



Are You Green?

Understanding ESG as a Municipal Bond Issuer





Gurtin

Municipal Bond
Management



**Are You Green?
Understanding ESG as a
Municipal Bond Issuer:
Part One**

February 6, 2020

Today's Agenda

- ESG
 - Investor interest
 - Credit factors and the incorporation of ESG analysis
 - Climate risk considerations
 - ESG disclosures
- Socially Responsible Investing (SRI)
 - Investor interest
 - Thematic investment strategies
 - Use of proceeds analysis
 - SRI disclosure

ESG

Defining ESG

The term “ESG” is often used to refer to a variety of concepts, such as environmental, social, and governance risks, sustainable investing, socially responsible investing, a values-based approach, impact investing.

We define ESG as:

Material environmental, social, and governance **risks** and **opportunities** that could affect credit quality

Investor Interest in ESG

- Represent some of the most rapidly evolving credit factors (e.g., pensions, climate change, demographic changes)
- Can be significant risk drivers for municipal bond investments



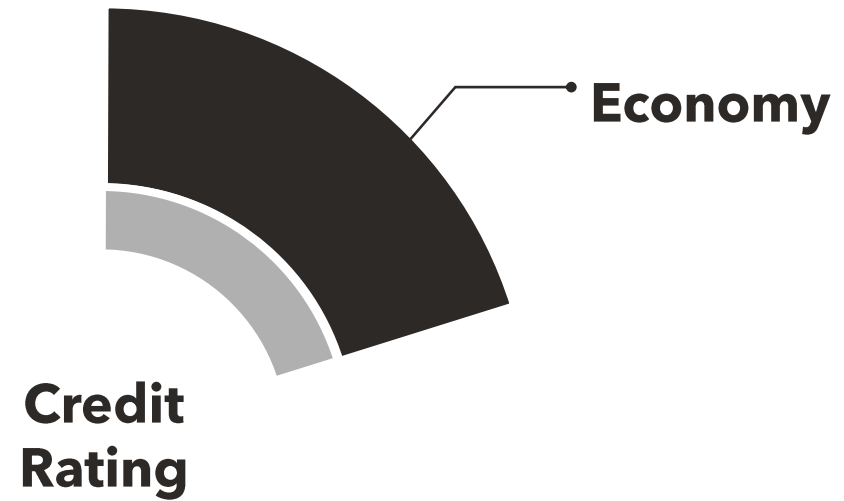
The evidence on climate risk is compelling investors to reassess core assumptions about modern finance. . . Investors are increasingly reckoning with these questions and **recognizing that climate risk is investment risk.**

