History of Green Bond Market

Social impact investing has been around for decades on the equity side, as market participants have accepted standardized off-the-shelf methodologies to measure a company's Environmental, Social, and Governance (ESG) factors. For instance, S&P Global ESG Scores provide a robust measure of company's financially material ESG factors based on the SAM Corporate Sustainability Assessment, an analysis of ESG criteria developed and enhanced since 1999 to identify companies well-equipped to recognize and respond to emerging sustainability opportunities and challenges in the global market. In the bond markets, the European Investment Bank was the first to issue green bonds in 2007 labeled a 'Climate Awareness Bond,' and the World Bank subsequently came to market in 2008 with green bonds to combat climate change, what proved to become the foundational base for future like-issuances. While naturally lending itself to social impact investing given the focus on debt issuance to benefit the public-at-large such as school buildings as well as water and sewer systems, the municipal market was slow to catch on to the growing popularity of green project financing but has since grown exponentially. The Commonwealth of Massachusetts was the first self-labeled municipal green bond issuer in 2013, coming to market with $100 million of general obligation debt for the purpose of funding certain statewide projects that fell into one of four categories: clean water and drinking projects, energy efficiency and conservation projects in state buildings, land acquisition, open space protection and environmental remediation projects, as well as river revitalization and preservation and habitat restoration projects. Given the growing interest in social impact investing and the need for a uniformed approach to ensure transparency, accuracy, and integrity of issuer information, a consortium of investment banks created voluntary best practice guidelines in 2014 called the Green Bond Principles (GBP). The International Capital Market Association (ICMA) has since assumed responsibility for ongoing monitoring and developments of the GBP, providing high level categories for eligible green projects with four core components: use of proceeds; process for project evaluation and selection; management of proceeds, and reporting. While the GBP are used as best practice guidelines for municipal issuers, the Climate Bond Initiative (CBI) took the process one step further, eliminating uncertainty with respect to self-labeling by certifying bonds to the extent the issuance conforms with the Climate Bonds Standard and providing approval by a third-party vendor. According to the Conservation Finance Network, total green debt issuance has grown from a single bond in 2007 to nearly $258 billion from nearly 500 issuers in 2019. In the municipal market, green labeled municipal issuance has blossomed from its modest beginnings to nearly $61 billion in green bonds outstanding in the roughly $4 trillion municipal bond market, according to Bloomberg and SIFMA data, with potential for further growth to satisfy investors' increasing ESG appetite. The CBI identified at least $264 billion in outstanding debt and over 1,400 unique climate-aligned U.S. municipal entities in 2018, not to mention the many non-pureplay issuers with potential green labeled debt to issue. This compares to only 460 green labeled municipal issuers (includes qualified energy conservation bonds) to-date, according to Bloomberg data. Given the strong investor demand within this sector, we expect new green bond municipal issuance to continue to rise, particularly via rebranded bonds with new green designations. While some issuers in this space have utilized the green designation as a marketing tool to lower finance costs, the GBP and CBI certification are two major frameworks that have standardize the issuing process, so that investors know that their investable dollars are truly being used to finance specific ESG initiatives.

Firm Capabilities

Veritable L.P.’s Fixed Income Group (“VLP FIG”) constructs and actively manages over $4.5 billion of investment grade fixed income portfolios on behalf of individuals, families, and entities. Portfolios are tailor-made based on each client’s circumstances articulated in a written investment policy that not only establishes basic constraints such as duration and credit quality but can also incorporate unique preferences such as environmentally responsible requirements. While certain clients may prefer green bonds that fund general environmentally-friendly projects, others may seek bond issuances that finance specific initiatives such as energy efficiency. A roll-up-your-sleeves approach was required during the green municipal market’s infancy period, as VLP FIG combed through issuer documents to identify seasoned issues that fund environmentally-friendly projects but lack the formal green label. For example, the Massachusetts Clean Water Trust is a state agency that issues municipal debt to fund infrastructure projects that help local communities enhance ground and surface water resources and ensure safe drinking water that adheres to the Federal Clean Water and Safe Drinking Water Acts. Over time, VLP FIG has built a robust database of diverse non-labeled green issuers under broad categories like water, mixed use for environmentally beneficial projects, transportation, energy, and environmentally-friendly facility construction. The broad categories have evolved into further sub-classifications to the extent clients required greater granularity (e.g., energy subcategorized as solar, wind, hydroelectric, recovered energy generation, or improved energy efficiency). While witnessing explosive growth in green municipal issuance, we estimate that only about 25% of the unique green labeled issuers actually trade in the secondary market with only 10% of the issuers considered ‘frequent traders’ in the marketplace. Consequently, VLP FIG continues to utilize the rich database of non-labeled green but environmentally-friendly issuers to complement existing officially designated municipals, successfully building diversified green municipal bond portfolios, while remaining disciplined with an overarching focus on principal preservation.

