Racial Equity and Municipal Bond Markets

BY CHRISTINE BAKER-SMITH, LOURDES GERMAN, SAMANTHA PEDROSA, AND STACY RICHARDSON*

Cities, towns, public authorities, states and other public entities across the country issue bonds every year to finance vital public infrastructure such as sidewalks, parks, affordable housing, sewer, housing and more. Historically, the allocation of resources to infrastructure has at times reflected inequities in many communities. In recent years, a growing number of issuances in the $4 trillion municipal bond market have emphasized equity, equality, and other social outcomes as important factors in the context of a bond issuance, particularly among stakeholders who participate in sustainable and impact investment.[1] Despite the sharp rise in the issuance of bonds that are meant to achieve racial equity, equity, or other positive social outcomes, many issuers are newly attentive to addressing systemic inequities via fiscal policies within their jurisdiction and some are starting to adopt promising practices to center racial equity and other social considerations in a bond issuance. This brief reports findings from focus groups we conducted with over 100 government officials to hear their perspectives, experiences, and challenges as issuers participating in this market, and to understand how racial equity and other social values are being centered in the investment process.

* **Christine Baker-Smith**, Director of Research, National League of Cities; **Lourdes German**, Executive Director, The Public Finance Initiative; **Samantha Pedrosa**, Program Manager, National League of Cities; and **Stacy Richardson**, Chief of Staff, National League of Cities.

Strategy Brief Takeaways

Issuers expressed a desire for a framework to act as a roadmap and guide them in the process of incorporating values into the bond issuance process. The framework developed in this project will be based on the range of practices issuers and other market stakeholders elevated

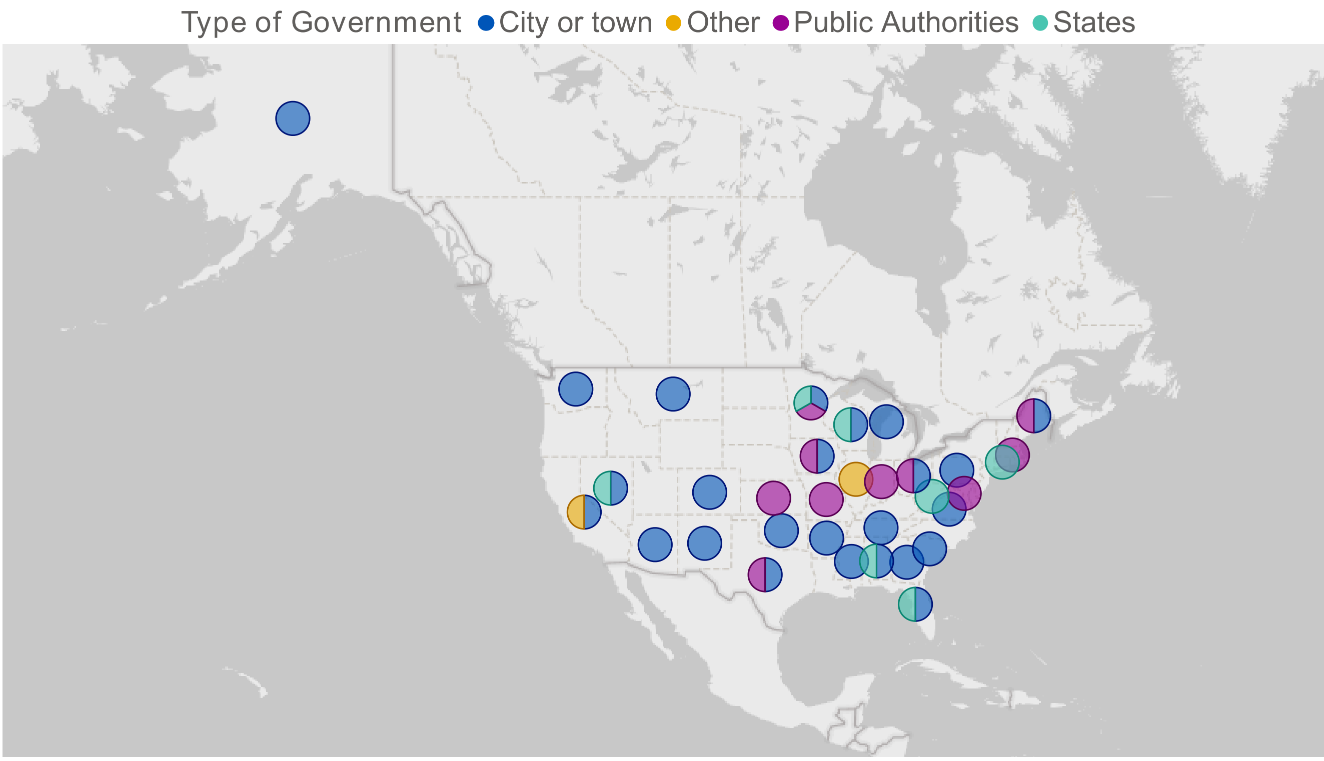
A prominent emerging practice by issuers is utilizing the bond proceeds to fund racial equity, or other social values. This practice is being considered broadly by some issuers to include all the proceeds of an issuance in some cases, including investment earnings

Issuers are using a wide range of emerging practices to center racial equity considerations in a bond issuance, including avenues for residents to provide meaningful feedback with respect to infrastructure projects that are financed with bond proceeds via community engagement, among other practices

Introduction

This brief analyzes the findings from focus groups we conducted with over 100 leaders from cities, public authorities, towns, and other units of government across America, who joined us from jurisdictions in the 34 states shown in Figure 1.