– Larry Fink, CEO of Blackrock

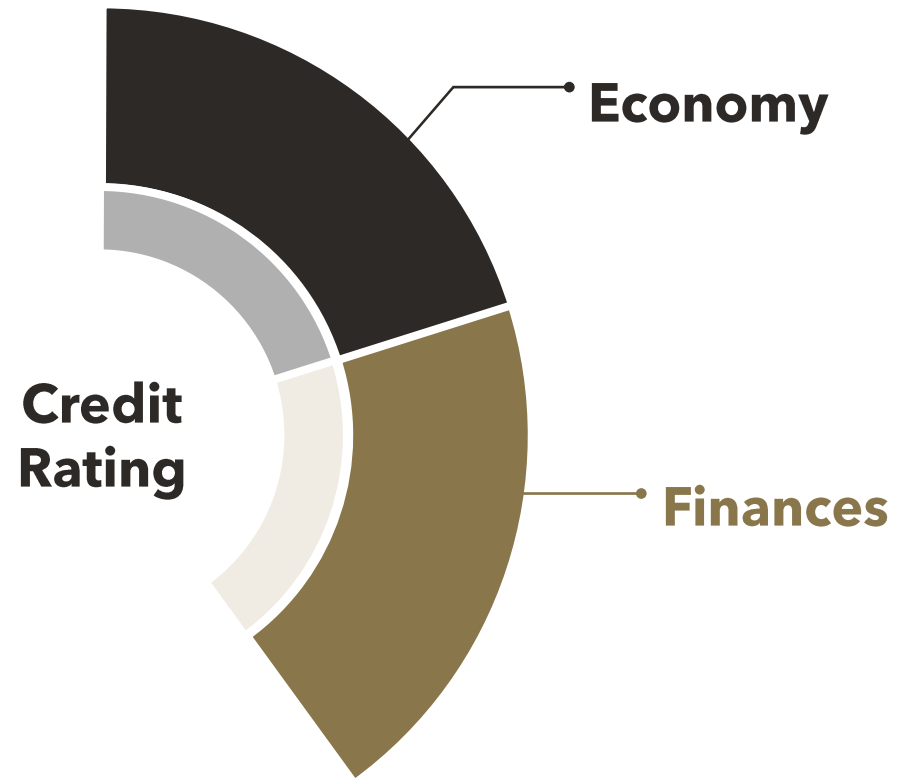
Primary Credit Factors

**Credit
Rating**

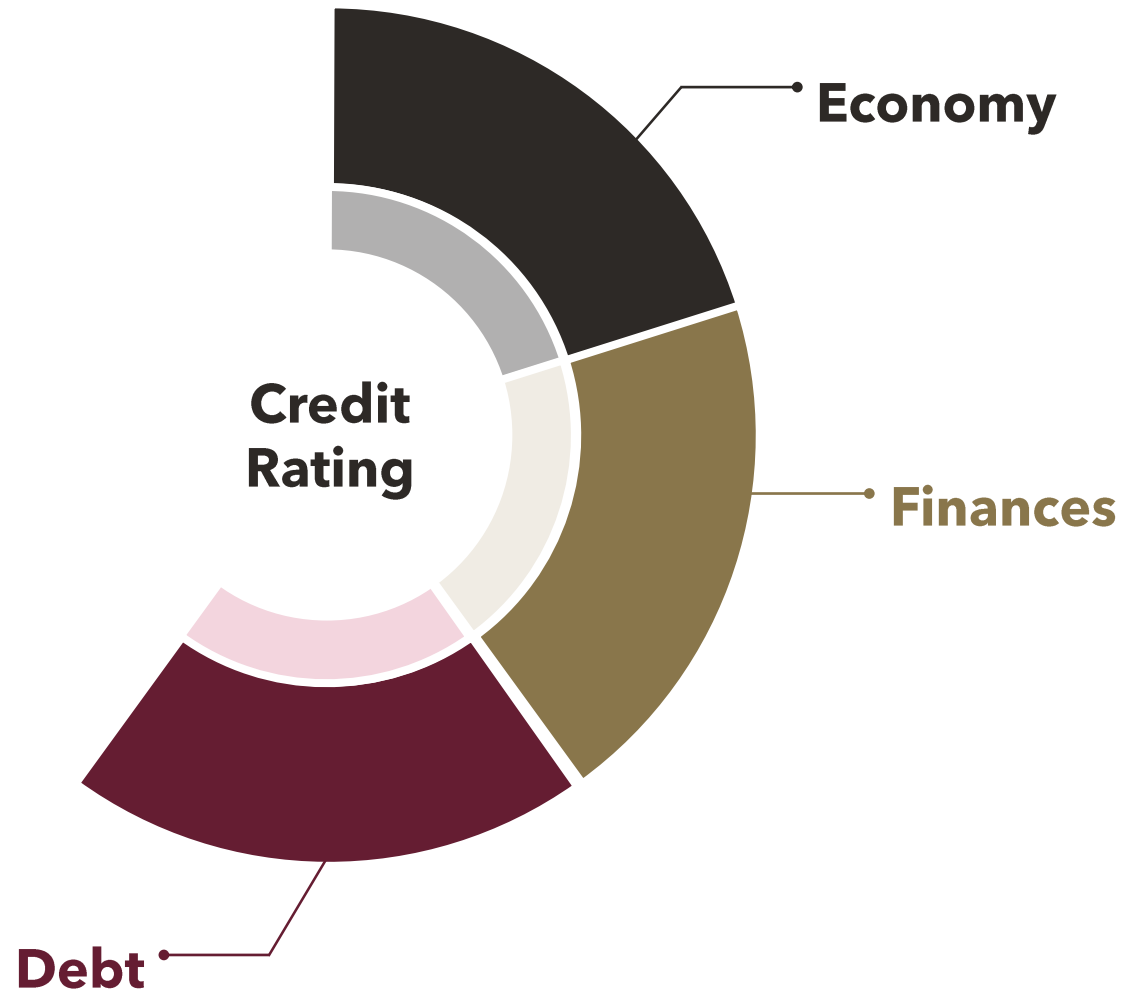
Primary Credit Factors



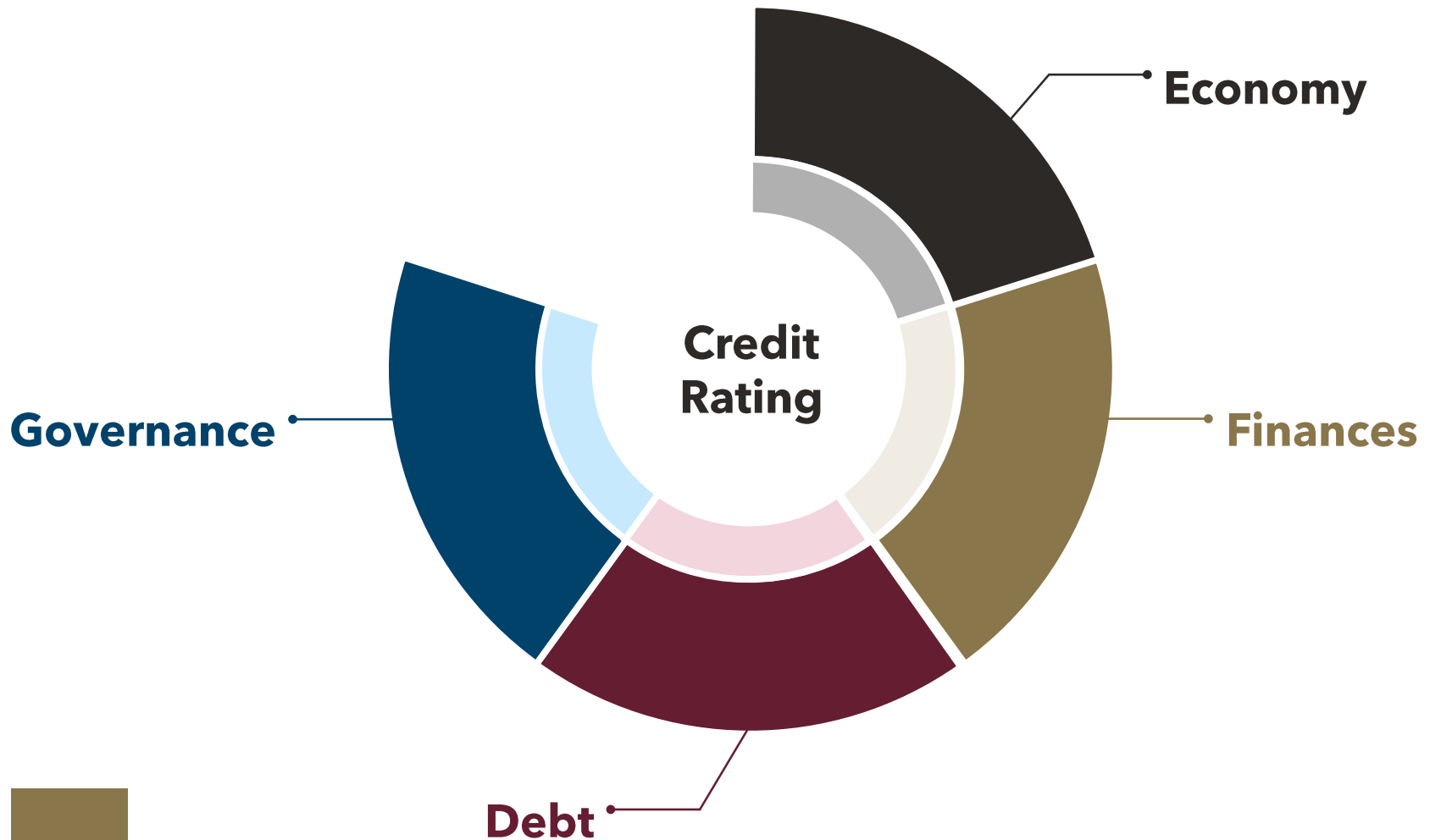
Primary Credit Factors



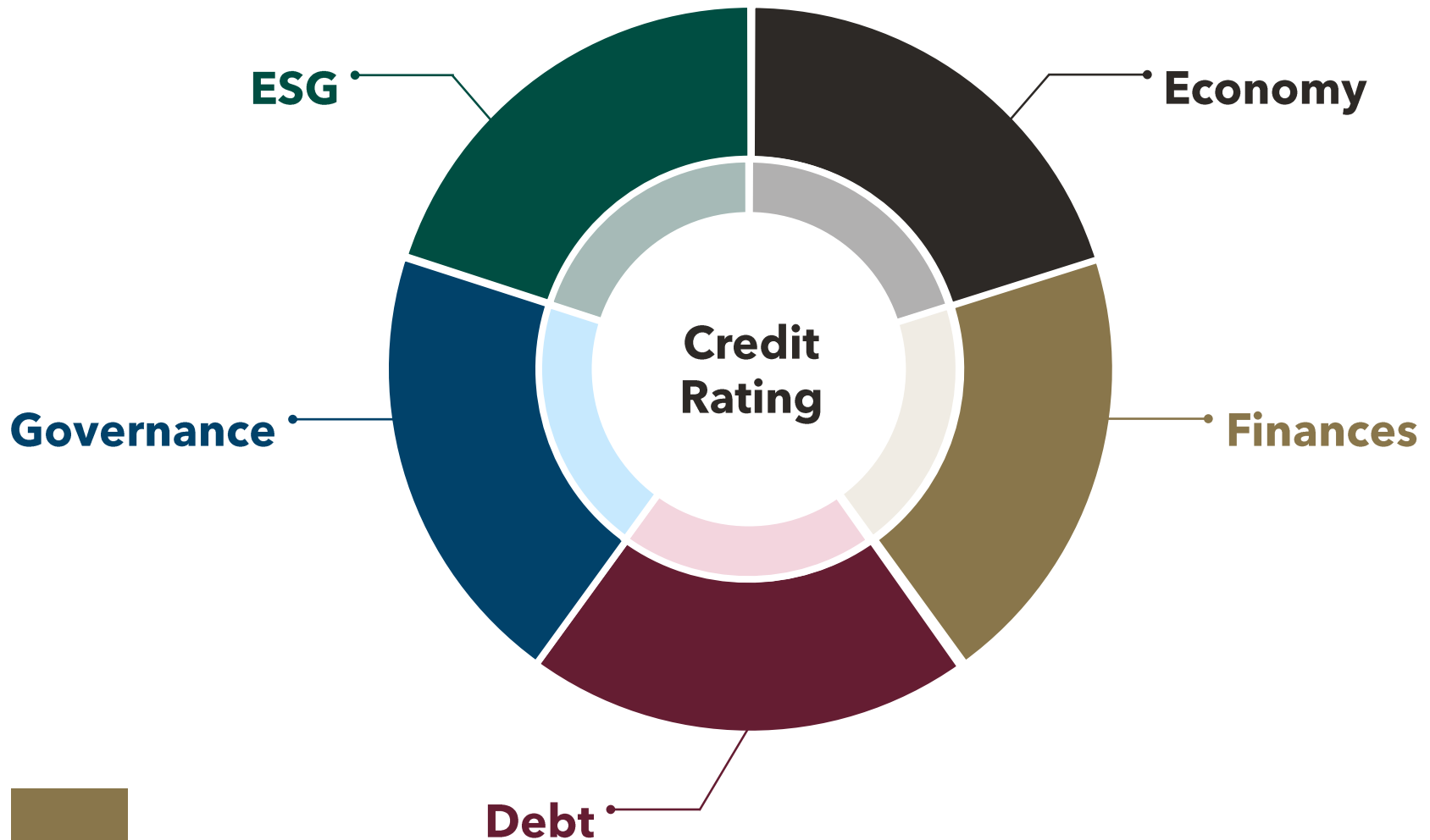
Primary Credit Factors



Primary Credit Factors



Primary Credit Factors



ESG Risk Analysis

Examples of local government ESG risks include:

Environmental



Examples:

- Physical risks from climate change
 - Water supply concerns
 - Excessive CSOs
 - Regulatory impact
-

Social



Examples:

- Declining population
 - Limited employment opportunities
 - High poverty rate
-

Governance



Examples:

- Material financial audit violations
 - Significant budget impasse
 - Weak management of long-term liabilities
-

Climate Risk: Investor Considerations

1. Identify applicable climate risks



2. Evaluate potential impacts from risks by timeframe

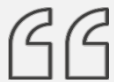


3. Consider potential mitigants and additional vulnerabilities

Type of Climate Risk	Examples	Potential Investor Considerations
Physical Risks	<p>Flooding, heat stress, wildfires, sea level rise, drought, water stress</p> <p>Potential secondary effects, including lower property tax values, inability to secure mortgages/insurance, population loss</p>	<ul style="list-style-type: none">• Natural resiliency against climate risks• Adaptation plans & signs of implementation• Likelihood of rebuilding after damage occurs.
Transition Risks	<p>Closure of fossil fuel-related taxpayers or employers, new state/federal regulations or taxes (e.g., carbon tax), stranded assets</p>	<ul style="list-style-type: none">• Diversity of local economy• Proactive moves to address potential regulations

