



ESG: THE MISSING PIECE TO Better Planning

Why and how ESG should be included in CIPs

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Everyone seems to be talking about environmental, social, and governance (ESG) investing—that is, mission-oriented investments with positive impacts beyond economic returns. But we're still working out how ESG fits into public finance and how governments can take part.

Most of the thought leadership so far, including from GFOA itself, has focused on municipal debt in the form of ESG bonds. But some securities are basically E, S, or G in name only. Governments of all sizes should expand their focus from the financing stage all the way to the initial planning phase to truly maximize the potential of ESG. (See Exhibit 1)

The successful execution of a capital improvement plan (CIP) is inextricably linked to the ability to finance the designated projects. Debt plays a key role in funding capital projects for many governments, and with municipal investors heightening both

their demand for and scrutiny of ESG bonds, the integration of these metrics is increasingly crucial in the drafting of capital plans. The finance officers in charge of capital planning need to consider these factors, but they must also highlight them in the CIP so that their colleagues who obtain financing (such as debt, grants, and development) can clearly identify and disclose which projects meet certain metrics.

With this in mind, in fall 2022, GFOA's Committee on Economic Development and Capital Planning revised its best practice, *Multi-Year Capital Planning*, to include integrating ESG into planning. In 2021, GFOA published *Best Practices on ESG Disclosures* to assist finance officers who are planning to issue municipal debt instruments in considering their ESG disclosure practices. These best practices (which you can find at gfoa.org) list and describe types of projects that would align with one of the E, S or G categories, then offer guidance as to what information to include in public

disclosures. The purpose of this article is to provide guidance on why and how these factors should be considered far in advance of a debt offering.

FIRST, THE WHY.

There are many reasons to contemplate ESG factors in the capital planning process—for example, investing in environmental resilience or social issues certainly strengthens communities. But this article will focus on the financial and economic benefits.

Executing the CIP requires optimizing all sources of financing, and

municipal debt investors are not the only stakeholders who care about ESG. Federal and state government grants—though they may use different language—may also seek to advance environmental, social, and governance projects. ESG information would provide granting agencies with greater transparency into the risks and opportunities faced by recipients of taxpayer-funded programs, as well as into the management programs.

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Considering ESG when identifying and prioritizing projects in the CIP will bolster an organization's ability to secure different forms of financing. With more options for financing, a governmental entity can choose the financing that best meets its cost and risk profile.

Investor demand for ESG debt products is dramatically shifting, and increased demand has resulted in heightened scrutiny. The Securities and Exchange Commission has drafted regulation for the corporate sector, and the Municipal Securities Rulemaking Board has requested comments weighing in on potential regulation for the public sector. Even without regulation, investors

want to see more information on ESG factors from public issuers before and after bond issuance. Finance officers who obtain financing will be more successful in attracting investors if the CIP illustrates how the government is addressing ESG risks. Attracting more investors increases competition for the debt and helps drive down its cost to the local government.

ESG metrics also present an opportunity for CIPs to improve resilience of capital projects in the planning phase, thereby mitigating maintenance and operational risk. Resilient infrastructure simultaneously improves residents' quality of life and decreases future costs by protecting against damages or emergencies. Resilience has long been key to CIPs and to public finance more generally—GFOA recommended this concept in its Role of the Finance Officer in Supporting Fiscal Sustainability best practice in 2012.

SECOND, THE HOW.

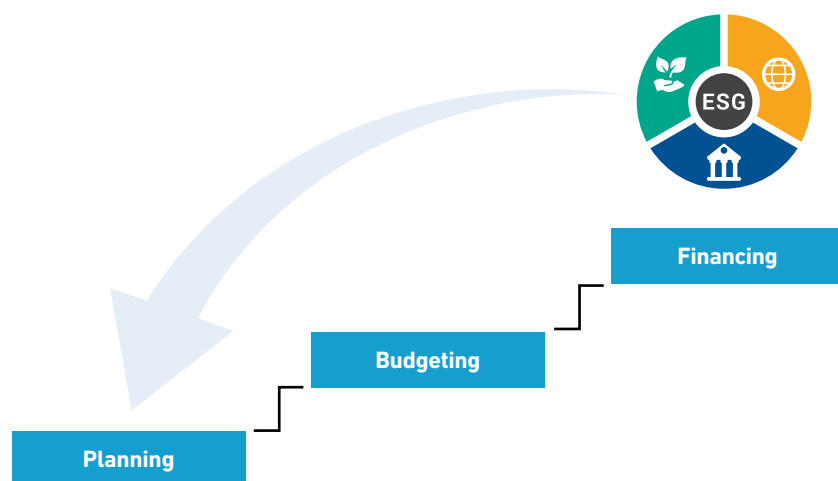
The CIP should not only consider ESG factors but clearly highlight them so that colleagues, constituents, investors, and other stakeholders can understand how governments are planning for resilience.

