



ESG Impact on the Public Sector – A Balanced Look at Theory vs Practice

2022 Q1 Economic Update & Yield Curve Analysis

Presented By:

Rene O'Day - Vice President, Public Trust

John Grady - Managing Partner, Public Trust

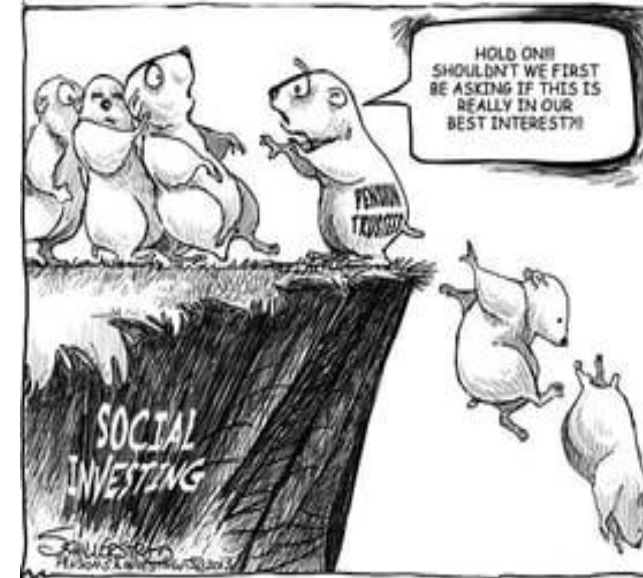
Rod Bettini - Director, Public Trust

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Presentation Overview

- Define (ESG) - still a relatively new, vague, unregulated and very broad concept
- Understand the different components of ESG and how the Public Sector is affected
- Explore regulatory framework. What is the SEC doing? Which other entities will set standards and provide guidance?
- 2022 Economic Update
- Yield Curve Analysis

... A quick video to follow ...



The world has changed...

What Exactly is E S G??

- Environmental, Social, and Governance is an evaluation of a firm's collective conscientiousness for social and environmental factors.
- These standards are the central factors that measure the ethical impact and sustainability of investment in a company.
- UN defines sustainability as “development that meets the needs of the present without compromising the ability of future generations to meet their own needs”.
- Impact Investing & SRI – Socially Responsible Investing



Diversity and Inclusion



The Role of ESG in Local Government Operations

- The environmental section of the ESG policy focuses on the company/local government's carbon footprint when it comes to things like greenhouse & gas emissions, waste and pollution, water use, and land use
- The social section of the policy determines the company/local government's focus on things like workplace diversity, safety management, and the communities they serve as a whole
- The governance piece of the policy primarily focuses on the structure & oversight of the agency, internal code & values, and financial transparency in its everyday operations

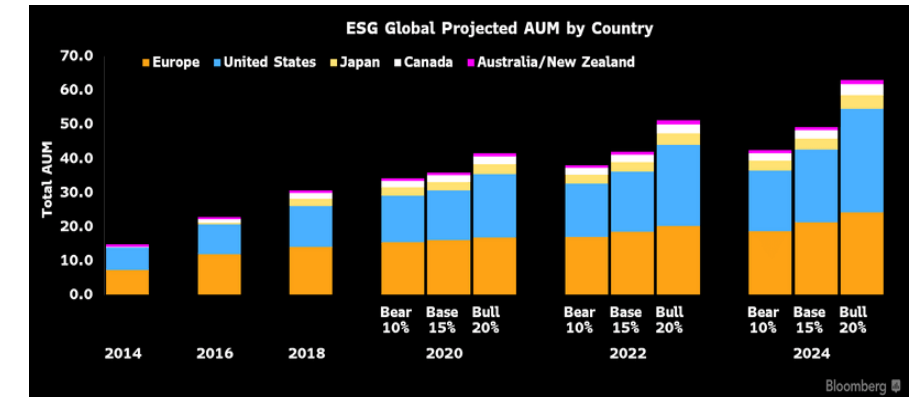
ESG Strategy for Local Governments

- More and more local governments are looking into the options for their current or upcoming projects to see if they qualify for the ESG label
- A municipality facing an increased flood risk, due to climate change or otherwise, decides to upgrade their storm water management system and given the proper disclosure, this issuance can qualify for the ESG label and potentially be more marketable
- Many of the light rail services, around the United States, are going the electrification route, reducing their dependency on fossil fuels and relying on electricity. This is beneficial in two ways:
 - The environmental benefit with less/no emissions with the electrified service
 - The monetary benefit where light rail may be generating LCFS (Low Carbon Fuel Credits); these credits can be sold in secondary markets to generate additional revenues for light rail services

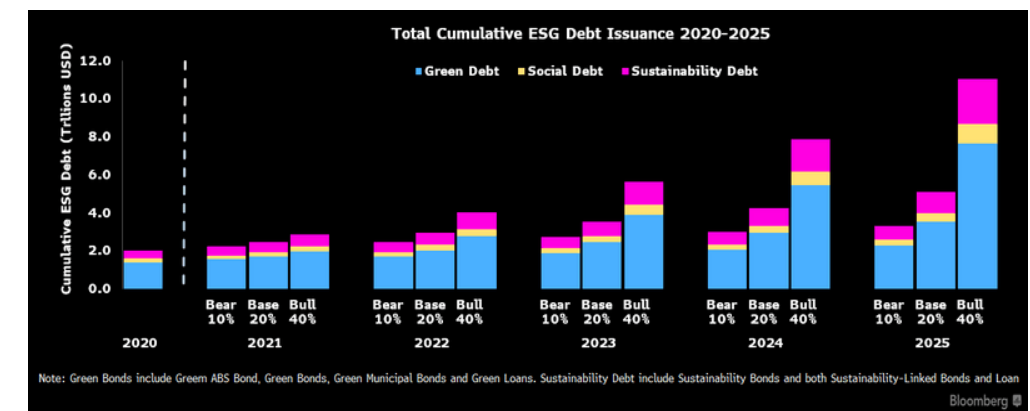
ESG Financial Impact

- Individual and institutional investors across the world seek attractive financial returns along with a positive impact on communities and the environment
- ESG assets may hit \$53 trillion by 2025, a third of global AUM
- While Europe accounts for half of global ESG assets, the U.S. has the strongest expansion this year and may dominate the category starting in 2022
- The \$2.2 trillion ESG debt market could swell to \$11 trillion by 2025
- Green, social and sustainability bonds are poised to surpass \$1 trillion in cumulative volume by the end of 2020

Source: [Bloomberg](#)



Top 10 Green Finance Issuers			
Pos.	Name	Country	Amount (USD)
1.	Republic of France	France	12.9 Bn
2.	Fannie Mae	USA	8.6 Bn
3.	Federal Republic of Germany	Germany	7.3 Bn
4.	KfW	Germany	6.8 Bn
5.	EIB	Supranational	6.1 Bn
6.	CaixaBank SA	Spain	3.1 Bn
7.	China Development Bank	China	3.1 Bn
8.	Intesa Sanpaolo	Italy	3.1 Bn
9.	SLG Office Trust 2021-OVA	USA	2.8 Bn
10.	HKSAR	Hong Kong, China	2.5 Bn



ESG in the Municipal Bond Market

- ESG factors have traditionally been integrated in muni bond valuations to an extent
- Historically not been a priority due to muni characteristics, such as their tax-advantaged status, better credit quality relative to corporate bonds and possibility of higher returns compared with Treasuries
- New developments have heightened awareness of the need for an explicit ESG risk assessment, including:
- Rising commercial pressure on asset managers to demonstrate ESG incorporation in bond assessment to asset owners:
- Growing demand from non-US investors, including European investors, who are now required to explain how they consider ESG factors in their investments
- Shifting priorities at the federal level, increased ambition to tackle climate change and boost infrastructure projects, many of which are funded by state and local governments
- Changing expectations from financial regulators around ESG disclosure and transparency, starting in Europe and spreading to the US ----- ENTER THE GREEN BOND



The Role of ESG in Local Government Operations

Specific examples of environmental factors that an issuer should consider discussing (which will vary depending on the geographical location of the government) include:

- Inland flooding, tornadoes, drought, ice storms and other extreme weather events
- Climate change affecting agriculture, infrastructure, major industries and tax base
- Frequency and intensity of wildfires
- Frequency and strength of hurricanes and flooding
- Sea level rise in coastal communities
- Water supply, both and quality and quantity
- Diversity of power generation sources and transition plans by providers

Who's lead are we following? → UN SDG's





- Goal 1: No poverty
- Goal 2: Zero hunger
- Goal 3: Good health and wellbeing
- Goal 4: Quality education
- Goal 5: Gender equality
- Goal 6: Clean water and sanitation
- Goal 7: Affordable and clean energy
- Goal 8: Decent work and economic growth
- Goal 9: Industry, innovation, and infrastructure
- Goal 10: Reduced inequalities
- Goal 11: Sustainable cities and communities
- Goal 12: Responsible consumption and production
- Goal 13: Climate action
- Goal 14: Life below water
- Goal 15: Life on land
- Goal 16: Peace, justice, and strong institutions
- Goal 17: Partnerships for the goals

Regulation, Governing Bodies and Standards




"Many on the buy and sell side have signaled very clearly how confusing the multiplicity of different ESG ratings choices can be, again raising serious questions about relevance, about reliability and about greenwashing," Ashely Adler, Chair IOSCO