Climate Risk: Rating Agency Considerations

Credit ratings agencies have similar climate risk considerations as investors, though they are less likely to move quickly as they give more attention to adaptation and mitigation plans.



Bound by geography, public entities are on the front lines of extreme weather events, natural phenomena, rising sea levels, and other environmental and climate-related risks.”

– S&P, *The Role of ESG Credit Factors in our Ratings Analysis*

Response From Rating Agencies

- Beginning to ask about climate risks and other ESG risks in calls with municipalities
- Adding paragraph to rating reports about environmental/climate risks.

Disclosure of ESG Risks

Disclosure of material ESG risks in offering documents and supplemental disclosure provides a central location for investors to find it.

- Increasingly, cities are disclosing risks, such as climate change, in official statements
 - Could include cataloguing of risks affecting your community, potential impact, existence of climate plan & link to it, mitigation or adaptation plans
 - Taskforce on Climate-Related Financial Disclosures (TCFD) provides some guidance, but corporate focused.

Climate Disclosure Example

From St. Paul's 2019H General Obligation bonds official statement:

Climate Change and Resiliency

Minnesota is susceptible to significant seasonal weather shifts during the course of the calendar year, including weather events such as flooding, blizzards and drought. Future changes to the climate in Minnesota could produce ecological, environmental and economic impacts on Minnesota and the City. Climate change as a result of emissions of greenhouse gases is also a significant topic of conversation and may generate future additional federal and state regulatory responses.

