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Wharton: Why ESG Scores Are Moving the \$4 Trillion Municipal Bond Market

Key Takeaways

- Investors are willing to pay more for municipal bonds with credible ESG scores, even when those bonds lack official "green" or "social" labels.
- The biggest price gains worth about \$870 million went to bonds that were ineligible for a formal ESG label but benefited from new ESG data that provided extra insight into risk.
- Most issuers still avoid labeling, held back by politics, demographics, and the fixed costs of verification, leaving potential savings untapped.

Investors in the \$4 trillion U.S. municipal bond market are paying more for bonds with credible environmental, social, and governance information, even when those bonds are not officially labeled as "green" or "social."

That is the key finding of a <u>new study</u> into the green bonds market, co-authored by Wharton finance professor Daniel Garrett, Penn PhD student Mahdi Shahrabi, and Oregon State University professor Brian Gibbons. It shows that municipal bonds with third-party ESG scores trade at higher prices, signaling cheaper borrowing costs for issuers. On average, yields — which move inversely to prices — dropped by 3 to 4 basis points when a bond received an ESG score, even if it had no formal label.

An ESG score is a third-party assessment of a bond's environmental, social, or governance features. A label, by contrast, is a formal designation — like "green bond" — from the issuer that requires meeting strict international criteria.

Continue reading.

Wharton

October 14, 2025

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