Companies that provide guidance, measure and rate ESG performance:

- TCFD
- CDP
- GRI
- SASB
- Bloomberg ESG Data Services
- Dow Jones Sustainability Index
- MSCI ESG Research
- Sustainalytics
- Thomson Reuters ESG Research Data
- World Benchmarking Alliance
- Principals for Responsible Investment
- ISS Ratings and Rankings
- CDP Climate, Water and Forest Scores

	Framework	Description	Audience and Scope
	Sustainability Accounting Standards Board (SASB)	<ul style="list-style-type: none"> Helps businesses identify wide range of ESG topics and report those measures in SEC filings Used in corporate filings to the U.S. Securities and Exchange Commission (SEC) 	<ul style="list-style-type: none"> For investors Sector-specific guidance
	International Integrated Reporting Council (IIRC)	<ul style="list-style-type: none"> Promotes guiding principles related to "integrated reports" to provide greater context for performance data Used to combine traditional and annual financial reports with ESG data 	<ul style="list-style-type: none"> For investors No sector-specific guidance

**Details on the proposed merger of these two frameworks are provided below*

COMING 2021	Task Force on Nature-Related Financial Disclosures (TNFD)	<ul style="list-style-type: none"> Coming 2021 Launched as initiative to report on nature-related disclosures Used when looking to address topics related to climate 	<ul style="list-style-type: none"> For investors Some sector-specific guidance
	Task Force on Climate-Related Financial Disclosures (TCFD)	<ul style="list-style-type: none"> Encourages companies to disclose climate-related risks and opportunities Used when looking to address climate-related topics 	<ul style="list-style-type: none"> For investors Some sector-specific guidance
	CDP (CDP)	<ul style="list-style-type: none"> Captures environmental-related data, including water, forests, and climate change measures Used when looking to address greenhouse gas (GHG) emissions and energy use 	<ul style="list-style-type: none"> For stakeholders Sector-specific guidance
	Global Reporting Initiative (GRI)	<ul style="list-style-type: none"> Broad reports on large numbers of issues related to economic, environmental, and social impacts of business Used when looking to inform stakeholders of current efforts underway 	<ul style="list-style-type: none"> For stakeholders Some sector-specific guidance

SEC Activity and Disclosure Considerations

- GFOA Best Practices (03/08/2021, E Only)
 - Identify Primary Risks
 - Identify Policy Actions
- SEC Investor Bulletin – Environmental, Social and Governance (ESG) Funds (02/26/2021)
 - Acknowledges growing popularity of “ESG” funds
 - Screening of investments – positive, negative and minimum standards screens
- SEC Climate and ESG Task Force (03/04/2021)
 - Identify ESG related misconduct
 - Monitor Issuer’s disclosure of climate risk
 - Monitor advisers and funds disclosures related to ESG strategies
- SEC Division of Examinations Risk Alert – Review of ESG Investing (04/09/2021)
 - “...the variability and imprecision of industry ESG definitions and terms can create confusion among investors...”

SECURITIES AND EXCHANGE COMMISSION 17 CFR 210, 229, 232, 239, and 249
[Release Nos. 33-11042; 34-94478; File No. S7-10-22] RIN 3235-AM87

The Enhancement and Standardization of Climate-Related Disclosures for Investors

AGENCY: Securities and Exchange Commission

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission (“Commission”) is proposing for public comment amendments to its rules under the Securities Act of 1933 (“Securities Act”) and Securities Exchange Act of 1934 (“Exchange Act”) that would require registrants to provide certain climate-related information in their registration statements and annual reports. The proposed rules would require information about a registrant’s climate-related risks that are reasonably likely to have a material impact on its business, results of operations, or financial condition. The required information about climate-related risks would also include disclosure of a registrant’s greenhouse gas emissions, which have become a commonly used metric to assess a registrant’s exposure to such risks. In addition, under the proposed rules, certain climate-related financial metrics would be required in a registrant’s audited financial statements.

DATES: Comments should be received on or before [INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER OR MAY 20, 2022]

2022, the SEC, and ESG

Given the SEC's specific targeting of ESG-related issues beginning in 2021, we predict that 2022 will see a great degree of SEC enforcement action seeking to curb overzealous marketing language or statements that it sees as **greenwashing**. Whether these efforts will intertwine with the potential for increased Department of Justice criminal investigation and prosecution of egregious violators over greenwashing remains to be seen, but it is nevertheless something that issuers and investment firms alike must closely consider.

Source: [The National Law Review](#)

DWS rocked by **\$1trillion SEC greenwashing** probe – reports

Deutsche Bank AG's asset-management arm, DWS Group, are under investigation by US Securities and Exchange Commission and federal prosecutors for allegedly overstating its ESG credentials across its \$1tn fund range, according to reports.

*The landmark probe - which will be heavily scrutinized by the global fund management industry - comes after the DWS's former head of sustainability acted a whistle-blower in an interview with [The Wall Street Journal](#), saying that **the company had overstated how much it used sustainable investing criteria to manage its assets.***

*Assets in ESG funds have surpassed **\$2 trillion** globally in the second quarter of 2021, almost tripling in size in the last three years, according to Morningstar statistics.*

Source: [INTERNATIONAL INVESTMENT REPORT](#)

What's Greenwashing???

greenwashing

(n.) deceiving people into thinking that a brand is green when **it is not**, by using loopholes in the law and using **vague terms** that mislead consumers.

JUSTINLECONTE.COM



GREENWASHING

Spending more time and money claiming to be “green” through advertising and marketing rather than actually implementing business practices that minimize environmental impact.

@unschools // @LeylaAcaroglu



Greenwash is disinformation disseminated by an organization, etc., so as to present an environmentally responsible public image.
-Oxford English Dictionary



GREENWASHING



Worst Greenwashing Examples

- Volkswagen was sued for false advertising in 2016 by the Federal Trade Commission. VW manufactured 600,000 “clean diesel” and installed software that in their cars that enabled them to pass annual emissions tests, but in fact were polluting more than 40 times the legal limits, thus also violating the Clean Air Act.
- In 2018, Nestle releases a statement saying that it had “ambitions” for its packaging to be 100% recyclable or reusable by 2025. In the ‘Break Free from Plastics 2020 Annual Report, Nestlé, along with Coca-Cola and PepsiCo, were named the world’s top plastic polluters for the third year in a row.
- In 2018, Starbucks released a “straw-less lid,” as part of its sustainability drive, however this lid contained more plastic than the old lid and straw combination.
- The Prius is marketed as an eco-friendlier car and many individuals hoping to reduce their carbon footprint forked over the money for one. However, according to Amanda Webster, the nickel contained in the battery is mined and smelted at a plant in Ontario that has caused so much environmental damage that NASA has used the ‘dead zone’ around the plant to test moon rovers.

The Role of ESG in Local Government Operations

The Government Finance Officers Association (“GFOA”) recommends that governments evaluate the development and disclosure of information regarding the primary environmental risks applicable to municipal issuers and their bonds in their preliminary and final official statements used in connection with bond sales and in other voluntary disclosure.

Governments should also disclose plans developed, strategies deployed, actions taken, and infrastructure built to address the environmental risks, which will vary depending on the geographical location of the issuer.



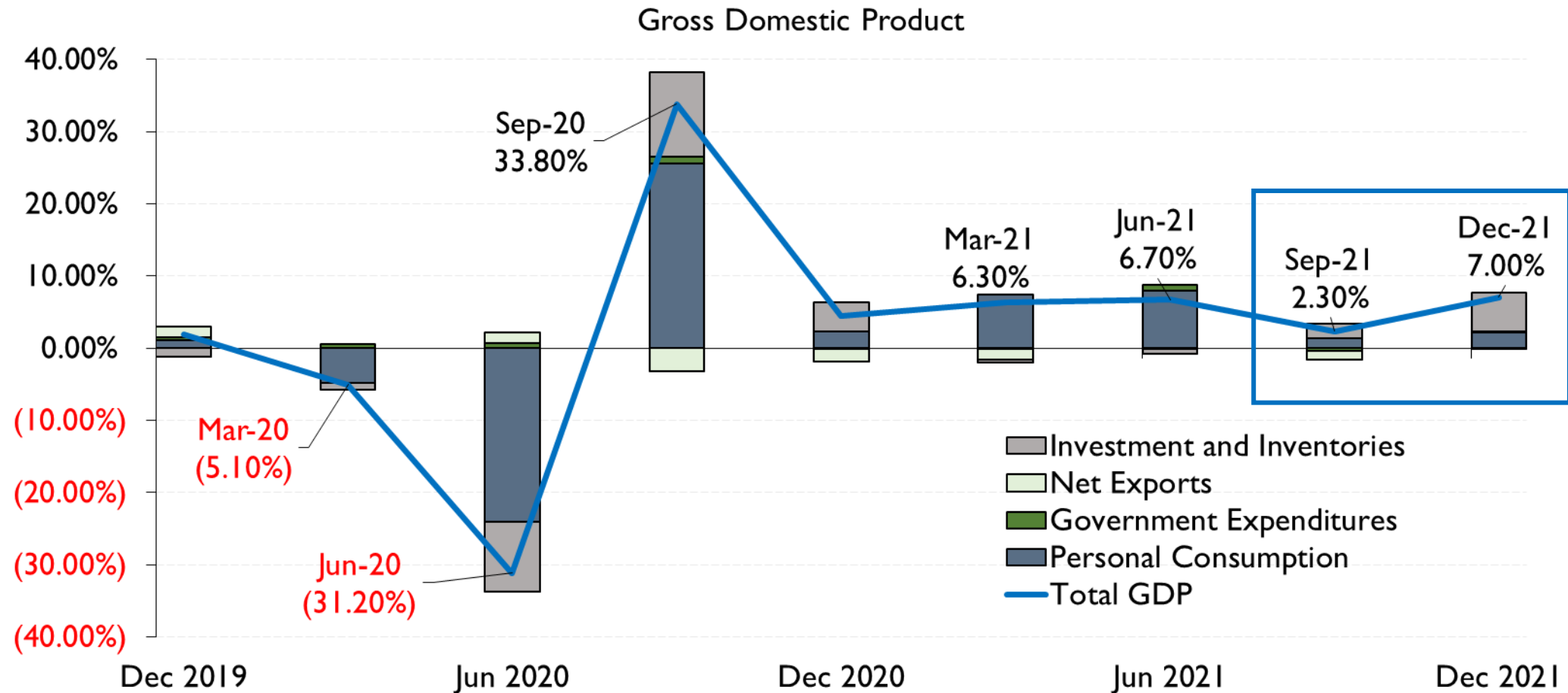
Economic Update and Yield Curve Analysis