Evolution of Social Impact Investing to Embrace Diversity, Equity, & Inclusion

Similar to our work in the green bond market, we understand that incorporating socially responsible investments focused on Diversity, Equity, & Inclusion (DEI) is an important consideration among a growing number of investors. VLP FIG can build customized portfolios with specific DEI mandates that align with a client’s personal values. Clients may prefer bond issues that help ensure housing availability and affordability for people with limited financial means. State Housing Finance Agencies (HFAs) issue debt in the municipal market to finance affordable mortgages for people with incomes that make traditional financing options less obtainable. According to the National Council of State Housing Agencies, the median income of single-family borrowers in 2018 under the HFA program was just $57,039 with a relatively larger percentage of mortgage loans to borrowers of color. Many times, social impact investing can go hand-in-hand with green investing, as addressing concerns that benefit the environment often overlap with issues of social justice. For example, the New York State HFA issued bonds that helped finance the construction of affordable housing developments with at least 40% of the units occupied by individuals or families whose income does not exceed 60% of the median income for the area.

Evolution of Social Impact Investing to Embrace Diversity, Equity, & Inclusion
(continued)

The projects incorporated certain energy efficiency standards with the goal of designating the structures as certified Low Carbon Buildings under the CBI criteria. State and local governments have also come to market with general obligation debt to support an affordable housing mandate. San Francisco has issued bonds to finance the rehabilitation of multi-unit residential buildings to convert such structures to affordable housing consistent with voter-approved Proposition E, which links the amount of new office space that can be approved annually to the city’s performance on building new affordable housing. Within the higher education sector, a large issuer of debt in the municipal space, the level of racial and ethnic student body diversity can be evaluated relative to other colleges and universities. The University of Hawaii, Rutgers University, Stanford University, and Massachusetts Institute of Technology were among the national universities rated highest in terms of diversity, based on a U.S. News & World Report index using 2019 undergraduate student body data. Diversity can also be assessed in other sectors of the municipal market such as hospitals and healthcare systems. In fact, Forbes released an annual list of the Best Employers for Diversity in 2020 and 14 hospitals and healthcare systems made the top 100 including Mount Sinai Health Systems, Penn Medicine, and Cincinnati Children’s. And, to take it one step further, VLP FIG can even allocate certain trades to minority owned broker-dealers such as Samuel A. Ramirez & Co., Inc., Siebert Williams Shank & Co with whom we already do business, while continuing to seek best execution. From the perspective of income inequality, while the United States is one of the richest countries in the world, the income gap is quite large among municipalities across the country. Investors can use developed rubrics to assess state and city income inequality such as the Gini coefficient, which is the measure of the distribution of income across a specific population. For example, New York, Connecticut, and Louisiana are among U.S. states that score poorly under this calculation using Census Bureau data, while Atlanta and New Orleans were among the U.S. cities with the largest income inequality gaps. We expect the DEI municipal marketplace to continue to evolve similarly to that of the green municipal sector in order to meet growing investor demand perhaps leading to greater transparency and more uniform practices among issuers. In the interim, VLP FIG will continue to build upon our DEI database by sifting through the marketplace to identify municipal issuers who satisfy this mandate without sacrificing significant yield or credit quality thereby allowing clients to simultaneously ‘do well and do good.’