City officials take climate change seriously and are in the process of developing a Climate Action & Resilience Plan (the "CARP") to provide a framework to address the impact of climate change on the City and its residents. The goal of the CARP is to achieve carbon neutrality by 2050 and cut emissions in the City in half by 2030. The City's is also identifying ways to cultivate long-term resilience, enhance the natural infrastructure of the City, and promote a vision for Saint Paul's future with diminished threats of climate change. The City was also recently awarded \$2.5 million of funding as a part of Bloomberg American Cities Climate Challenge as an initial building block in this process.

ESG: How to respond

Investors and rating agencies are increasingly paying attention to a community's ESG risks and how the community is responding and adapting.

A community's natural resiliency and ability to adapt can be considered an *ESG opportunity*. You may be able to strengthen your community's resiliency through:



Planning future capital projects with expected climate and other ESG considerations in mind



Proactively preparing for climate risks (e.g., increased flooding, precipitation, heat, or water stress)



Proactively preparing for future regulations or potential carbon taxes through working to reduce greenhouse gas emissions

Socially Responsible Investing (SRI)

ESG vs. SRI

Despite frequent conflation, ESG risk analysis differs from **socially responsible investing**, which evaluates for impact or outcomes.

ESG Risk/Opportunities Analysis

Assesses environmental, social, and governance factors that affect the **ability and willingness of the issuer to repay debt**

vs.

