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PIMCO's Best Practice Guidance for Municipal Sustainable Bond Issuance

PIMCO's ESG (environmental, social, and governance) and U.S. municipal teams outline the following best practices for municipal issuers of green, social, sustainability, or other labeled bonds[1].

DEFINING GREEN, SOCIAL, AND SUSTAINABILITY BONDS

Green, social, and sustainability (GSS) bond labels can be used for bonds that explicitly fund projects that fulfill certain green, social, or sustainability purposes.

The International Capital Markets Association (ICMA) sets forth the most widely referenced standards for what encompass GSS-labeled bonds, and these standards have been widely adopted by the municipal market.

Definitions and examples of projects from the ICMA's guidelines are listed in Figure 1.

Figure 1: International Capital Markets Association's Sustainable Bond Principles

	GREEN BOND	SOCIAL BOND	SUSTAINABILITY BOND
Definition	Bonds that fund projects that provide clear environmental benefits and do no significant harm.	Bonds that fund projects that provide clear social benefits and are looking to address a specific social issue or to achieve positive social outcomes.	Bonds that encompass projects that have both "green" and "social" components.
Potential Muni Projects	• Renewable energy • Energy efficiency • Pollution prevention • Sustainable land use • Clean transportation • Climate change adaptation	• Providing affordable basic infrastructure • Access to essential services • Affordable housing	• Lead removal in water infrastructure • Energy-efficient affordable housing • Environmental projects tied to jobs or other programs explicitly aiding low-income communities
Standards/ Guidelines[2]	MA Green Bond Principles; EU Taxonomy; Climate Bonds Standard	MA Green Bond Principles; EU Taxonomy; Climate Bonds Standard	ICMA Sustainability Bond Principles
Potential Linkages to UN Sustainable Development Goals (SDGS)	**#6** Clean Water and Sanitation **#7** Affordable and Clean Energy **#9** Industry, Innovation, and Infrastructure **#11** Sustainable Cities and Communities **#13** Climate Action **#14** Life Below Water	**#1** No Poverty **#3** Good Health and Well-Being **#4** Quality Education **#10** Reduced Inequalities **#11** Sustainable Cities and Communities	Same as Green and Social bond categories

1 PIMCO's Best Practice Guidance for Corporate Sustainable Bond Issuance and other asset classes

2 ICMA Green, Social and Sustainability Bond Principles are located on ICMA's website: https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/. See below for additional information on the EU Taxonomy and Climate Bonds Standard.

In addition to ICMA's guidance, several voluntary and regulatory initiatives have developed standards and complementary content to support best practices when issuing sustainable bonds:

Climate Bonds Standard	This standard goes beyond the ICMA Green Bond Principles to set forth more targeted criteria for bond proceeds that are consistent with the 1.5 degrees Celsius target for containment of temperature increase[3].
European Union (EU) Green Bond Standard	A voluntary standard which evaluates bond proceeds based on specific criteria outlined in the EU Taxonomy for sustainable activities[4].
UN Sustainable Development Goal (SDG) bonds	This label incorporates the SDG Impact Standards developed by the United Nations Development Programme[5].

External review versus self-designation by issuer

Obtaining independent, external verification of a GSS-labeled bond remains a best practice, though we recognize that within the municipal market, issuers self-designate their bonds at times. Below is a description of both types of labels.

INDEPENDENT EXTERNAL REVIEW

There are two main options for independent reviews:

1 **SECOND-PARTY OPINION:**
An organization that is independent from the issuer and that gives its opinion as to whether the bonds meet the ICMA Sustainable Bond Principles. The opinion generally describes the issuer's framework and other details about the offering. Many different private firms provide these opinions[6].

2 **CERTIFICATION:**
For the Climate Bonds Standard, the bonds are certified as to whether they meet the specific climate bonds criteria. This review can only be conducted by verifiers approved by the Climate Bonds Initiative.

SELF-DESIGNATION

Bonds can be self-designated by an issuer as green, social, sustainability, linked to the SDGs, or under some other category. To self-designate, the issuer puts the label, e.g., Green Bonds, in the title of the Official Statement, and adds a section within the Official Statement that includes the issuer's framework and description of how the issuer will voluntarily follow the ICMA's Green, Social, or Sustainability Bond Principles. In this case, the issuer is making claims about whether the bonds fit ICMA or other principles, rather than a second party providing an opinion or certification.