April 8, 2022



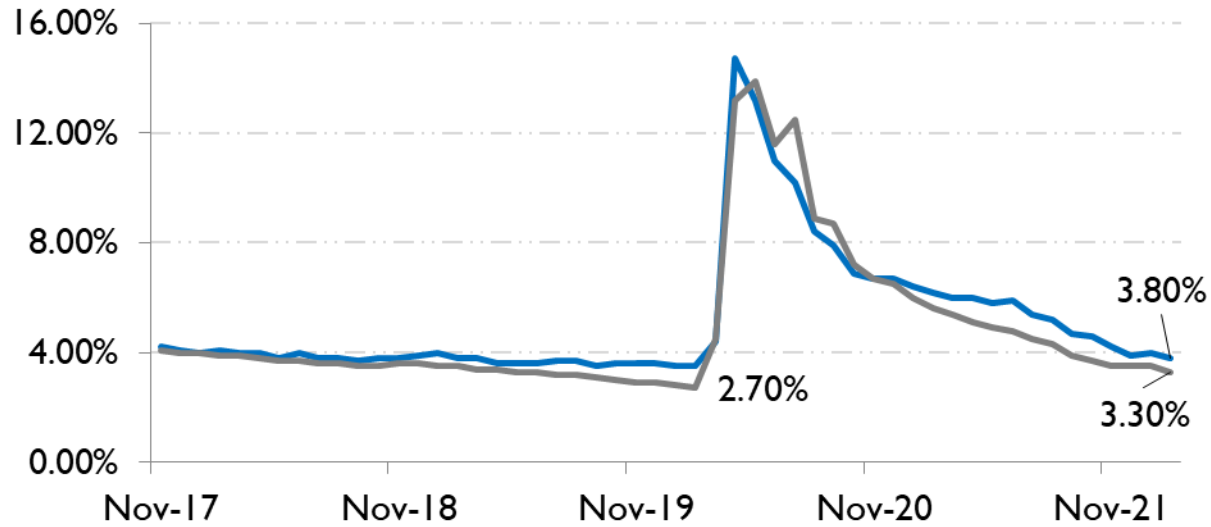
U.S. Gross Domestic Product

- The U.S. economic pace of expansion expanded 7.0% during the fourth quarter of 2021, a welcomed surprise as expectations were closer to 5.5% for the period. Increases in inventories made up most of the growth at 5.38%, while consumer spending picked up from the third quarter at 2.13%. Consumer spending will need to increase in order for GDP to meet or exceed the current estimate of 3.6% for 2022.

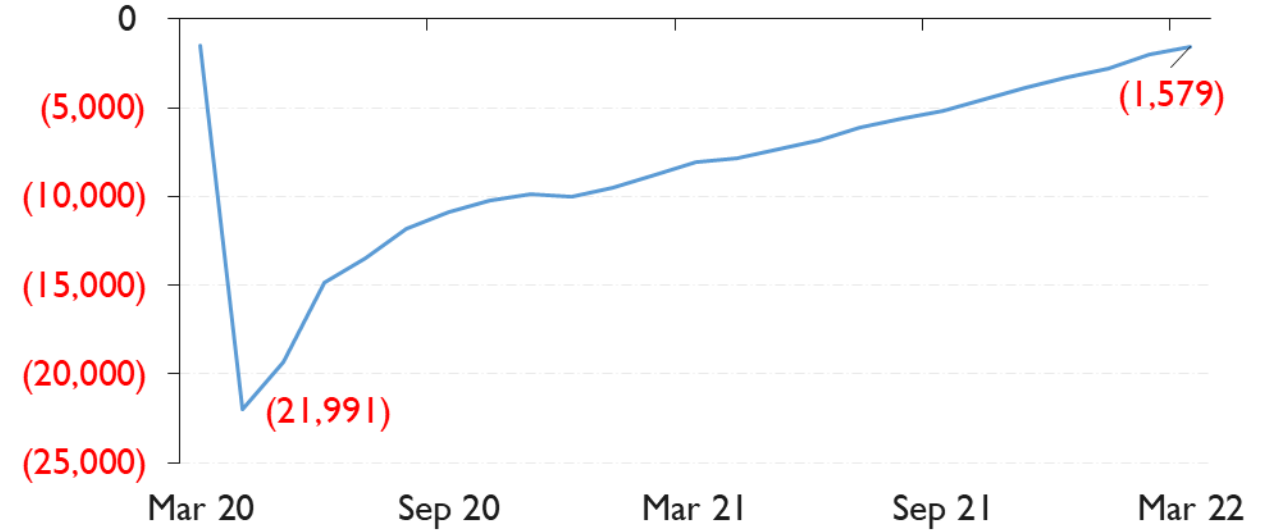


The Labor Market

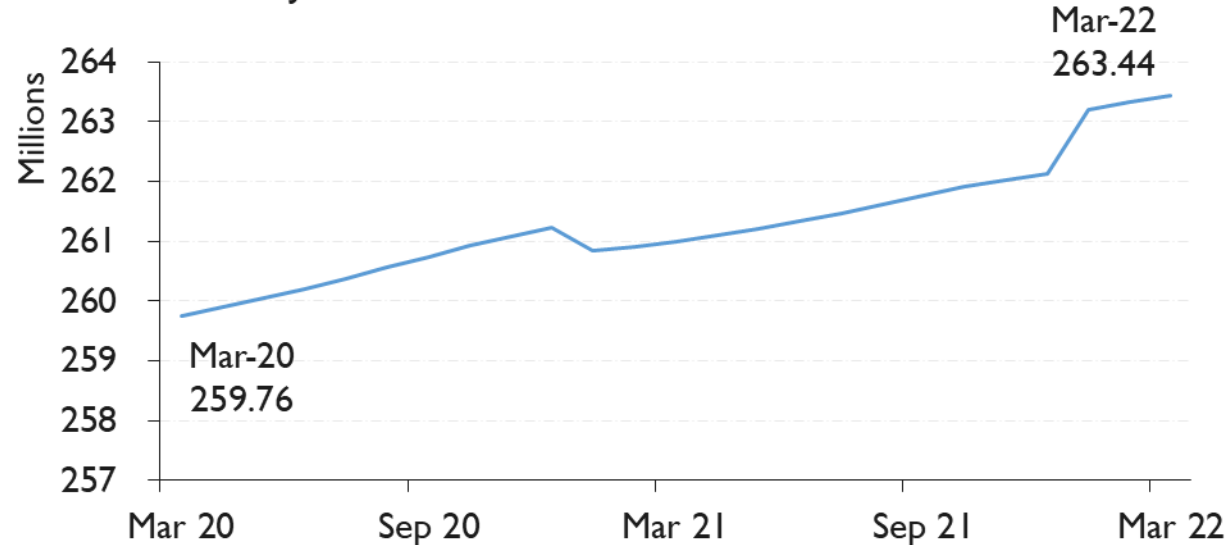
Unemployment Rate



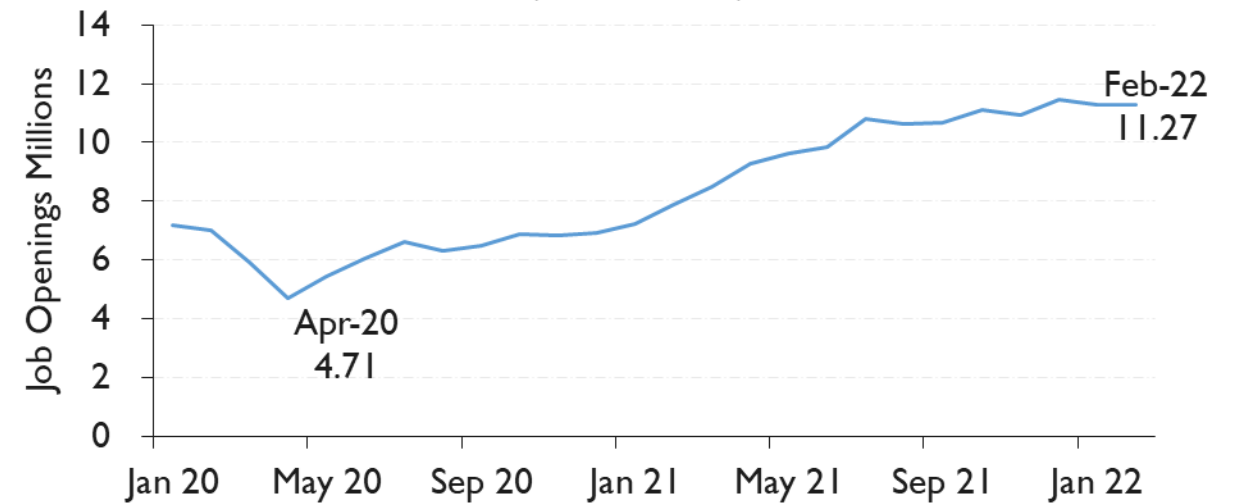
Net Jobs Since Pandemic/Economic Lockdown