SRI Impact/Outcomes Analysis

Assesses potential **impact of projects funded by the bonds**, which often includes analysis of use of bond proceeds, or of the obligor's practices

Defining Socially Responsible

While socially responsible investing often varies from firm to firm, it typically includes investing in bonds funding projects that address essential government purposes, such as:



Education facilities



Libraries, community centers, and parks



Police and fire infrastructure



Water and sewer infrastructure

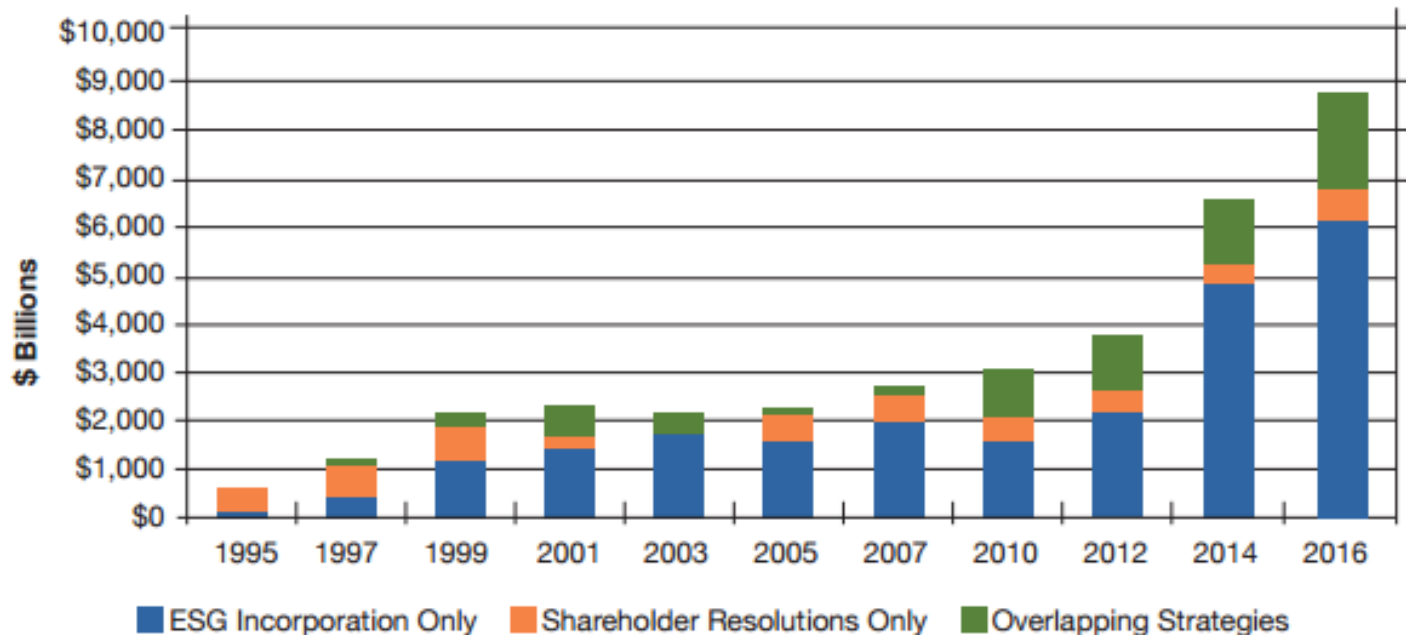
Could also include assessment of the obligor itself, including characteristics such as:

- Measure of income inequality (Gini coefficient)
- Affordable housing availability
- Transition off fossil fuels

Investor Interested in SRI

According to the U.S. SIF Foundation, more than \$1 out of \$5 under professional management in the U.S. was invested in SRI strategies in 2016.

Fig. A: Sustainable, Responsible and Impact Investing in the United States 1995–2016



SOURCE: US SIF Foundation.

Source: Figure from *U.S. SIF 2018 Report on U.S. Sustainable, Responsible and Impact Investing Trends*. <https://www.ussif.org/trends>. October 31, 2018.

Thematic Investment Strategies

Some investors will choose a specific theme for their strategy, representing the investor's particular focus or values, and only buy bonds that fit within those parameters.

- Thematic strategy examples include:
 - Environmental (could include green bonds and other non-labelled projects)
 - Gender focus
 - Education
 - Poverty/low-income communities
 - UN Sustainable Development Goals

UN Sustainable Development Goals

Many investors seek to align their socially responsible strategies with the United Nations' Sustainable Development Goals.

SUSTAINABLE DEVELOPMENT GOALS



Use of Bond Proceeds

Socially responsible investors are focused on confirming that the bonds are funding projects believed to contribute to the sustainability of local communities.

Socially responsible investing often requires:

Analysis of use of bond proceeds to determine eligibility

SRI Disclosure Challenges

When the use of bond proceeds included in an official statement lacks sufficient detail, it can be a challenge to place in an SRI strategy.

Common Concerns	Use of Bond Proceeds Examples
Too vague	“Bond proceeds will be used for capital purposes.” “Bond proceeds will be used for equipment and municipal buildings.”
Many projects included together	“Bond proceeds will be used for roads, water, sewer, libraries, police and fire infrastructure, jails, city offices, and computer equipment.”
Refunding of multiple bonds	“Current official statement may lack detail about original bond purpose.”