3 Climate Bonds Initiative. Certification under the Climate Bonds Standard. https://www.climatebonds.net/certification.

4 Taxonomy Report. Technical Annex. March 2020. https://finance.ec.europa.eu/system/files/2020-03/200309-sustainable-finance-teg-final-report-taxonomy-annexes_en.pdf

5 SDG Impact Standards for Bond Issuers. https://sdgfinance.undp.org/resource-library/sdg-impact-standards-bond-issuers

6 For more information on external reviews and a list of external reviewers, as maintained by ICMA, see ICMA's website. https://www.icmagroup.org/sustainable-finance/external-reviews/

There are pros and cons of each approach.

Figure 2: Pros and cons of issuing labeled bonds with an external review or with a self-designation

	PROS	CONS
External review	• Additional transparency • Independent verification • May see price savings • Can receive feedback from independent verifier about projects • Reduced likelihood of greenwashing claims	• Monetary cost • May take extra time • Post-issuance reporting requirements
Self-designation	• No additional cost • Lower barriers to entry • Issuer has more discretion on how much information to disclose	• No evidence of a lower cost of financing • Not viewed as having same market transparency • Misaligned with ICMA key recommendations
Both approaches	• May attract new investors • Can align with issuer's overall sustainability strategy • May be appealing to prospective new employees or issuer's community	• Require separating out GSS projects into a separate bond series from other capital projects

Green, social, and sustainability bond frameworks

Best practice is for an issuer to create a bond framework that explains in detail the types of projects to be funded with the GSS bond proceeds; how those projects are eligible to be considered a green, social, or sustainability bond; and how the projects fit into an issuer's overall sustainability strategy or plan.

Issuers should include a bond framework regardless of whether the issuer is receiving an external review or self-labeling the bonds. The framework should be clearly aligned with the ICMA guidelines with specific details where feasible.

Under the ICMA Green, Social, and Sustainability Bond Guidelines, the framework should include four main categories of information:

1. Use of proceeds and eligibility for label
2. Process for project evaluation and selection
3. Management of proceeds post-issuance
4. Reporting to investors post-issuance

More information about each of these categories can be found in ICMA's Principles documents.

Other best practices for bond frameworks:

1	**Sustainable Development Goals (SDGs)**	Clearly align use of proceeds with the SDGs with specific targets or indicators referenced in impact reporting, where applicable. ICMA has provided a high level mapping to the SDGs[7]. Describe how the projects funded by GSS bond proceeds fit into an issuer's organization-wide sustainability strategy, objectives, and plans.
2	**Connection with the issuer's long-term strategy**	Describe how the projects funded by GSS bond proceeds fit into an issuer's organization-wide sustainability strategy, objectives, and plans.
3	**Demonstrate ambition**	Issuing GSS bonds can be a tool to help municipalities strengthen and fund sustainability plans and programs. Achieving net zero and science-based targets or progress in social areas implies meaningful improvements versus business as usual, and the ambition to improve should be increased over time.
4	**Transparency**	Best practices for transparency: 1. Bond framework should be a stand-alone document, not just a Use of Proceeds paragraph in the Official Statement. 2. External review 3. Sustainability report or update from the issuer 4. Allocation or impact reports for previous GSS bond issuances
5	**EU Taxonomy**	For issuers that may be looking to expand their set of investors who can invest in the bond to the EU, it can be helpful to additionally include a description of how the bonds align with the EU Taxonomy for sustainable activities.

7 Mapping to the Sustainable Development Goals. https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/mapping-to-the-sustainable-development-goals/

Post-issuance reporting

One of the areas that many municipal issuers ask about is the extent of post-issuance reporting required. The reporting requirement can be fairly simple, depending on what information an issuer has available.

The primary reason for reporting is to verify that bond proceeds were, in fact, used for the purposes that the issuer stated they would be used for, and secondarily, to report any impact or outcome metrics that are available. Best practice would be to cover both areas of reporting, though we recognize that impact metrics may not be available to all municipal issuers.

The ICMA Green, Social, and Sustainability Bond Principles state that issuers should annually provide information on use of bond proceeds and, if possible, on the expected impact of the bond proceeds.

USE OF PROCEEDS REPORTING

This type of post-issuance reporting can be fairly simple. Per ICMA, it should include "a list of the projects to which bond proceeds have been allocated, as well as a brief description of the projects and the amounts allocated[8]." This would be provided annually until bond proceeds have been fully spent.

