3) management of proceeds; and (4) reporting. The Green Bond Principles focus on climate-related or environmental projects including investments related to clean energy or pollution reduction. The Social Bond Principles focus on projects "that address or mitigate a special social issue and/or seek to achieve positive social outcomes." The third qualification for ESG bonds is governance, and it is broadly understood to mean the way in which an organization's internal system of rules, policies, and procedures are managed.

Prior to marketing either an ESG bond or a Green bond, an issuer will post the framework that the issuer used to make the determination as to why this financing qualifies as either type of bond in accordance with either the Social Bond Principles or the Green Bond Principles. This disclosure is important for investors to understand the reasoning behind either of these designations. Once this disclosure has been made to potential investors, the investors are able to analyze each component to determine whether the disclosure meets the investors' specific socially responsible investing requirements and guidelines.

In addition to the initial disclosure, there may be a continued obligation to report on the impact of the ESG bond proceeds or the Green bond proceeds depending on the issuer and the investor. Some issuers may hire a third party to track the spending of the ESG bond proceeds or the Green bond proceeds to ensure that the funds are creating the outcomes desired by the issuer and the investor. Until such time as there is a standard requirement for either the designation of ESG bonds or Green bonds, the disclosure and reporting obligations will remain subject to the discretion of the issuer and the demands of the investors.

The Securities and Exchange Commission has taken an active role in monitoring ESG bonds and Green bonds to identify any type of misconduct. In March 2021, the Climate and ESG Task Force (the "Task Force") in the SEC's Division of Enforcement was created in response to the increasing investor interest in these types of bonds (www.sec.gov/news/press-release/2021-42). The Task Force evaluates certain concerns regarding the criteria used for establishing these issuer frameworks by identifying any disclosure gaps. In addition, the Task Force will monitor the continued compliance requirements associated with ESG bonds and Green bonds.

As this market continues to grow, issuers are finding an opportunity to move forward with socially responsible projects and investors are supporting these projects.

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