Net Jobs Since Pandemic/Economic Lockdown



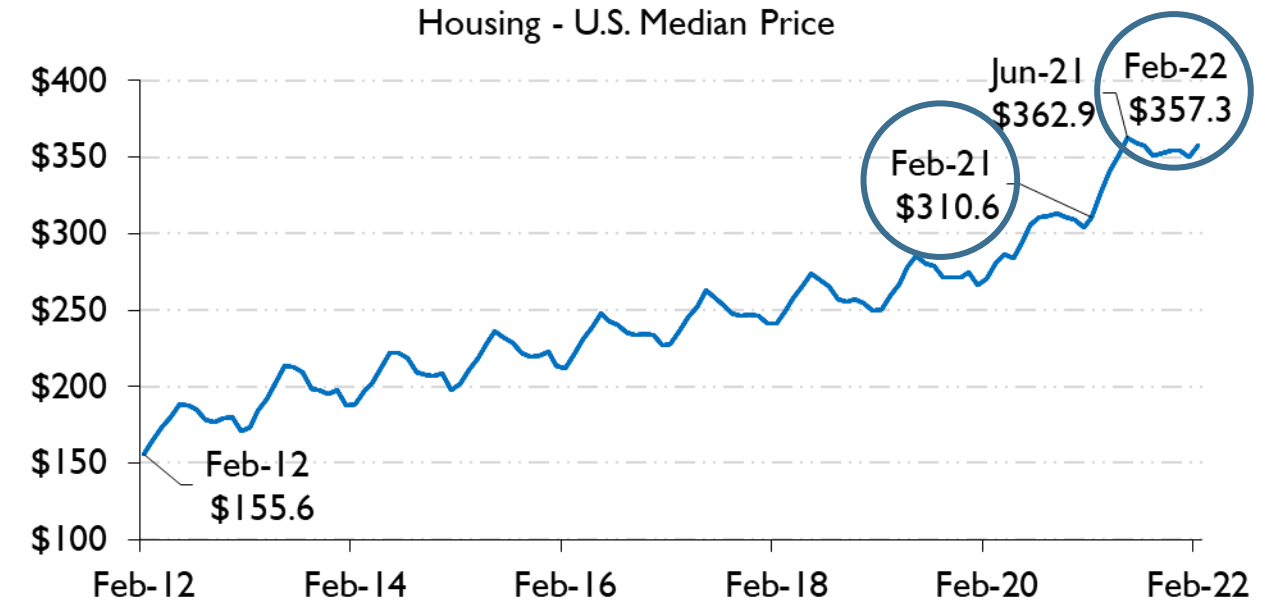
Job Openings (In Thousands)



The Housing Market

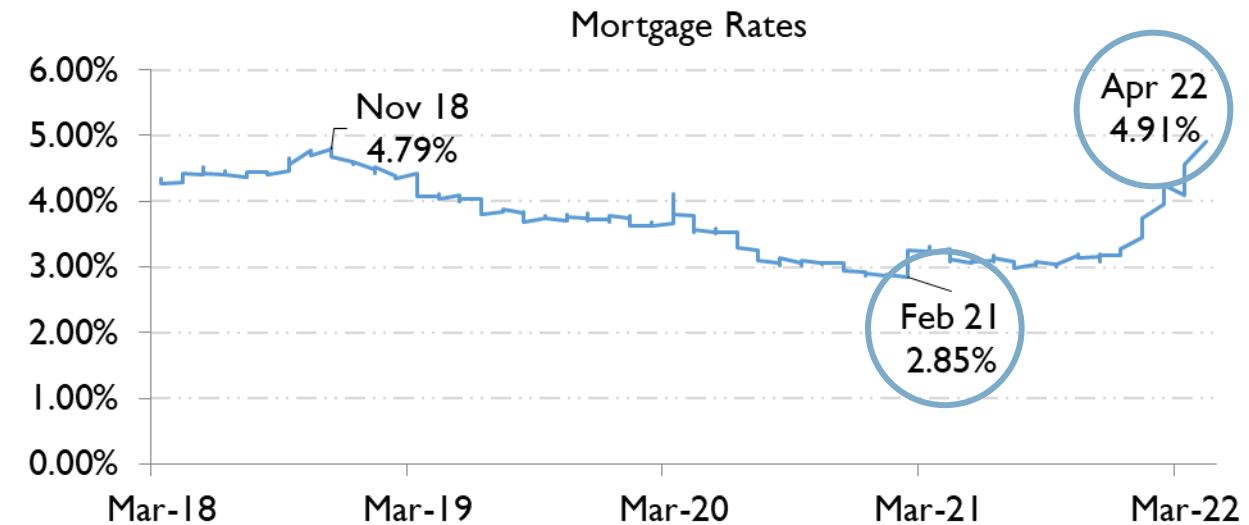
Median Housing Prices

- Amazingly, even the COVID19 pandemic has not impacted housing demand and prices.
- The median home price increased 15.0% for the last 12 months ended February.



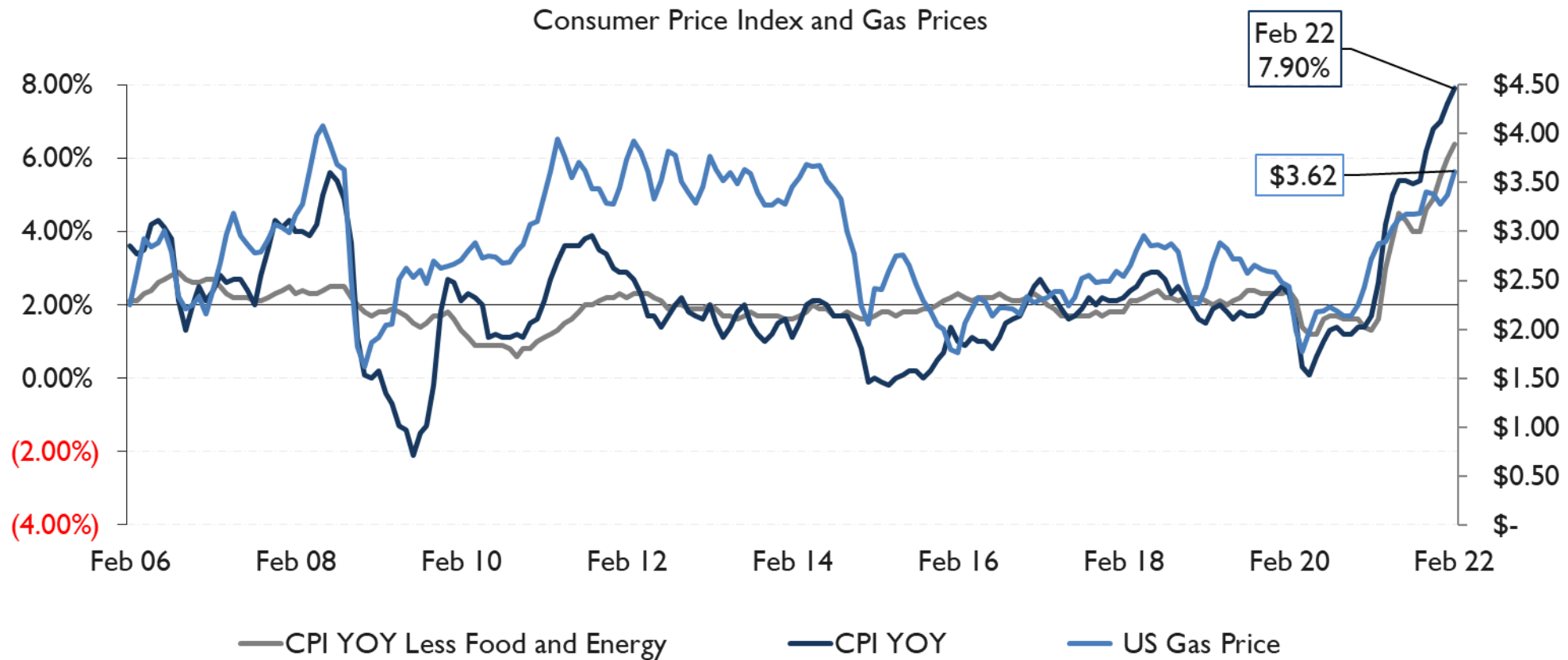
Mortgage Rates and Demand

- Historically low mortgage rates have encouraged buyers and helped maintain pricing trend.
- Rates are more than 2.0% higher from February 2021.