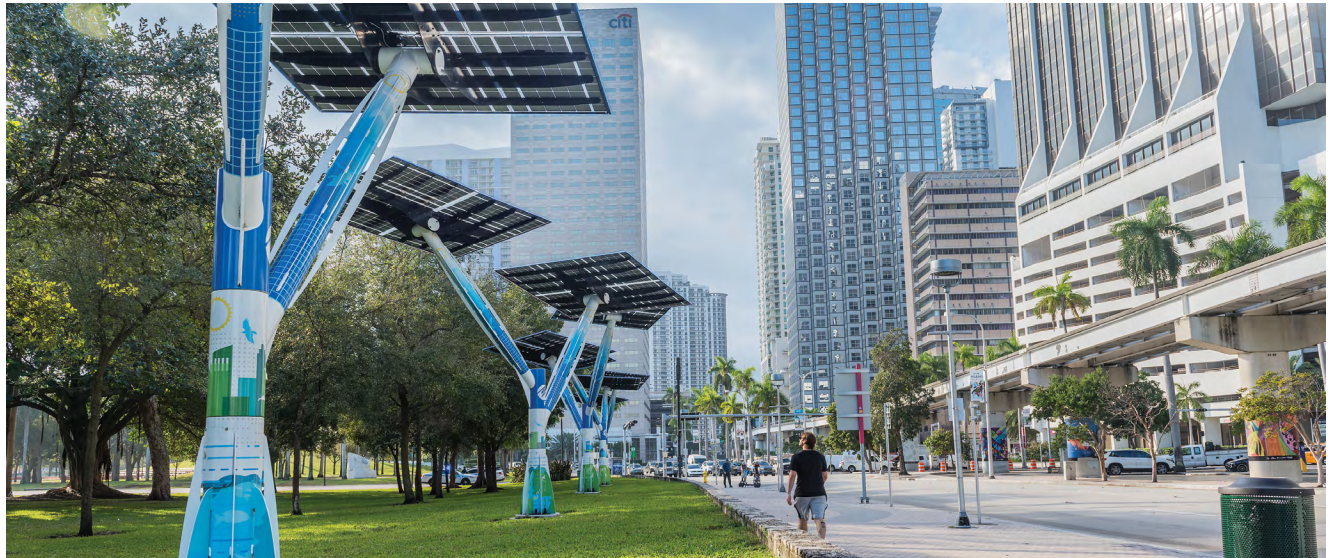
Highlight any project with an ESG component. Projects in the CIP can be identified by a marker of E, S, and/or G to identify that a project addresses one or more factors. Include an explanation (a clause, sentence, or paragraph) that describes the ESG metric. For example, a project to build seawalls in a coastal area prone to flooding would be denoted with an E and accompanied by a sentence such as, "The seawall will protect the designated area from worsening flood events caused by the changing climate, enhancing the environmental resilience of this community and saving an estimated \$X dollars in damages." Also consider ongoing disclosure for the project and the government's ability to report on achieving the anticipated result.

Provide a summary section to succinctly identify all ESG components of projects included in the CIP. A simple matrix of columns for E, S, and G and rows for the projects, with a short description of each, would accomplish this. (See Exhibit 2.) A summary section also makes it easy for colleagues in other departments to identify opportunities for their respective sources of finance, as well as provides clear information for investors, stakeholders, and constituents.

When possible, the CIP should explain how projects may reduce the risk of property damage and their estimated cost. This comparison will help demonstrate the economic benefits of investing in resilient infrastructure and could even improve a government's long-term budget outlook if there's a significant net positive impact over time. It will help build the business case to gain the support of government officials and the public, which could secure project success. One example of assessing infrastructure costs, meant to combat extreme weather, would be taking an average from the previous five years of damages to show how much of that would be avoided by implementing the capital improvement.

EXHIBIT 1 | ESG SHOULD COVER THE FINANCING STAGE THROUGH THE INITIAL PLANNING PHASE





Examples of Projects that Could Leverage ESG Metrics

- Renewable Energy Generation
- Energy Efficiency
- Electric Vehicle Infrastructure
- Urban Blight Removal
- Digital Infrastructure for Government
- Solid Waste Infrastructure
- Stormwater Drainage
- Parks and Recreation, Green Spaces, or other Community Infrastructure
- Flood Mitigation
- Public Education and Workforce
- Internet Access
- Affordable Housing
- Health Services

For more details and examples, see GFOA's best practices for each ESG metric:

E – Environment: gfoa.org/materials/esg-disclosure

S – Social: gfoa.org/materials/esg-best-practice-s-social

G – Governance: gfoa.org/materials/esg-best-practice-g-governance

The solar panels at FPL Solar Amphitheater at Bayfront Park in downtown Miami generate about 250 kilowatts of emissions-free energy, more than enough to power the average concert.

CONCLUSION

The letters ESG have created a phenomenon that has surged because of investor demand for projects that have a positive impact on communities. The idea of improving communities through investments, however, has long been at the core of government planning. At the moment, a gap persists between finance officers who issue ESG bonds and the finance officers who plan ESG-qualified projects.

Governments nationwide have an opportunity to attract and obtain more investment—from both private and public sources—simply by thinking about ESG potential in earlier stages. Investors may have coined the term, but it's the government officers who have the power and responsibility to make an ESG impact. **■**

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EXHIBIT 2 | A SUMMARY SECTION SUCCINCTLY IDENTIFIES ALL ESG COMPONENTS

CAPITAL PROJECT	E	S	G
Flood mitigation infrastructure	✓	✓	
Digital infrastructure for government			✓
Renewable energy plant	✓		
Community parks		✓	