SRI Disclosure Effectiveness

When outlining the use of bond proceeds, it's beneficial to include:

- Detailed description of the projects funded to help investors determine if a project qualifies for the SRI strategy
- Information about expected outcomes or expected impact of the project on the local community can also be helpful, if available

Thank you.

If you have any questions, please do not hesitate to contact us at:

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Green bonds advisory services for corporate and public finance teams and issuers

External Reviews of Green Bonds

Green Bond Frameworks

Consulting

Reporting

Introduction to Kestrel

- 20 year consulting business, based in USA
- **Climate Bonds Initiative** Approved Verifier
- Water, energy and environmental projects experience
- A **Woman-owned Small Business**, SBE, DBE
- Focus on green bonds



What are Green Bonds?

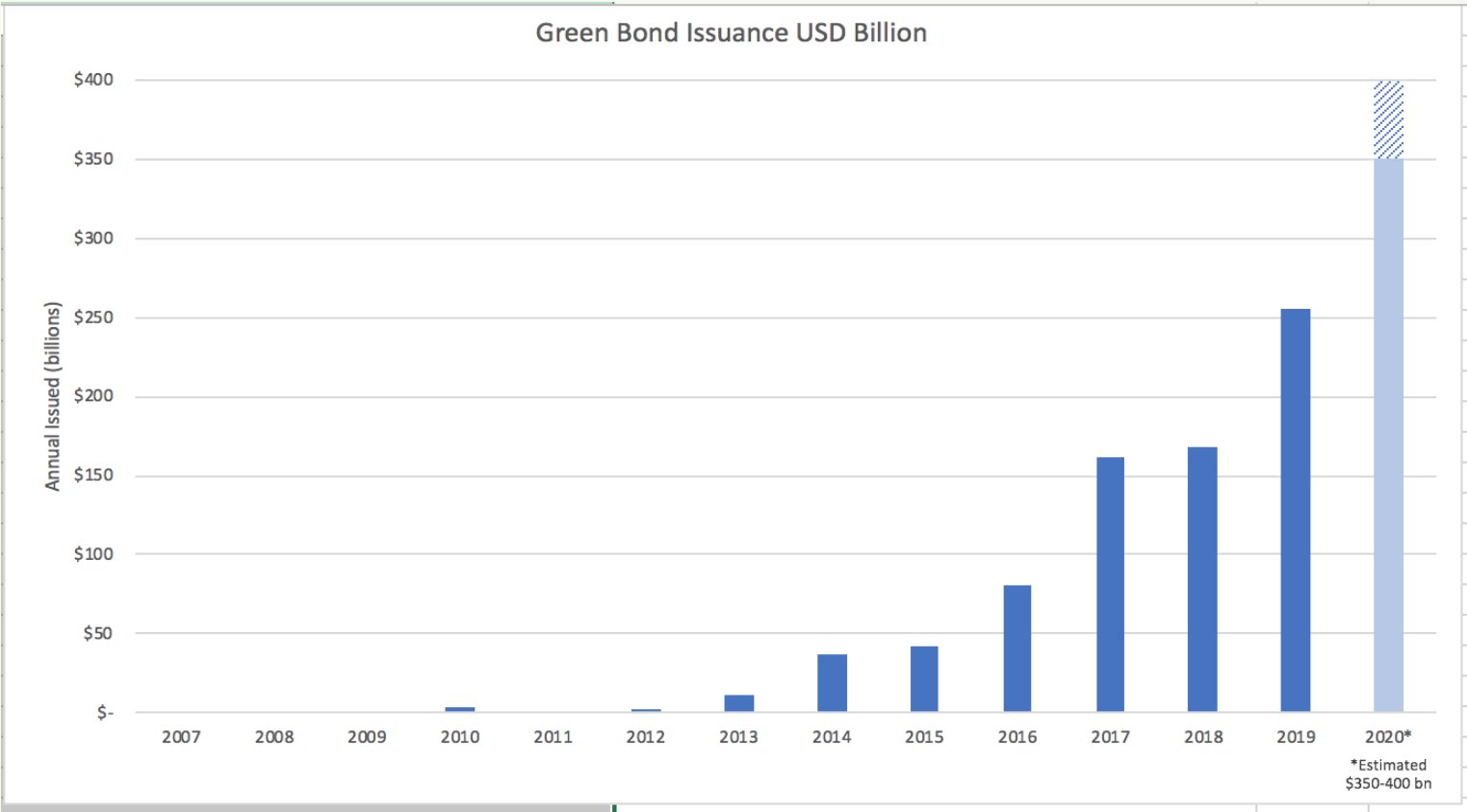


There are green **standards and certification criteria.**



Green Bonds Are Having A Moment

Worldwide issuance exceeded \$250 Bn in 2019.
Moody's predicts \$400 Bn for Green, Social & Sustainability bonds in 2020.