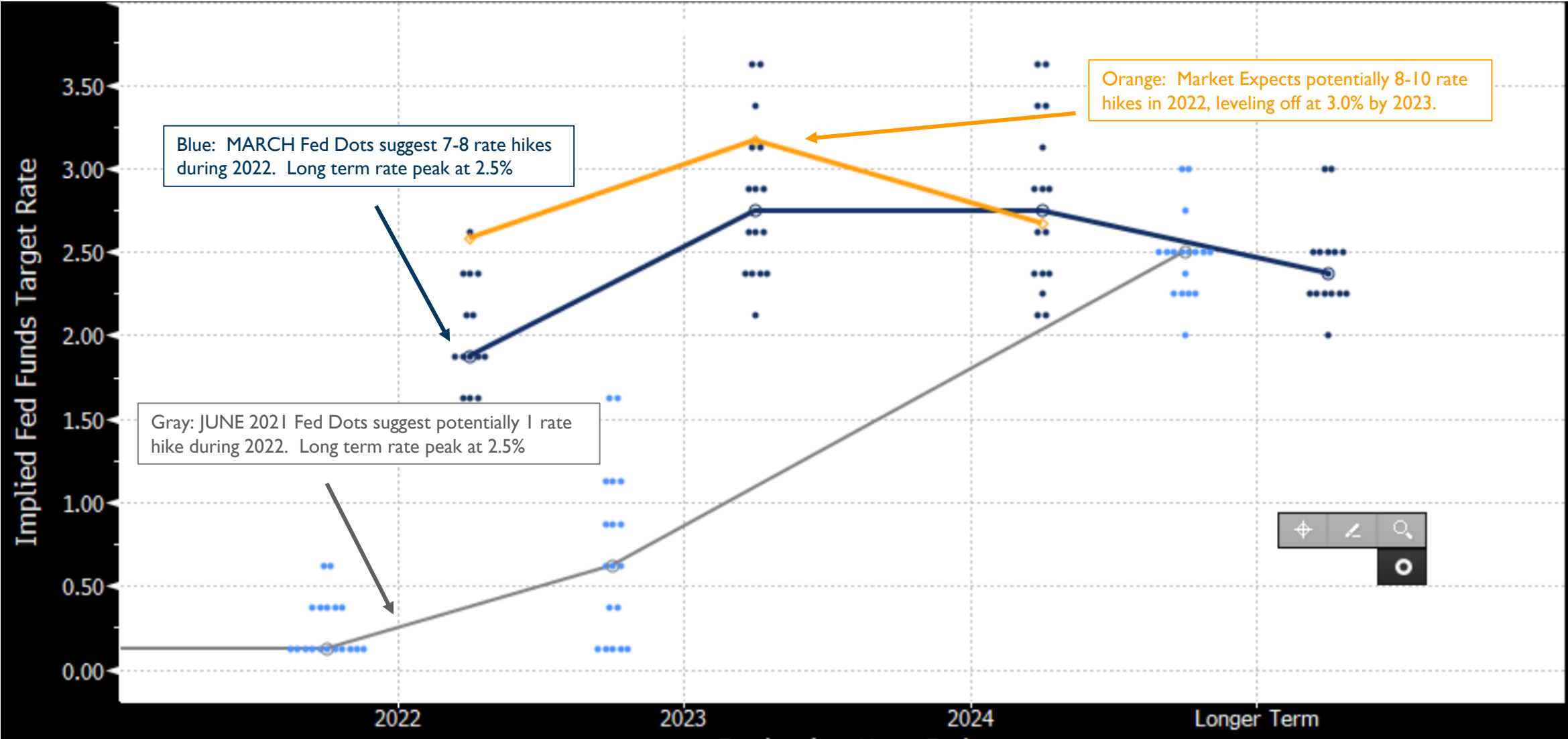


Inflation

- The Consumer Price Index continued its red-hot trend, posting a 7.9% (6.4% Core) year over year increase for February 2022. This was the largest year over year increase since January 1982. After months of suggesting inflation was transitory during the Spring and summer of 2021, Fed Chair Powell acquiesced in the fall of 2021 that inflation indeed is likely to be higher, and last longer than initially anticipated, a scenario many economists had predicted for months. The recent conflict between Russia and Ukraine is likely to result in additional increases to oil and energy prices and further pressure already highly elevated inflation.

