Green Bonds and Local Infrastructure Projects

GREGORY D. MILLER, BICKERSTAFF HEATH DELGADO ACOSTA, LLP WITH PRACTICAL LAW GOVERNMENT PRACTICE

Search the Resource ID numbers in blue on Westlaw for more.

A Practice Note discussing what green bonds are, how they are used in financing local government public works infrastructure, types of eligible projects, the use of green bonds in environmentally sensitive projects, Leadership in Energy & Environmental Design (LEED) projects, disclosure requirements (including project labeling and transactional labeling), and certifications, including ISO 2600 and ISO 14030. The Note discusses Green Bond Principles (GBP), the Climate Bond Initiative (DBI) and the Electronic Municipal Market Access Function of the Municipal Securities Rulemaking Board (EMMA).

Local governments need bond money for multiple infrastructure needs and are often looking for new sources of bond money. (See Practice Notes, Government Bonds: an Introduction to Issuing Government Bonds for State and Local Government Attorneys (w-008-1426), Financing US Infrastructure Projects: Sources of Capital (W-007-0293), Financing US Infrastructure Projects: TIFIA (W-015-2524), and Financing US Infrastructure Projects: WIFIA (W-015-2540)).

Also, many local governments have an interest in encouraging environmentally conscious projects and promoting environmentally sustainable practices. Using green bonds for eligible projects can accomplish both goals.

There is no universal or legal definition of the term green bond. Market participants generally agree that the term refers to a bond issued to finance projects (initially or as a refunding bond) that will have a net-positive environmental impact. Local governments have issued many bonds to finance environmentally friendly projects without green bond designations. However, local governments (issuers) are more likely to want to label those bonds as green bonds today. The increase in the designation reflects:

- Issuers' interest in promoting efforts to address the negative effects of climate change.
- Investor's' interest in financing low carbon and climate change-resilient projects.

The European Investment Bank issued the world's first green bond in 2007. Designated as a "climate awareness bond," it was used to finance renewable energy and energy efficiency projects. In 2013, the state of Massachusetts issued the first US municipal green bond. It was used to finance a range of environmentally beneficial projects, including the improvement of drinking water, making state buildings more energy efficient, and river habitat restoration. The green bond market has grown significantly from the first climate awareness bond sold in 2007. For example, global issuances in the First Quarter of 2019 were in the amount of approximately $47.9 billion with US issuers accounting for approximately $14.7 billion of that total. (Climate Bonds Initiative, Green Bonds Summary-Q1 2019, April 2019.)

BENEFITS OF GREEN BONDS

The attractiveness of green bonds, for either the issuer or the buyer, does not appear to be related to any difference in interest rates between municipal green bonds and typical municipal bonds. Instead, the increased use of green bonds seems to be motivated primarily by three general types of non-economic benefit that are unique to green bonds. These include:

- The societal and ecological benefit of the project.
- The reputational benefits that accrue to the issuer responsible for the financed project.
- The policy-specific benefits for the investors that purchase green bonds to further ethical and environmental commitments.

Because of these unique motivating factors, issuers should treat any facts pertaining to the green qualities of the project as material when preparing disclosure documents for its green bonds offering. Section 17(a) of the Securities Act (15 U.S.C. § 78q-1), Section 10(b) of the Exchange Act (15 U.S.C. §78j), and Rule 10b-5 (17 C.F.R. §240.10b-5) forbid making a false statement of fact, or omission of a material fact, regarding the purchase or sale of a security. A fact is considered material if "there is a substantial likelihood that a reasonable investor would consider it important to an investment decision." (*In re* County of Orange, Cal., SEC Rel Nos. 33-7260. p. 32 (Jan. 24, 1996).) A municipal issuer should consider how to show that the bonds are "green" without misstating or omitting any material information.

GREEN BOND TRAITS

Green bonds share two common traits:

- The issuer has designated the bond proceeds for application to projects that the issuer describes as "green" (see Green Project).
- The disclosure documents for the bonds almost always address:
  - how the "greenness" of the project is to be verified; and
  - the issuer's continuing obligation to report to the market on the project's progress.

GREEN PROJECT

A green project typically includes any project that seeks to accomplish a discernible environmental benefit. Green projects financed with municipal green bonds generally fall under one or more of the following categories:

- Climate change adaption.
- Energy efficiency.
- Land use and land management.
- Pollution prevention and control.
- Renewable energy.
- Transportation.
- Water and wastewater management.

According to one recent report, as of the second quarter of 2018, municipal issuers in the United States had issued:

- $170 billion in green bonds for water and wastewater projects.
- $78.5 billion for transportation-related projects.
- $8 billion for waste management.
- $4.8 billion for land protection and conservation.
- $2.6 billion for energy-related projects.

(Climate Bonds Initiative, Can US municipals scale up green bond issuance? Likely, "yes", July 2018.)

DISCLOSURE ITEMS

The disclosures made by the issuer in the offering documents for green bonds about the greenness of the issue typically follow the pattern established by the Green Bond Principals (GBP). First published in 2014 by an international committee representing investors, issuers, and underwriters, GBP provide clarity for issuers and investors about what should and should not count as a green bond. The GBP are now under the management of the International Capital Markets Association which is responsible for updates to the GBP.