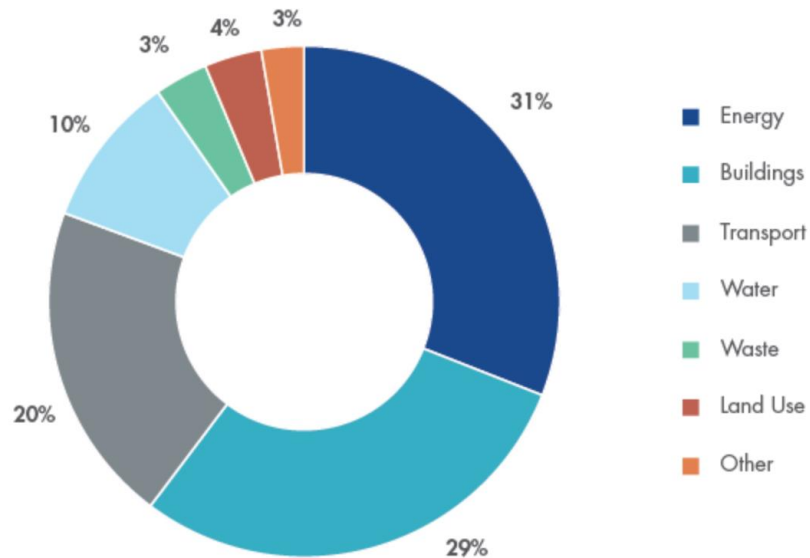


Source: Climate Bonds Initiative January 16, 2020



Green Sectors - 2019

Green Bonds Issued by Use of Proceeds



- Green buildings
- Transportation
- Grid Modernization
- Energy Efficiency
- Water
- Wastewater/ Recycled Water
- Flood Control
- Recycling
- Pollution Prevention
- Land Uses
- Adaptation and Resilience

Source: Climate Bonds Initiative January 16, 2020



Internationally Accepted Green Standards

Green Bonds



Standard: ICMA

Use: Projects with a beneficial environmental or climate impact.

Examples: Renewable energy and energy efficiency, clean public transportation, pollution prevention and control, conservation, sustainable water and wastewater management, and green buildings

Certified Climate Bonds



Standard: CBI

Use: Projects consistent with lowering greenhouse gas emissions as established in the Paris Agreement.

Examples: Investments that contribute to addressing climate change, such as bus rapid transit systems, low carbon transportation, green buildings and water infrastructure.

Social Bonds



Standard: ICMA

Use: Social Bonds are used to raise funds for new and existing projects with positive social outcomes.

Examples: Affordable housing, education, libraries

Sustainability Bonds



Standard: ICMA

Use: Sustainability bonds meet BOTH Green and Social Bonds Principles.

Examples: Green, affordable housing, green public buildings, residential solar programs

European Green Bonds Standard -2020

7



Green Bond Benefits for Muni Issuers

- ✓ In High Demand – tighter spreads, over-subscriptions
- ✓ Bring New Investors to the Table
- ✓ Advance multiple objectives – climate action, transparency
- ✓ Build Stakeholder Engagement
- ✓ Enhance Reputation and Leadership

External reviews (verifiers) provide confidence and consistency in this market.



Green Clients Need Green Bonds ...

These Minnesota cities have committed to climate action and sustainability through the following initiatives/programs.

- Bloomberg Philanthropy Climate Challenge
- Global Covenant of Mayors for Climate & Energy
- The Rockefeller Foundation, 100 Resilient Cities
- Climate Mayors Coalition
- C40 Cities
- US Climate Alliance Governors

Rochester, MN	Bloomington, MN	Falcon Heights, MN
Carver, MN	Burnsville, MN	Maplewood, MN
St. Paul, MN	Minneapolis, MN	Duluth, MN
Lanesboro, MN	Eden Prairie, MN	Edina, MN
	Governor Tim Waltz,	Minnesota



Three Easy Steps to a Green Label

Initial Consultation

Kestrel will recommend which Green Labels are most appropriate.

Some green is better than no green...

Did you know a deal can be partially green?

Efficient review

We utilize public and non-public information to craft our opinions. We are efficient in our interactions with the issuer and team to minimize impacts.

Second Opinion or Verifiers Report

The Issuer reviews a draft to approve our content. We finalize the report, which may be included in the POS. We send talking points and a draft press release.