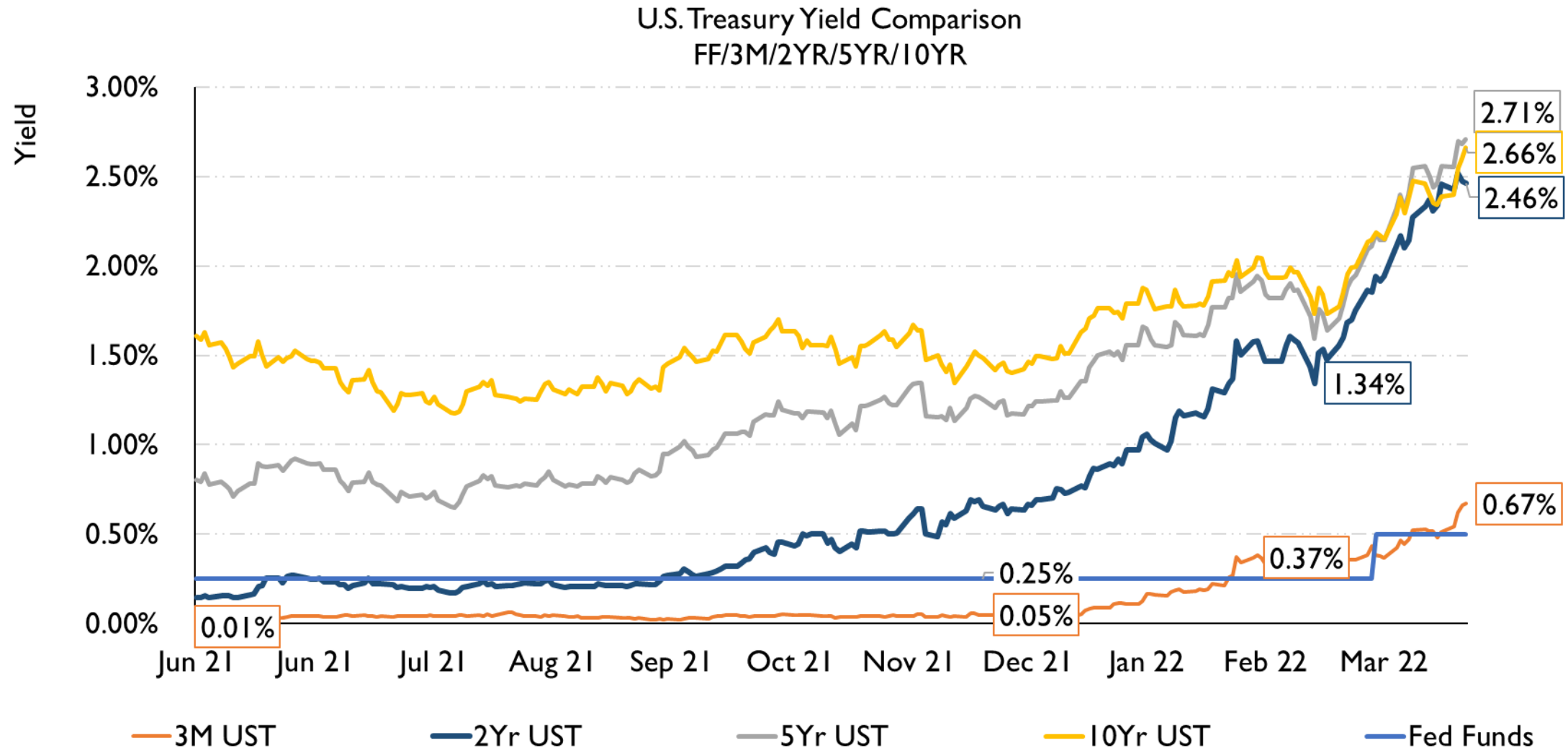


FOMC Dot Plot – June 2021 vs. March 2022



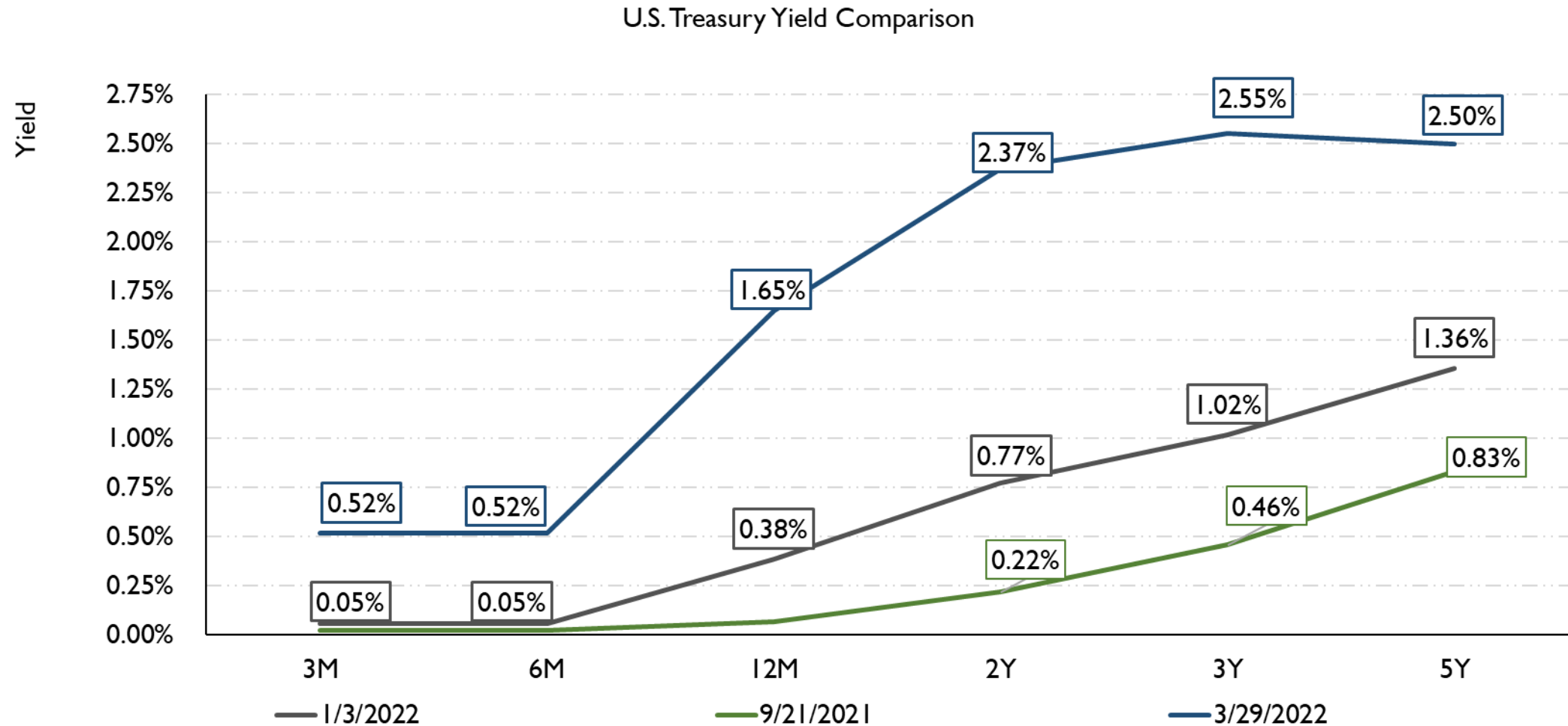
Inflation takes hold....Slope of yield curve increases

- 2 Year UST Yields have increase more than 100 basis points in the month of March



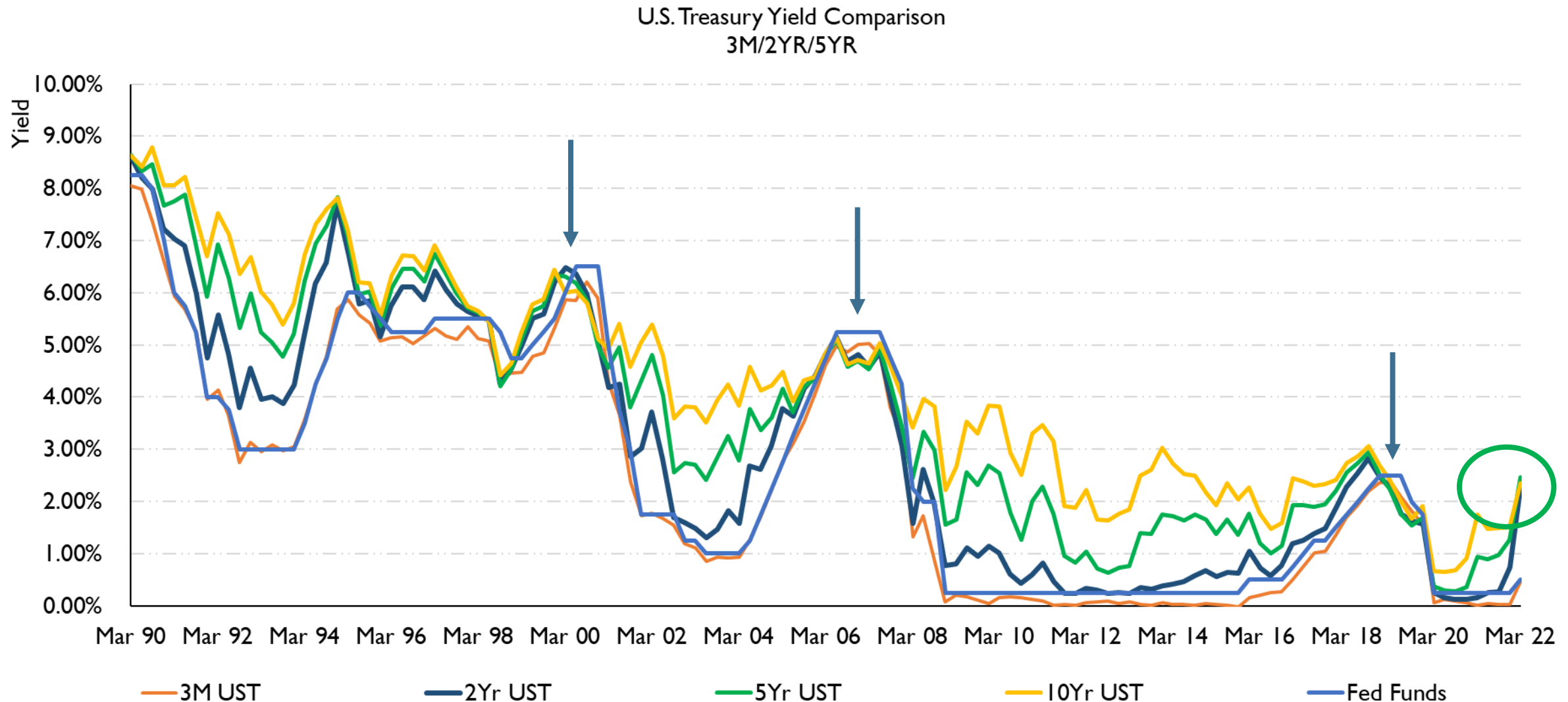
Inflation takes hold....Slope of yield curve increases

- Yields have increase 130 – 200 basis points for maturities between 1yr and 5yrs since September 2021



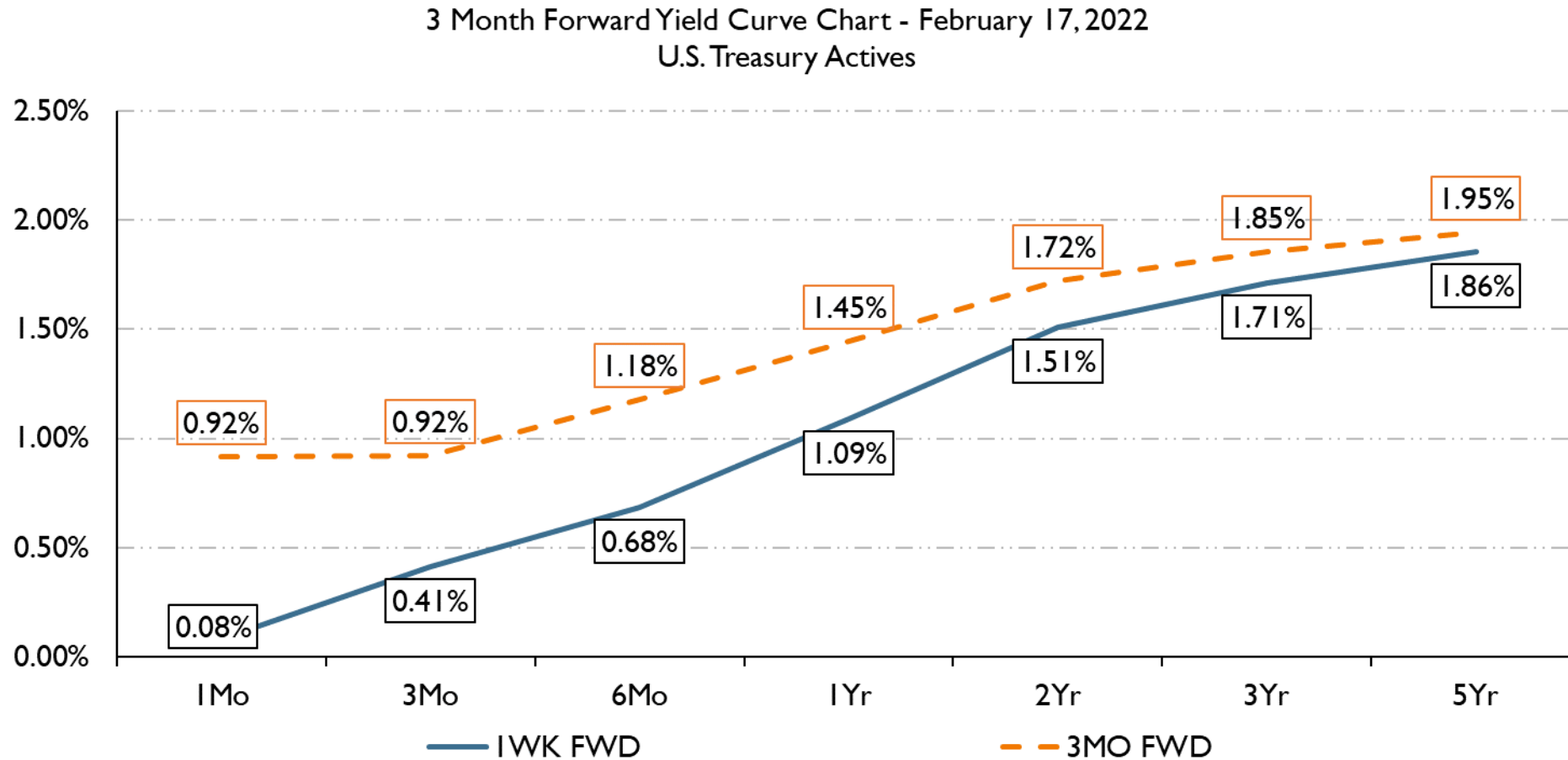
A Longer Term Perspective of the Treasury Yield Curve