The GBP do not set out definite criteria for determining whether a green bond merits designation as green. Although called the Green Bond Principles, the GBP are a set of four topics that the issuer must address to show that the bonds being offered are green bonds. The GBP represent the investors' expectation that any offering documents for a green bond will:

- Show that the proceeds are for a green project.
- Describe how the project furthers the issuer's overall approach to addressing climate change.
- Confirm that the issuer will manage the proceeds to accomplish the project.
- Obligate the issuer to report to the market the completion of the project or accomplishment of the intended environmental benefits or both.

HOW LOCAL GOVERNMENTS HANDLE DISCLOSURE

As the municipal green bond market continues to develop, there are two general approaches used in the offering document to show that the green label is appropriate. Municipal green bond issuers will typically address the greenness of the transaction in the offering documents by either referencing:

- A standard that relates to the environmentally beneficial aspects of the financed project (see Project Labeling).
- A certification provided by a second party verifying that the bonds, taken as a whole, are green, according to a specific standard, which usually mirrors the GBP (see Transaction Labeling).

PROJECT LABELING

Project Labeling relies on a certification, such as a Leadership in Energy & Environmental Design (LEED) designation or Energy Star award, that the financed project will achieve certain environmental benefits. For project labeling, the certification is limited to a certification about the type of project (such as a LEED project).

Example of Project Labeling

As an example of this approach, the Board of Regents of the University of Texas System (the University), on January 1, 2016, issued new money bonds in the amount of $206,040,000 to finance the construction of four buildings, which are defined in the official statement collectively as the "Green Projects." (See *$206,040,000 Board of Regents of the University of Texas System Revenue Financing System Bond Series 2016B (Green Bonds), Official Statement*.)

The official document states that the bonds are designated as green bonds to allow investors to invest in debt "issued for certain projects that have been identified by the University as promoting environmental sustainability purposes."

To support the claim that the financed projects will promote environmental sustainability purposes, the University stated that: "The [University] has either obtained or intends to pursue LEED (Leadership in Energy & Environmental Design) Silver certification for all of the Green Projects . . .The [University] presently intends to achieve a LEED Silver certification for all the Green Projects; however, there can be no assurance that such certification or any particular minimum LEED certification will be achieved for those Green Projects that have not already received such certification, and the failure to achieve any particular LEED certification level will not constitute a default under the [authorizing resolution of the issuer]."

The University also stated that it will provide notice of the completion of the Green Projects through the Municipal Securities Rulemaking Board (MSRB) (See Practice Notes, Municipal Securities Regulation: Overview (W-006-4694) and Federal Securities Regulators: Overview (W-000-7587)).

Other than the reference to LEED certification, the University did not represent that the project or the issue will be certified as green by any second or third party. Significantly, issuers that use Project Labeling typically address the other GBP criteria in the offering documents in one way or another.

TRANSACTION LABELING

Transaction Labeling is a method of designating the bond green. The designation is supported by a certification from a second party that verifies that the issue complies with project management and reporting obligations that tend to mirror the GBP. The second-party reviewers that provide the opinion tend to be firms that specialize in environmental, social, and governance (ESG) analysis.

Example of Transaction Labeling

The District of Columbia Water and Sewer Authority (the Water Authority), for example, issued $350,000,000 of bonds that it designated as green bonds in 2014. (See *$350,000,000 District of Columbia Water and Sewer Authority 4.814% Public Utility Senior Lien Revenue Bonds, Series 2014A (Federally Taxable) (Green Bonds) Official Statement*.) The Water Authority used the proceeds of that issue for the construction and development of overflow tunnels as part of the "DC Clean Rivers Project." In its Official Statement, the Water Authority premised the green bond designation on the "independent assessment of the DC Clean Rivers Project, and of the [Water] Authority, conducted by Vigeo based on environmental, social and governance criteria . . ."

Vigeo-Eiris (Viego) is an international investment services firm that supports environmental, social, and governance activities of organizations. The Water Authority incorporated Viego's opinion in the offering document. The opinion state that Viego measured the sustainability of the project and the bonds against Viego's environmental, social, and governmental methodology. The opinion states: "[The Water Authority] is issuing a 'Green Bond', to finance the DC Clean Rivers Project which we consider commits to contributing to the improvement of water quality, climate resilience and quality of life. The objectives of the project are in line with DC Water's sustainable development commitments and are supported by a commitment to report on fund allocation, project performance and project management."

The opinion tracks the Green Bond Principles in that it addresses each of the four principles. These include:

- The financed project.
- The issuer's overall approach to addressing environmental matters.
- Management of the proceeds.
- Reporting.

Viego states that the criteria it applies to its assessment is based on International Standards Organization (ISO) standard 2600 (see Current Standards Used – ISO 2600). ISO 2600 sets guidelines for social responsibility and is intended to promote sustainable development.

