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Fitch: ESG Factors Affect All US Public Finance Sectors

Fitch Ratings-New York-10 May 2021: Fitch Ratings provides insight into the credit relevance and materiality of environmental, social and governance (ESG) factors for each US Public Finance sector, highlighting the rating effect of ESG factors in case studies, in its new report Where ESG Matters for U.S. Public Finance. Fitch uses ESG Relevance Scores (ESG.RS) to communicate the effect of these factors on both US tax-supported and revenue-supported issuer ratings.

Governance is the most influential ESG factor for US Public Finance (USPF) as a whole, given the importance of management strategy, internal controls, quality of service provision and financial transparency to every sector. Cybersecurity risks, a governance and social consideration, continue to raise significant governance and social issues that may pose harm to consumers or residents and reveal management weakness, potentially negatively affecting ratings. Governance factors are expected to remain highly relevant to ratings beyond issuer navigation of the pandemic recovery.

Environmental factors have gained more importance in USPF rating decisions since the ESG.RS were introduced in May 2019. Recent events bring this issue into sharp focus, resulting in elevated ESG.RS for Exposure to Environmental Impacts for 19 public power issuers following severe weather events in Texas in February 2021 and for some military housing projects due to moisture remediation issues. Environmental factors continue to have a more modest influence in the tax-supported portfolio, with elevated scores largely recorded in Biodiversity and Natural Resource Management, as well as Natural Disasters and Climate Change.

Social factors such as Labor Relations, Customer Access and Customer Welfare have negative rating effects for a number of USPF sectors and credits. Conversely, social factors have an overwhelmingly positive influence on community development and social lending credits.

ESG.RS incorporate 15 general ESG issues for tax-supported issuers and 14 general ESG issues for revenue issuers, and are expressed on a ‘1’ to ‘5’ scale, with ‘1’ indicating irrelevance and ‘5’ being highly relevant for the rating. An ESG.RS of ‘4’ or ‘5’ can be positive or negative to a rating decision, although the majority of assigned scores reflect a negative impact.

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The above article originally appeared as a post on the Fitch Wire credit market commentary page. The original article can be accessed at www.fitchratings.com. All opinions expressed are those of Fitch Ratings.