IMPACT/OUTCOMES REPORTING

Recognizing that impact information may not always be available, where it is, best practice would be to include both qualitative and quantitative measures of performance or expected impact.

It can be helpful if the impact reporting links to specific organization-wide targets and the issuer's overall sustainability strategy. Sample impact reporting metrics for different types of projects, including a suggested template, are available from ICMA[9].

Other helpful impact reporting information:

- The geographic location of each project.
- Attribution of outcome metrics specifically to the investment funded by the bond, rather than just organization-wide numbers. In cases where the bond only partially funds a larger project, the portion funded by the bond should be disclosed on a project-by-project level.
- Details on the methodology and calculation for the metrics reported.

PIMCO's internal GSS-labeled bond framework

At PIMCO, when reviewing GSS-labeled bonds as potential candidates for inclusion in our ESG funds, we conduct our own internal analysis, mapping the bonds across a spectrum based on three criteria:

1	**Strategic Fit**	Alignment of the issuer's climate/environmental/social strategies with the bond's objectives and use of proceeds.
2	**Impact Assessment**	Evidence of significant positive outcomes compared with "business as usual" by the issuer.
3	**Red Flags and Reporting:**	Screening for "red flags" and controversies and analysis of reporting and process.

This internal review results in a bond-level score and recommendation regarding the appropriateness of these bonds for PIMCO's ESG portfolios.

8 https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/.

9 Harmonized Framework for Impact Reporting. https://www.icmagroup.org/sustainable-finance/impact-reporting/green-projects/.

Green, social, and sustainability municipal bond examples

Below is a non-exhaustive list of bonds that have received external reviews and provide examples of the type of disclosure that can be helpful to bondholders. All of the examples followed the ICMA Green, Social, and Sustainability Bond Principles and included the bond frameworks in the offering documents.

A number of the examples were winners of 2022, 2021, or 2020 labeled "bond of the year" awards from Environmental Finance, an online news service known for its bond awards. More information about the awards and award winners can be found here.

Issuer	Use of proceeds	Helpful disclosure
GREEN BOND		
Massachusetts Clean Water Trust	Clean water and drinking water projects, including stormwater management, green infrastructure, infiltration/inflow reductions, and facility improvements.	Appendix with extensive detail on eligible project categories and descriptions of funded projects. Alignment with the UN SDGs.
San Francisco Public Utilities Commission	Preserving habitat, utilizing natural infrastructure, implementing upgrades to infrastructure to reduce seismic risk and delivery reliability, and improvements to groundwater storage.	Alignment with the UN SDGs. Link to annual post-issuance Green Bond reports.
City of Minneapolis, MN	Construction of a new Public Service Center and a new Storage and Maintenance Facility, with both buildings expected to be certified as LEED Gold.	Discussion of connection between the projects funded by the bonds and the City's Climate Action Plan and climate strategy.
SOCIAL BOND		
The Ford Foundation	For providing grants to nonprofits specifically aimed at building resilience in the nonprofit sector, in light of the pandemic and related impacts.	Extensive discussion of how bonds fit within the Foundation's larger strategy.
SUSTAINABILITY BONDS		
City of St. Paul, MN	To remove and replace infected ash trees on city land. The City planned to prioritize trees in low-income or Black, Indigenous, and persons of color (BIPOC) communities. Additionally, a portion of the bonds were used to create a living wage jobs program that prioritized hiring low-income and/or BIPOC residents.	Significant detail on projects and their expected benefits provided in Second-Party Opinion. Alignment with the UN SDGs.
New York State Housing Finance Agency	For low-income and very low-income multifamily housing projects. Projects were expected to meet or exceed the U.S. EPA's ENERGY STAR energy efficiency standards for multifamily high rise buildings and certified homes.	Discussion of alignment with Climate Bonds Initiative's low carbon buildings criteria and conformity to Green Bond Principles. Had third party conduct post-issuance verification.

Sources: Massachusetts Clean Water Trust. April 2021. https://emma.msrb.org/P11497219-P11159865-P11574768.pdf; San Francisco Public Utilities Commission. October 2020. https://emma.msrb.org/P11428776-P11108772-P11518438.pdf. City of Minneapolis. October 2018. https://emma.msrb.org/ES1208424-ES943762-ES1344533.pdf. The Ford Foundation. June 2020. https://www.munios.com/munios-notice.aspx?e=QLKC7. City of St. Paul. March 2022. https://emma.msrb.org/P11576233-P11216741-P11637547.pdf. New York State Housing Finance Agency. June 2018. https://emma.msrb.org/ES1170927-ES915081-ES1316193.pdf.

