Academy ESG

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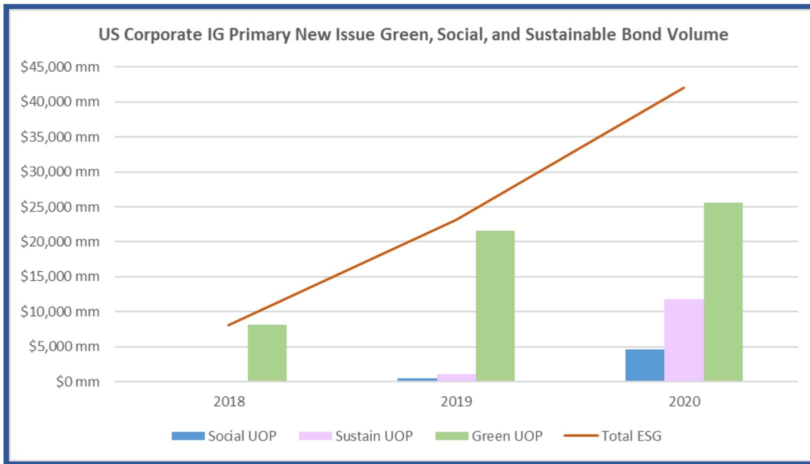
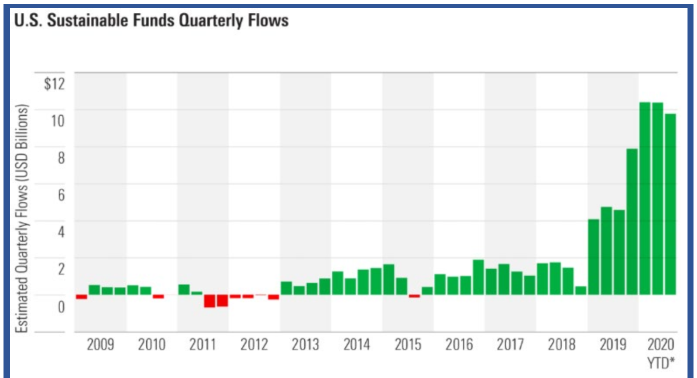
With less than two weeks left in the year, we continue with our annual review of analyzing the trends in ESG across the capital markets, including new issue debt, issuer diversity, investment funds, structured products, and asset back securities. Given the incoming Presidential adminstration's amenability to environmental issues and spending, we anticipate the further incorpration and evolution of ESG by investors, issuers, and regulators alike.



Despite 2020 being a banner year for ESG-themed debt issuance, December has remained relatively calm with no recent US IG Green, Social or Sustainable related transactions. AES Corp and UDR Inc. were among the last issuers this year to come to market with green bonds. AES printed $1.8bn in green bonds mid-November intended to fund eligible green projects and back tender offers, while UDR priced a $350mm green bond late November to boost the environmental efficiency of its portfolio.

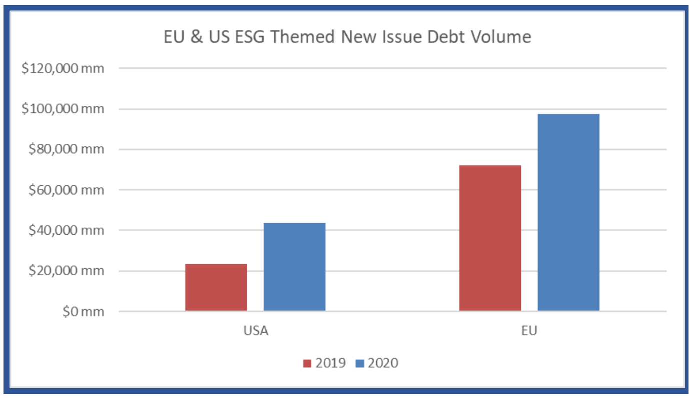
ESG Fund Flows & Fixed Income

2020 was an extraordinary year for ESG funds and investors. Globaly, 2020 experienced inflows of over $190 billion into sustainable funds. Europe accounts for a majority of the inflows, with the US expected to have $30 billion of inflows by year-end 2020. At the start of Q4 it was estimated that here in the US, sustainable funds managed a total of $179 billion in assets.



Source: Morningstar Direct. Data as of 9/30/2020. *YTD 2020 as of 9/30/2020.
Includes ESG Integration, Impact, and Sustainable Sector funds as defined in Sustainable Funds U.S. Landscape Report, 2018. Includes funds that have been liquidated; does not include funds of funds.

Blackrock's iShares remain among the more popular choices for investors—as the lion's share of 2020 fund inflows continue to be made into passive equity funds as opposed to fixed income. In addition to more sustainable funds in the marketplace to meet the increasing inflows, we continue to note the increased implementation of ESG criteria in investment decisions. The USSIF reports that there is now over $16 trillion in total US domiciled assets that money managers, institutional investors, and community investment institutions oversee. These entities are now utilizing some component of ESG criteria. Chief ESG concerns include: diversity & inclusion, climate change/carbon, anti-corruption, board composition, executive pay, conflict risk (terrorism), tobacco, and sustainable natural resources/agriculture.



