Muni Investors Seek Proof From Governments Selling ESG Debt.

- **Allowing money managers to track goals could cut funding costs**
- **Regulator MSRB is looking at developing ESG standards**

But some governments are reluctant to spend more money tracking and reporting whether their projects are meeting environmental, social, or governance goals. The Municipal Securities Rulemaking Board, the market's industry-funded regulator, is looking at developing standards related to ESG disclosure. Still, only around half of muni ESG issuance is subject to outside verification, data compiled by Bloomberg show.

Getting this right is critical for the development of the ESG portion of the $4 trillion market for muni bonds. Until issuers and investors can determine standards that both can live with, governments likely won't be able to cut their funding costs by selling muni ESG bonds, because money managers won't pay extra for the securities.

"We haven't been willing to pay more because we haven't been receiving the information that we're looking for," said Alexa Gordon, head of municipal ESG at Goldman Sachs Asset Management LP, speaking on a February panel about ESG practices in the muni bond market. "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."

The market for muni ESG debt has been growing fast from a small base. About $50 billion of bonds were sold with social, green or sustainability labels in 2021, around 11% of overall issuance and nearly a twofold increase from the year prior, according to data compiled by Bloomberg. S&P Global Ratings projects that the market will continue to expand, with issuance likely topping $60 billion in 2022.

Progress is slower than in other markets, such as in corporate and sovereign debt, where global issuance last year topped $1 trillion.

Sally Bednar, head of municipal ESG solutions at Wells Fargo, says that her group is "beginning to see signs" of a pricing benefit for issues that carry ESG labels, but there's not enough evidence to say there's a definitive link.

"We do know that as more investors increase their focus on ESG bonds, the ESG label can lead to a broader universe of investor interest, which can drive demand for the bonds," she said.

Investor Pressure

About half of all new municipal bonds labeled as having an environmental, social or governance benefit in the last two years are verified by an outside company, up from just 35% in 2019, according to data compiled by Bloomberg. And in 2021 more than three-quarters of governments selling the debt had committed to continually updating investors for years, the data show.

That is in response to investor pressure, but the muni bond market is fragmented, which has made it difficult to develop standard disclosure or labeling practices, said Daniel Rabasco, head of municipal bonds at Insight Investment Management Ltd. There are about 1 million municipal securities outstanding divvied among tens of thousands of issuers.

“The muni market moves at a snail’s pace,” he said. He said he’s fielding more and more queries from clients on how to factor ESG into their investments, especially as wealth continues to transfer to a younger generation.

“We all intuitively know that municipal governments have a lot of sustainable requirements and what muni bonds finance in many cases we know are ESG projects, but investors are demanding the data to back it up,” he said.

‘Overly Burdensome’

The MSRB last year asked issuers, investors, broker-dealers and municipal advisers for suggestions to improve disclosure of ESG related risks and labels.

Cities and states have reservations about being required to take specific steps. In its response to the MSRB inquiry, the city of Detroit said that standardized ESG disclosures would be “overly burdensome” and “costly,” potentially inhibiting borrowers from using the designations.

But for investors to be willing to accept slightly lower yields on the debt, they have to be confident their money is actually serving an ESG purpose, said Goldman Sachs Asset Management’s Gordon.

“When bonds are labeled without an independent certification, there is a lot less confidence that industry standards are being met,” she said.

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