- Zero Interest Rate Policy lasts 2 years compared to 8 years in the previous cycle



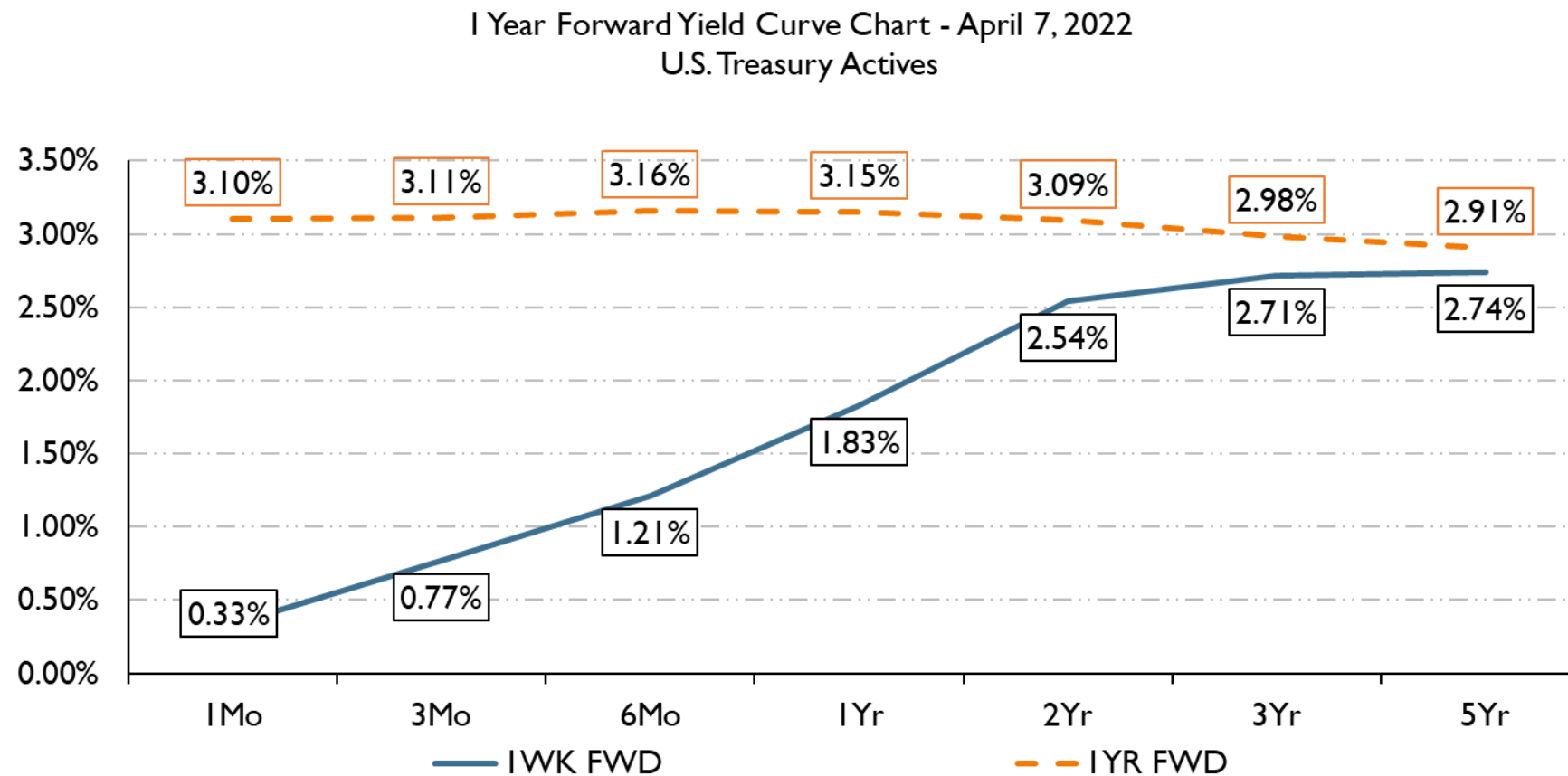
Three Month Forward Yield Curve

- The current three month forward yield curve suggests rates may increase 14 – 19 basis points over the next three months.
- This curve is only an indication of interest rate expectations based on current available market information and should not be used to make investment decisions.



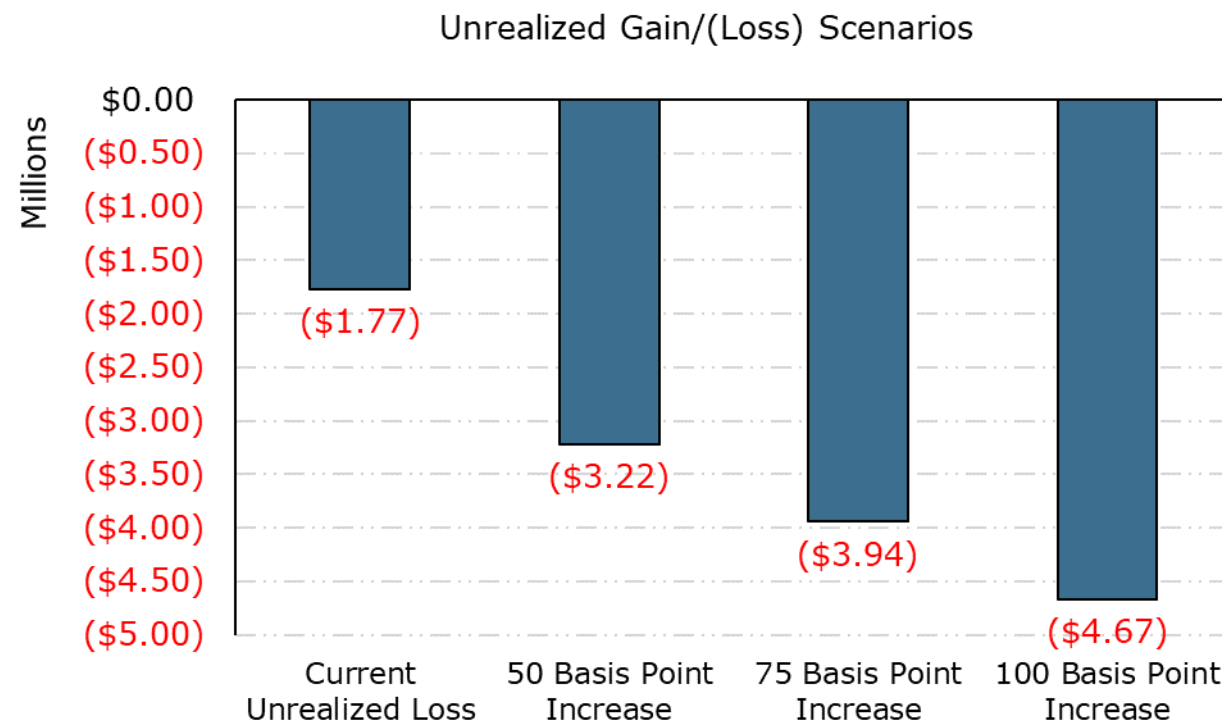
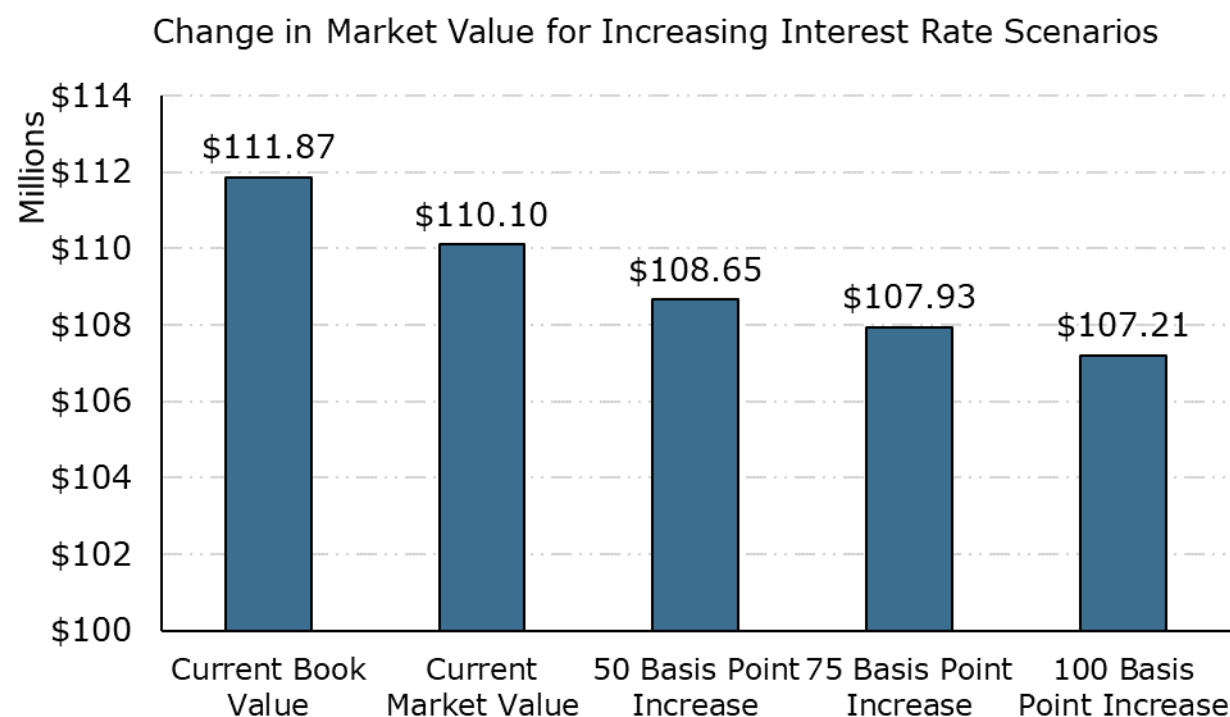
Three Month Forward Yield Curve