Other examples of this approach include bonds issued by the New York Metropolitan Transit Authority and by the Public Utilities Commission of the City and County of San Francisco, which were certified as green bonds by the Climate Bonds Initiative (CBI). CBI is an international non-profit entity organized to enable investment in low-carbon and climate change-resilient infrastructure projects.

CBI's certification is based on an assessment of the project's ecological benefits and of the issuer's approach to addressing the GBP in its offering documents. The New York Metropolitan Transit Authority and the Public Utilities Commission of the City and County of San Francisco are the first US municipal issuers to obtain CBI certification for their bonds. (See *Metropolitan Transit Authority $309,225,000 Dedicated Tax Fund Green Bonds, Subseries 2017B-1 (Climate Bond Certified); $371,040,000 Dedicated Tax Fund Refunding Green Bonds, Subseries 2017B-2 (Climate Bond Certified) Official Statement*; and *Public Utilities Commission of the Commission of the City and County of San Francisco $229,050,000 2018 Series A (Green Bonds); Public Utilities Commission of the Commission of the City and County of San Francisco $179,145,000 2018 Series C (Green Bonds) Official Statement*.)

THE INTERNATIONAL STANDARDS ORGANIZATION AND EUROPEAN STANDARDS

CURRENT STANDARDS USED – ISO 2600

The International Standards Organization (ISO) has adopted ISO 2600, which is a standard used to evaluate the sustainability of an entity or project. In the example of the D.C. Water Authority's green bond issuance, Vigeo-Eiris as a second-party certifier used the ISO 2600 to assess:

- The financed project.
- The Water Authority's approach to sustainability.
- The Water Authority's continuing obligation for the bonds for suitability as a green bond offering.

NEW DEVELOPING STANDARD – ISO 14030

The ISO is currently developing ISO 14030. ISO expects ISO 14030 to serve as the international standard for what qualifies as a green bond. The new standard will build on the CBI standards and GBPs. According to the ISO, the new standard (ISO 14030) will serve three purposes:

- Clarifying for all market participants what qualifies as a green bond.
- Providing a classification of assets and project that can be financed with green bonds, which will simplify transactions.
- Providing the market with assurance that the green bonds will deliver meaningful environmental benefits.

(See Rick Gould, ISO, The Secret to Unlocking Green Finance, May 8, 2018.)

NEW DEVELOPING STANDARD IN THE EUROPEAN UNION

The European Union is currently developing a green bond standard, which also relies on the GBP and CBI, to enable the growth of the green bond market across Europe. Like the ISO standards, any measures implemented by the European Union to standardize the green bond market should be monitored. US municipal green bonds tend to follow trends that originate in the European Union, as shown by the common reliance on the GBPs and standards adopted by second-party certifying agents. (EU Green Bond Standards Working Group, Report on EU Green Bond Standard, June 2019.)

ELIGIBILITY ANALYSIS FOR USE OF GREEN BONDS IN FUTURE BOND PROJECTS

A local government that wants to use green bonds in its next infrastructure project should first consider whether the project might be suitable for designation as a green project.

RESOURCES FOR MAKING THE DETERMINATION

Resources for making this determination include:

- *The Electronic Municipal Market Access Function of the Municipal Securities Rulemaking Board* (EMMA). EMMA provides access to the offering documents for virtually any US municipal bond sold by competitive sale or by negotiated sale. EMMA can be used to:
  - identify municipal green bond sales; and
  - analyze offering documents used by each issuer.
- *The Green Bond Principles*. The GBPs include a list and a brief description of green project categories, including the following categories that are relevant to municipal functions:
  - energy efficiency;
  - pollution prevention and control;
  - clean transportation;
  - sustainable water and wastewater management; and
  - climate change adaption.
- *The Climate Bond Initiative*. The CBI develops and publishes sector-specific criteria that establishes carbon reduction or resiliency goals for different categories of infrastructure as part of its certification program. These criterial apply directly to issuers who are seeking a CBI certification, but they may also be useful in setting out expectations for bonds that are not CBI certified. The sectors currently covered by CBI criteria are:
  - energy (wind, solar, geothermal, and marine);
  - transport (rail, vehicles, and bus and rapid transit);
  - utilities (water);
  - buildings (residential and commercial); and
  - natural resources (forestry).

HIRING CONSULTANTS

If a local government determines that its project might be eligible to use green bonds, the local government should include experience or knowledge about green bonds in its request for qualifications for bond attorneys or consultants (See Practice Note, Principal Stages and Steps in a Municipal Bond Offering (W-016-4015)). The local government will want to engage the services of its bond counsel and financial advisors early in the process of developing the financing program (see Practice Note, Legal Issues in Municipal Finance (W-001-5064)). Bond counsel are useful in analyzing potential disclosure and tax issues, and the financial advisor can ascertain the state of the market and investor expectations. Because green bonds require the municipal issuer to communicate the environmental benefits of the project to the market, the local government's financing team should work closely with the engineering team to ensure that:

- The nature, scope, and benefits of the project are accurately described in the offering documents.
- Any ongoing reporting obligations that the local government offers to undertake are feasible.