While still only a subset of broader issuance, ESG-themed debt financing remains strong. Both the EU and US witnessed increased ESG debt issuance, and while the EU remains in the lead based on volume (with over $90 billion printed), in a year-over-year comparison, ESG issuance in the US outshines its trans-Atlantic counterparts with an 85% increase. Perhaps the most notable trend has been the adoption of sustainability and social bond financing by US IG corporate issuers. In 2020, US Sustainability bond financing increased over 9x (over 8x for social bonds) compared to green bonds which are up 18% YOY.

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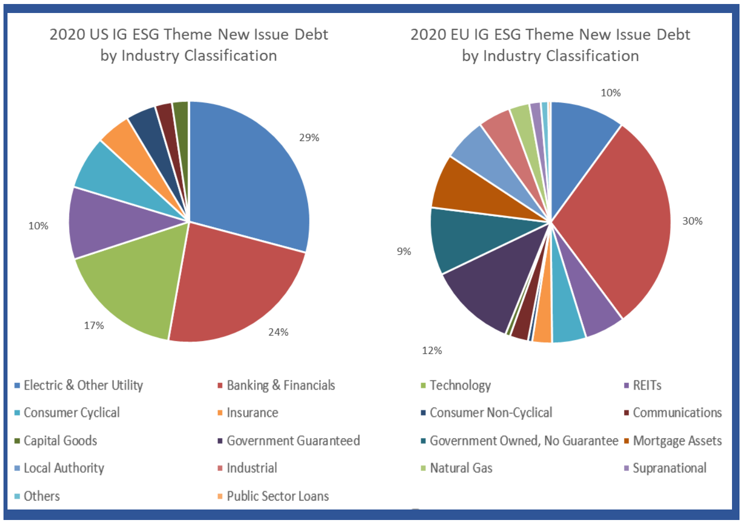
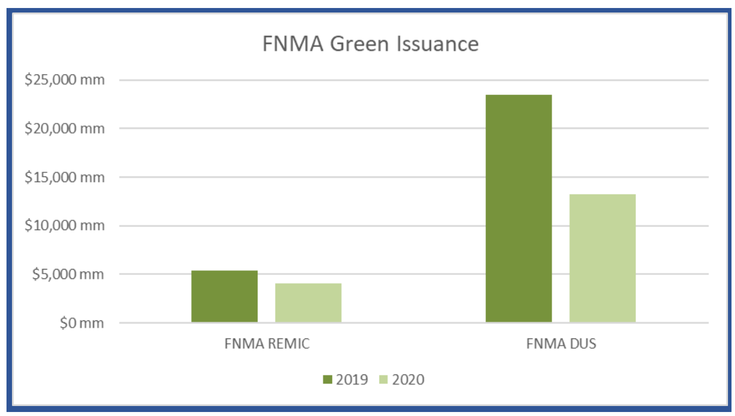


Issuer Diversity

With the increased traction among investors and issuers on ESG issuances, it was no surprise to see an uptick in issuer diversity. Traditionally, it has been REITS, Banks/Financials, and Utilities that represented the largest issuers of ESG-themed debt. This year in the US, Tech supplanted REITS for third place, accounting for 17% of US 2020 IG ESG debt issuance. Simultaneously, more issuers are utilizing diversity in the syndicate of their capital markets transactions, providing opportunities to minority, women, and veteran owned banks. Google, Pfizer, Morgan Stanley, Citigroup, Prologis, and many others all used D&I banks on their respective ESG offerings in 2020. Allstate, while not earmarked for ESG purposes, also issued a bond using solely D&I bookrunners and co-managers, and Academy served as a joint-bookrunner.

ESG, ABS, & GSEs

Here in the US, FannieMae continues to be one of the largest issuers of green structured products under its multi- and single-family green MBS program, which is designed to encourage improvements in energy and water efficiency. This year, both its Green REMIC and DUS programs showed deceleration, but we anticipate an uptick in 2021 given the Biden administration's focus on climate. There is also opportunity in the near-term for autos to issue green ABS. Given the transportation industry's contribution to climate change it could look to the securitization of electric voltaic, and now green hydrogen vehicles, to fund its transition.



Bottom Line

- Continue to expect increased ESG themed issuance and structures.
- With the increased investment and issuance, we anticipate further regulatory guidance and involvement.
- Continued evolution on how asset managers incorporate and invest using ESG criteria: including the use of ratings, exclusion/best-in-class/thematic investing, issues of materiality, and diversity.

Wishing you the best…Have a great holiday and new year!!!

~Michael (USMC ret)

Further Resources

- USSIF Report: https://www.ussif.org/files/Trends%20Report%202020%20Executive%20Summary.pdf
- Morningstar Sustainable Q3 Fund Flow: https://www.morningstar.com/articles/1007284/us-investors-continue-to-endorse-sustainable-investing
- FannieMae Green Bond Program: https://www.fanniemae.com/about-us/esg/green-bonds

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