- The current three month forward yield curve suggests overnight rates may increase up to 300 basis points over the next three months.
- This curve is only an indication of interest rate expectations based on current available market information and should not be used to make investment decisions.



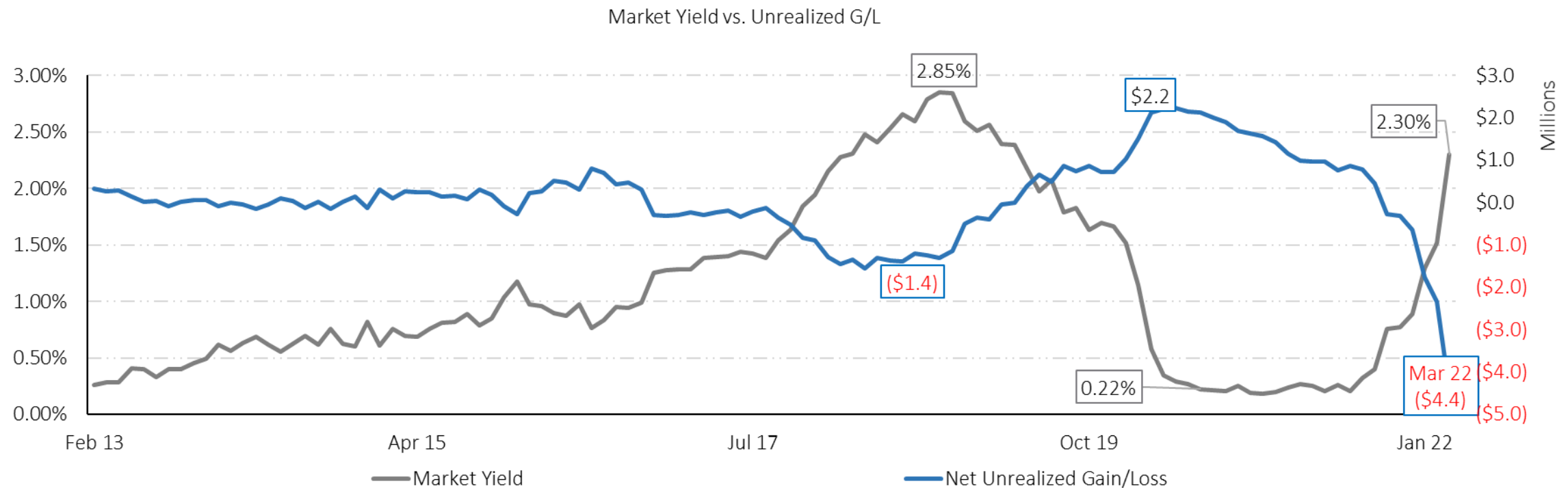
Increasing Rates and Change in Market Value

- Increasing interest rates generally result in larger unrealized losses due to the inverse relationship in yields and bond prices.
- The unrealized gains/loss is the difference between the book value and the market value.
- The charts below show the portfolio book and market value as of January 31st and the decrease in market value with a given increase in interest rates of 0.50%, 0.75% and 1.00%.



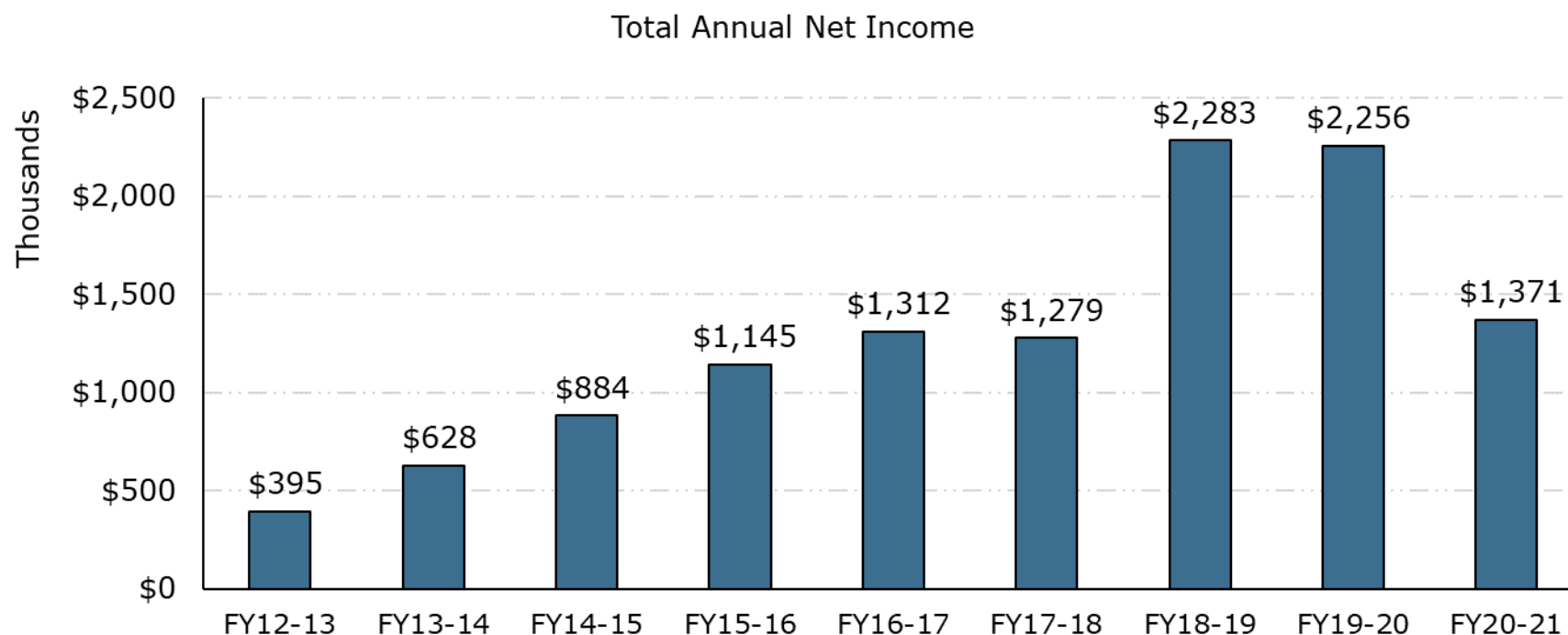
Market Yields and Unrealized Gain Losses

- As interest rates have increased in recent months, as reflected in the market yield, unrealized losses have also increased as they are inversely related.
- This same scenario occurred between 2017- 2018 and then interest rates reversed course in December 2018. Interest rates began increasing in July 2021, resulted in the unrealized losses.
- The unrealized losses are not cumulative and represent the difference between book and market value on that date. These unrealized losses would only be recognized if the portfolio were sold on that date.



Rising Interest Rates and Historical Income Opportunities

- Increasing interest rates provide an opportunity to reinvest at higher yields, which provides higher income over time. This strategy also protects against a declining interest rate environment.
- Even as interest rates began to decline in early 2019, the longer term portfolio strategy resulted in higher earnings through FY19-20. While FY20-21 net income was lower due to the interest rate environment, the earnings remained higher than prior FY18-19 in this sample portfolio strategy.



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Public Trust Advisors
717 17th Street, Suite 1850
Denver, Colorado 80202