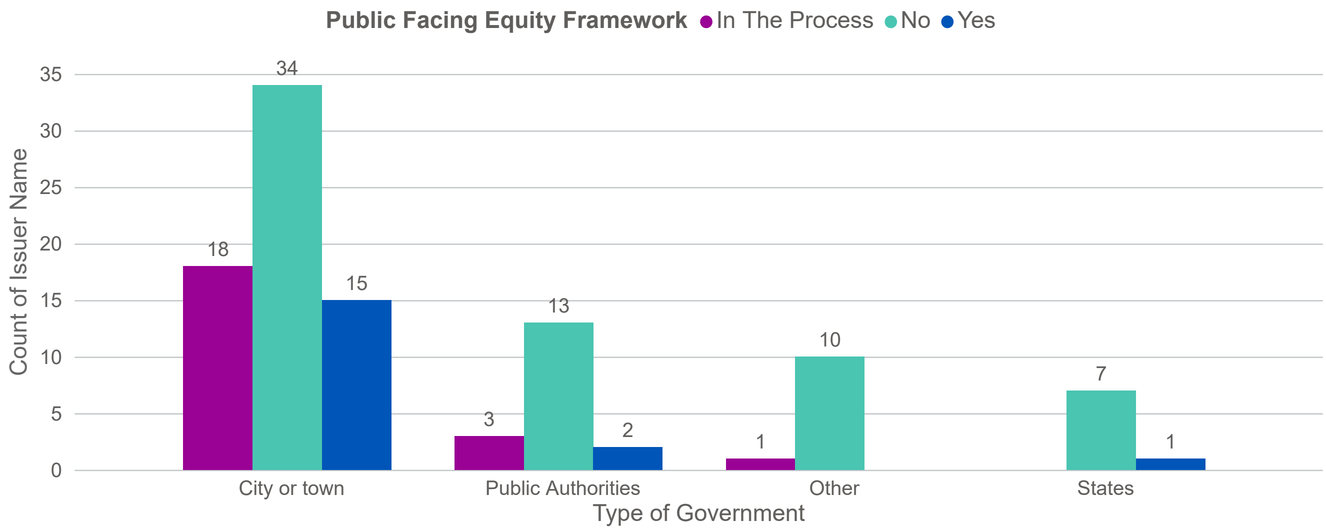
FIGURE 1: FOCUS GROUP ATTENDEES BY STATE AND TYPE OF GOVERNMENT*



---

* Information provided by focus group participants to NLC in 2022.

