

Bond Case Briefs

Municipal Finance Law Since 1971

S&P: Uncovering Local-level Risk Factors for Municipal Exposures

The Muni Landscape

Municipal securities, or “muni bonds”, issued by states, cities, counties and other governmental entities in order to fund infrastructure, schools and other projects represent an extensive marketplace. As of the first quarter of 2021, there was \$4 trillion in outstanding issuance, accounting for over 50,000 issuers.

Muni bonds come in two varieties: general obligation and revenue bonds. General obligation bonds are used to finance public projects that aren’t linked to a particular revenue stream. Revenue bonds, by contrast, are bonds whose interest and principal are backed by the revenues of a specific project that the bonds are funding, such as toll roads and universities.

Often, revenue bonds are issued through a conduit, which is usually a government agency or government-sanctioned entity that issues debt to raise funds for large-scale projects, such as hospitals and airports, on behalf of a borrower. Conduits typically are not responsible for the payment of principle or interest for the issue(s) in question, as this falls to the borrower. In addition, conduits are often not located in the same geographic area as the projects they are funding.

The Rise of ESG Concerns are Impacting Munis Too

Environmental, social and governance (ESG) factors are taking center stage and playing an increasingly important role in the evaluation of risks associated with investments. In March of this year, for example, the European Union’s Sustainable Finance Disclosure Regulation (“SFDR”) came into force requiring certain asset managers and financial advisers to make ESG disclosures to potential and current investors. This new regulation also impacts large U.S. firms that market funds in Europe.

To fully understand potential ESG risks, it is imperative to know where assets are located. This applies to muni bonds, as well, but there are three major challenges here:

1. Conduit issues are assigned to the state where the conduit issuer resides, not where the actual projects are located.
2. Revenue bond issues often represent projects that are located across numerous cities, counties and even states, but are assigned to a single state at issuance.
3. Many revenue bond issuers (e.g., hospital obligated groups, gas districts and water districts) cover multiple locations, and it is important to map these multiple entities to the issuer in question in order to effectively assess ESG risks.

To address these challenges, CUSIP Global Services (CGS) partnered with ISS ESG[2] to create a location mapping solution.

Shining a Light on Municipalities to Assess Potential Risks

CUSIPs are nine-character alphanumeric security identifiers that capture the unique attributes of issuers and their financial instruments throughout the U.S. and Canada. In the muni bond market, a CUSIP is used by investors to uniquely identify and track municipal securities and link them with the underlying issuing entity. This represents approximately 1.5 million CUSIPs today.

Working with ISS ESG, CGS has created a mapping file that links the first six characters of the unique CUSIP identifier for each municipal issue with the geographic identifier (GEOID) hierarchy for the issuer, including state, county, city and school district. The GEOID is a unique geographic identifier assigned by the U.S. Census Bureau to administrative/legal and statistical geographic areas.

ISS ESG has also developed its Muni QualityScore based on socioeconomic, environmental, health and crime data, which can be accessed through a separate mapping and is updated quarterly. The GEOID-level detail enables muni bond identifiers to be paired with these ESG scores, giving market participants insight into the level of exposure their municipal securities have to certain ESG attributes.

This new capability addresses a longstanding challenge in the U.S. muni bond market, where interested parties could not easily make the link between underlying issuer and related census, socioeconomic, climate change and crime data. Through this partnership, CGS and ISS ESG are able to deliver more transparency into the muni bond market, facilitating links to data that can be used to inform risk models and values-based investment strategies.

[Click here for more information on the CGS/ISS ESG solution.](#)