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Navigating the ESG Nine-Lane Highway: A Roadmap for Public Sector Entities

Environmental, social and governance (ESG) discussions have become more prevalent in recent years and the topic continues to be an evolving subject in the public sector. In the public sector space, a comprehensive approach to ESG may address a spectrum of topics, ranging from day-to-day operations to policy initiatives to capital borrowings. The ESG journey summarized below focuses on capital or other projects that may require long-term borrowing, which projects can relate to a typical annual capital improvement plan, ensured continuity of utility operations or specifically addressing ESG or sustainable initiatives.

With respect to capital borrowings and the municipal marketplace, it is important for all participants in the public finance arena (governments/issuers, municipal advisors, counsels and bankers) to recognize the numerous ESG-related interactions in a municipal financing transaction. Placing an over-emphasis on certain aspects of ESG could result in additional costs or lost opportunities from other ESG components.

To help organize and ensure every ESG aspect is addressed, consider looking at ESG as a "nine-lane highway," with the likelihood that an organization will spend time in multiple lanes while planning for and completing projects and financings in the municipal marketplace. Also keep in mind that, as with any voyage, an organization's ESG journey will involve crossing lanes at various times to ensure ongoing progress.

Lane 1
Review and define goals, objectives and requirements that involve ESG and your organization.
Is a thorough ESG-related assessment or plan needed to review ESG-related strategies, develop sustainability initiatives, identify and address any perceived risks or understand all the ways ESG affects your organization? Proactive organizations that complete and act upon the findings of this assessment can benefit from ESG-risk awareness, opportunities and strategies.

Lanes 2 and 3
Designation or labeling determinations on bond issues for ESG-related projects may both attract investors looking for certain investments that produce social or environmental benefits and display leadership of your organization with ESG-related initiatives.

Lane 2: Does the financed project address energy or environmental matters and are there any environmental-related designations (such as green, climate or sustainable) applicable to the bond issue? Are the overall costs (verification and any reports) and benefits (reduced borrowing rates from increased investor interest) of such designation understood by the issuer?

Lane 3: Does the financed project address social matters and are there any social-related designations (such as social, housing or sustainable) applicable to the bond issue? Are the overall costs and benefits of such designation understood by the issuer?

Lanes 4-6
Disclosure and rating agency considerations of an issuer will relate to all credits and all financings, even if no designation or label are added to a bond issue.

Lane 4: Are there any environmental risk factors for disclosure and rating agencies? Examples will vary with geographic location but may include extreme weather events, significant impacts of climate change (wildfires, hurricanes, flooding) and the cost and reliability issues associated with energy transition, such as power generation sources and diversity/transition plans. Are there environmental considerations or initiatives of the issuer or related to the project that may be of interest to investors?

Lane 5: Are there any social risk factors for disclosure and rating agencies? Examples include a lack of housing for vulnerable populations, significant demographic and population trends/changes affecting services and the tax base, increased income disparities, labor-related issues, availability and access of health services, public education and infrastructure. Are there social-related considerations or initiatives of the issuer or related to the project that may be of interest to investors?

Lane 6: Are there any governmental risk factors for disclosure and rating agencies? Examples include organizational structure, debt and reserve policies, management oversight, internal controls and financial reporting, risk mitigation (such as cybersecurity), federal and state funding streams, pension and other post-employment benefits (OPEB) liabilities, internet availability and affordability and deferred maintenance. Are there governance-related considerations or initiatives of the issuer or related to the project that may be of interest to investors?

Lanes 7-9: Identify cross-over topics and considerations that relate to ESG, with some specific to determination of adding a designation or label to a bond issue.

Lane 7: Are there additional verifications or reports/assessments needed to support the designation/label assigned to bond issue? One option for consideration is self-designation versus verification or second-party opinion. In addition, does the issuer understand what standards must be adhered to related to any designation/label and how these standards relate to the financed project?

Lane 8: How does primary market disclosure need to change to address information required at time of issuance to support the designation/label? Examples include use and management of proceeds, project selection and evaluation criteria, and any project performance measures. Is there a requirement to verify actual use of bond proceeds? It is important to clearly identify if the issuer is committing to any ongoing project performance monitoring and reporting.

Lane 9: How do post-issuance compliance and secondary market continuing disclosure need to change for any covenants made to support the designation/label or generally addressing ESG-related disclosures? Who is responsible for preparation and what are the deadlines?

Public sector entities need to consider all lanes on the ESG highway, but they don’t need to navigate it alone. Municipal advisors/consultants can assist with managing all ESG interactions and offer ESG-related services with rating preparation and disclosure strategy; assessments, reports and investor outreach; designated/labeled bonds and post-issuance compliance.

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