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IMPORTANT INFORMATION

Please note that these best practices contain the opinions of the manager as of the date noted, and may not have been updated to reflect real time market developments. All opinions are subject to change without notice.

Environmental ("E") factors can include matters such as climate change, pollution, waste, and how an issuer protects and/or conserves natural resources. Social ("S") factors can include how an issuer manages its relationships with individuals, such as its employees, stakeholders, customers and its community. Governance ("G") factors can include how an issuer operates, such as its leadership, pay and incentive structures, internal controls, and the rights of equity and debt holders.

Sustainable Strategies are strategies with client-driven sustainability requirements. For these strategies, PIMCO actively incorporates sustainability principles (i.e. excluding issuers fundamentally misaligned with sustainability factors, evaluating issuers using proprietary and independent ESG scoring) consistent with those strategies and guidelines. Further information is available in PIMCO's Sustainable Investment Policy Statement. For information about funds that follow sustainability strategies and guidelines, please refer to the fund's prospectus for more detailed information related to its investment objectives, investment strategies, and approach to sustainable investment

PIMCO is committed to the integration of Environmental, Social and Governance ("ESG") factors into our broad research process and engaging with issuers on sustainability factors and our climate change investment analysis. At PIMCO, we define ESG integration as the consistent consideration of material ESG factors into our investment research process with the goal of enhancing our clients' risk-adjusted returns. Relevant factors may include, but are not limited to: climate change risks, resource efficiency, natural capital, human capital management, human rights, regulatory risks, and reputation risk at an issuer. Further information is available in PIMCO's Sustainable Investment Policy Statement.

With respect to comingled funds with sustainability strategies and guidelines ("funds that follow sustainability strategies and guidelines"), we have built on PIMCO's over 50-year core investment processes, while actively incorporating sustainability principles. Through these guiding principles—excluding issuers fundamentally misaligned with sustainability factors, evaluating issuers using proprietary and independent ESG scoring (in addition to externally sourced and internally developed criteria), and engaging with issuers on ESG-related topics with the objective of improving investment outcomes - funds that follow sustainability strategies and guidelines seek to deliver attractive returns while also pursing to provide a vehicle through which investors can meet their sustainability preferences. Please see each fund that follows sustainability strategies and guidelines prospectus for more detailed information related to its investment objectives, investment strategies and approach to ESG. There is no assurance that the socially responsible investing strategy and techniques employed will be successful.

A word about risk: All investments contain risk and may lose value. Investing in the **bond market** is subject to risks, including market, interest rate, issuer, credit, inflation risk, and liquidity risk. The value of most bonds and bond strategies are impacted by changes in interest rates. Bonds and bond strategies with longer durations tend to be more sensitive and volatile than those with shorter durations; bond prices generally fall as interest rates rise, and low interest rate environments increase this risk. Reductions in bond counterparty capacity may contribute to decreased market liquidity and increased price volatility. Bond investments may be worth more or less than the original cost when redeemed. **REITs** are subject to risk, such as poor performance by the manager, adverse changes to tax laws or failure to qualify for tax-free pass-through of income. **ESG investing is qualitative and subjective by nature**, and there is no guarantee that the factors utilized by PIMCO or any judgment exercised by PIMCO will reflect the opinions of any particular investor, and the factors utilized by PIMCO may differ from the factors that any particular investor considers relevant in evaluating an issuer's ESG practices.

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ESG-labeled instruments are defined as green, social, and sustainable bonds and sustainability-linked bonds. **Green Bonds** are those issues with proceeds specifically earmarked to be used for climate and environmental projects. **Social Bonds** are use-of-proceeds bonds earmarked to finance new and existing projects or activities with positive social impacts. **Sustainability Bonds** are use-of-proceeds bonds earmarked to finance new and existing projects or activities with positive environmental and social impacts. **Sustainability-Linked Bonds (SLBs)** are bonds that include sustainability-linked covenants, as explained by the issuer through use of a framework and/or legal documentation.

The issuers referenced are examples of issuers PIMCO considers to be well known and that may fall into the stated sectors. References to specific issuers are not intended and should not be interpreted as recommendations to purchase, sell or hold securities of those issuers. PIMCO products and strategies may or may not include the securities of the issuers referenced and, if such securities are included, no representation is being made that such securities will continue to be included.

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