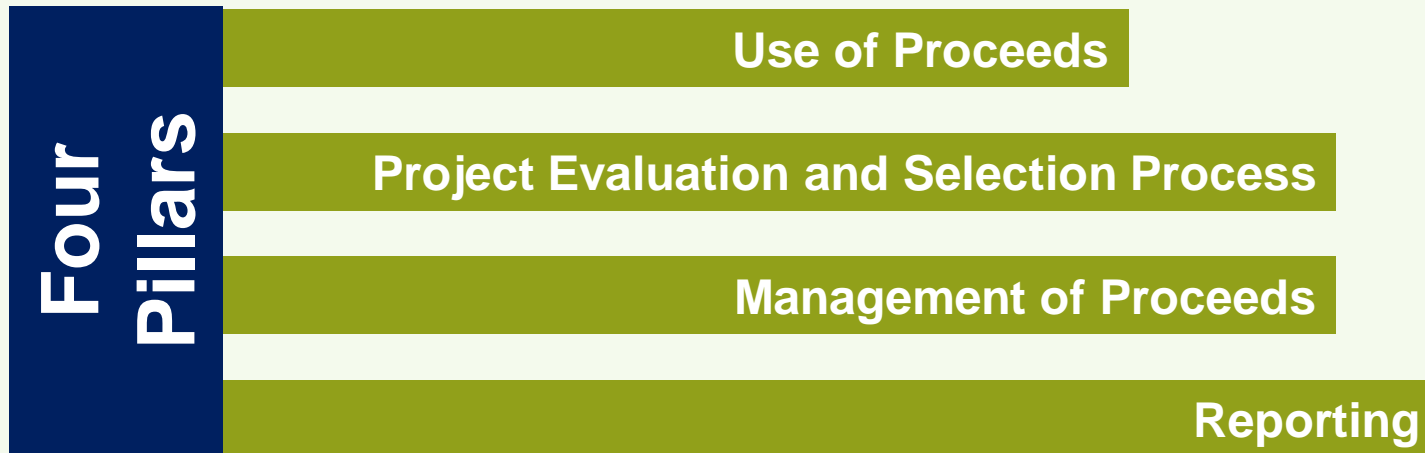
Proactive Approach

- When preparing the CIP, identify assets that are likely to be Green Bond eligible.
- Develop a replicable reporting approach
- Prepare a **Green Bond Framework**, with or without consultant assistance.
- Engage a verifier for an Opinion on the Framework or on a specific bond.
- Efficient, reduces need for external reviews.



What Verifiers Look For

Alignment with Green Bond Principles or CBI Standards and Sector Criteria



A Green Bond Framework gathers all of this information into one place.



Reporting for Green Muni Bonds

Standard Continuing Disclosures	Voluntary Impact Reporting	Post-Issuance Report
<p>Required for all municipal bonds, green or not. Report on EMMA</p>	<ul style="list-style-type: none">○ Best practice & recommended○ Issuer decides what impact to measure. The <u>Global Reporting Initiative</u> has recommendations.○ Can be simple○ Improves transparency○ Post on EMMA	<p>Required if using Certified Climate bonds.</p> <p>A one-time report produced by the Verifier within 24 months of issuance.</p> <p>No other required reports for green bonds.</p>



Could My Deal Be Green ?

Muni Deals	Green Sector	Eligible Project Types
GO's Revenue Bonds Water/Sewer School Districts Airports Light rail Higher Ed Utility Districts Public Utilities Housing Health Care	Transportation	Infrastructure, Bike, Metro, Tramways, Low-carbon fueling, Rail-both passenger and freight, Fleet Upgrades-Buses, Passenger Vehicles, EV, Hydrogen fueling, PORTS, Marine Freight
	Buildings	New energy efficient projects and retrofit projects. Environmental Building Materials and Codes Incentives Programs. Retrofits.
	Energy	Grid Modernization, Transmission, Distribution, Energy Storage, Solar Projects, Wind, Geothermal, Bioenergy, Biomass, Hydropower, Property Assessed Clean Energy (PACE), Electrification of Ports
	Water	Water Supply, Water Infrastructure, Water Storage, Stormwater Management, Metering, Water Conservation, Flood Control, Drought Response, Wetlands Restoration, Brackish Desalination, Watershed Protection, Wastewater Treatment
	Waste Management	Refurbishment and manufacture of waste facilities, energy recovery from waste and landfill diversion, recycling systems, anaerobic digestion, composting.



Kestrel Recent Transactions

PAR	Issuer	Series	State	Use of Proceeds
\$96,220,000	City of Minneapolis	General Obligation Capital Improvement Bonds (Green Bonds), Series 2018	MN	Low carbon buildings (2)
\$38,600,000	Connecticut Green Bank	Solar Home Renewable Energy Credits (SHREC) Series 2019-1 Class A & B	CT	Solar loan securitization
\$48,775,000	South Bayside Waste Management Authority	Solid Waste Enterprise Refunding Revenue bonds Series 2019B (Green Bonds)	CA	Regional recycling facility upgrades and solar
\$75,000,000	Sacramento Municipal Utility District	Electric Revenue Bonds, 2019 Series G	CA	Low carbon buildings
\$560,000,000	Georgia Renewable Power, LLC	GRP Franklin and Madison "Green Term Loan B and C"	GA	Renewable energy-biomass
\$272,605,000	California Infrastructure and Economic Development Bank (CalSTRS)	Lease Revenue Bonds Series 2019 (Green Bonds - Climate Bond Certified)	CA	Low carbon buildings - Headquarters expansion
\$114,420,000	City of Minneapolis	General Obligation (Green Bonds), Series 2019	MN	Low carbon buildings - Public Service Center
\$466,125,000	California Public Finance Authority, for California Ethanol & Power, LLC	Imperial Valley Economic Development Revenue Bonds, Series 2019 A and 2019 B	CA	Sugarcane to ethanol biofuels facility
\$295,170,000	California Public Finance Authority, for California Ethanol & Power, LLC	Imperial Valley Economic Development Revenue Bonds, Series 2019 C	CA	Wastewater treatment and bioenergy
160,000,000	Arizona Industrial Development Authority	Benchmark-Raeford Ethanol Project	NC	Sorghum to ethanol biofuels facility
80,000,000	Milwaukee Metropolitan Sewer District	2020 General Obligation Green Bonds	WI	Wastewater and stormwater projects in CIP





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