FIGURE 2: FOCUS GROUP ATTENDEES BY BOND ISSUER, EQUITY FRAMEWORK AND TYPE OF GOVERNMENT*

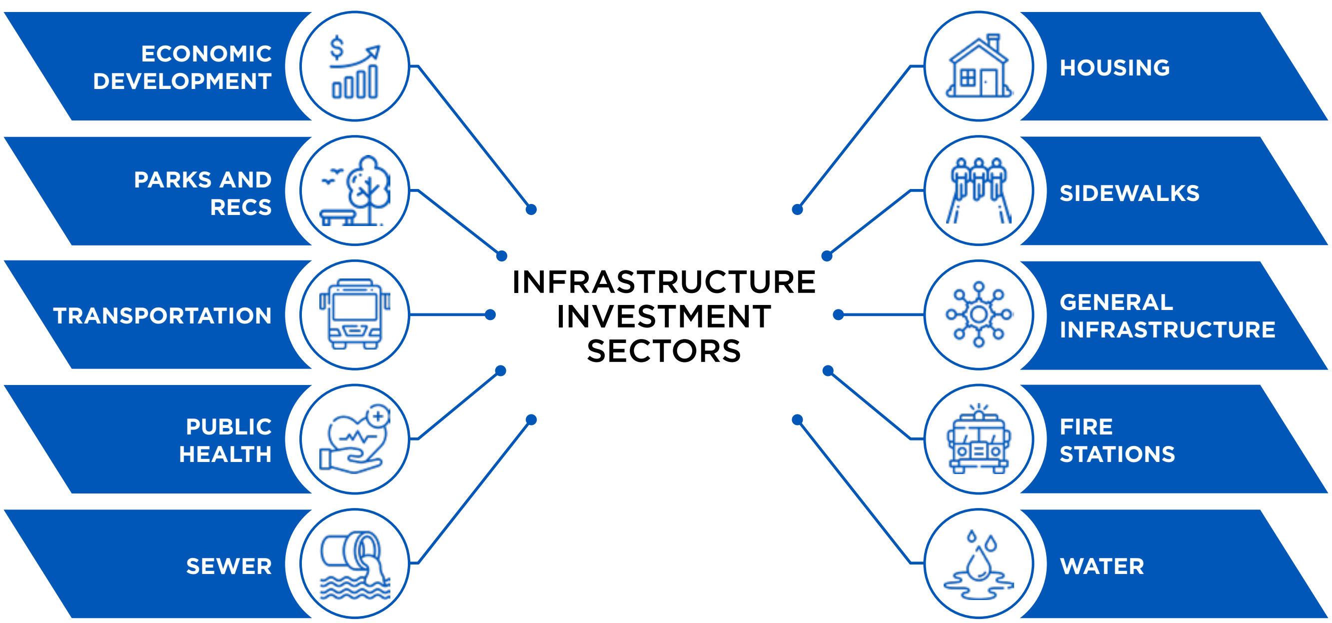


We invited participants to tell us how and whether they were using municipal bond issuances to fund infrastructure, and whether they were approaching that investment instrument in ways that centered racial equity and other social values. Our goal was to understand the range of market practices that exist in this area, and to understand the needs, challenges, and resource gaps government officials who are issuers are encountering when accessing the capital markets. We also asked participants to share what new resources they would find helpful to support them in leveraging municipal bond market strategies in ways that further racial equity outcomes.

* Information provided by focus group participants to NLC in 2022.

The Intersection of Infrastructure and Racial Equity

Infrastructure projects are essential components to the fabric of a community – water system improvements, sewer projects, sidewalks, educational facilities, and more have the potential to help cities, towns and villages address racial equity issues. To invest in infrastructure municipalities must secure funding for these projects and they often rely on municipal bonds. In our focus groups we found that issuers were often funding a variety of infrastructure sectors using bond proceeds:



The infrastructure investment sectors in the diagram above, and others, demonstrate the wide range of projects that can potentially be financed with municipal bonds that have the potential to impact many aspects of resident well-being, health, and other population outcomes. The resource allocation decisions made by municipalities with respect to infrastructure investments, programs, and services matters, and can promote or hinder racial equity outcomes within a municipality. For example, in Detroit, the decision to invest in water system improvements in certain areas of the city versus others impacted the public health and well-being of the city's residents of color.[2] In addition, disparities in student access to high quality broadband services during the COVID-19 pandemic exacerbated disparities in learning outcomes for many BIPOC students, and students from economically disadvantaged communities.

Focus groups participants reported the availability of affordable housing as one top area of need that, in their perspective, disproportionately impacts BIPOC communities and can be met with municipal bond investments. Several issuers and stakeholders who identified this as a priority highlighted how the COVID-19 pandemic induced the significant migration of individuals and families to new municipalities and states resulting in an influx of new residents in many of their jurisdictions. This, combined with changes to remote and hybrid work flexibility, contributed to rapid population growth in many jurisdictions who joined our focus groups and reported experiencing a housing shortage. Focus group participants also expressed heightened concerns regarding displacement due to gentrification in jurisdictions where income disparities are widening. To address these challenges, some focus group participants also discussed the need to fund the acquisition of land as a necessary strategy to enable the construction of new affordable housing units.

Throughout our focus groups, we heard from countless leaders regarding the challenge and difficulty of introducing, elevating, and adopting a narrative of racial equity, equity, or justice – particularly in certain politically charged environments. Several focus group participants framed the challenge as one centered in culture change, and expressed that it requires delicacy, diplomacy, and careful navigation of resident sentiments.

Many public officials who elevated this concern discussed the strategic communications alternatives they pursued to address the noted challenge. For example, some public officials in jurisdictions with commitments to equity expressed that they might not label a specific capital project or bond deal as being specifically rooted in racial equity, as they fear losing public support, threats, or harassment. A survey of 600 local officials done by the Benenson Strategy Group and Brennan Center for Justice reported an increase in the number of local officials experiencing work associated threats.[3] Threats of harassment pose real concerns for leaders who are passionate about pursuing racial equity-centered strategies that offer targeted resources to underserved populations in their jurisdictions while navigating challenging or hostile environments.

Key Definitions

Equity, equality, racial equity, social justice are terms that were often used interchangeably by focus group participants in our conversations, but they carry many different meanings. To report our findings accurately, we present those terms in this brief in the manner that they were introduced by the focus group participants in our conversations. We share prevailing definitions for those terms below from leading partners in the field to highlight the important distinctions among them:

Equality: Providing the same resources and opportunities to all.[4]

Equity: The state, quality or ideal of being just or impartial, which is achieved by giving people what they need to enjoy full, healthy lives and providing them with resources that are proportional to what they need.[5]

Racial Equity: When race can no longer be used to predict life outcomes and outcomes for all groups are improved.[6]

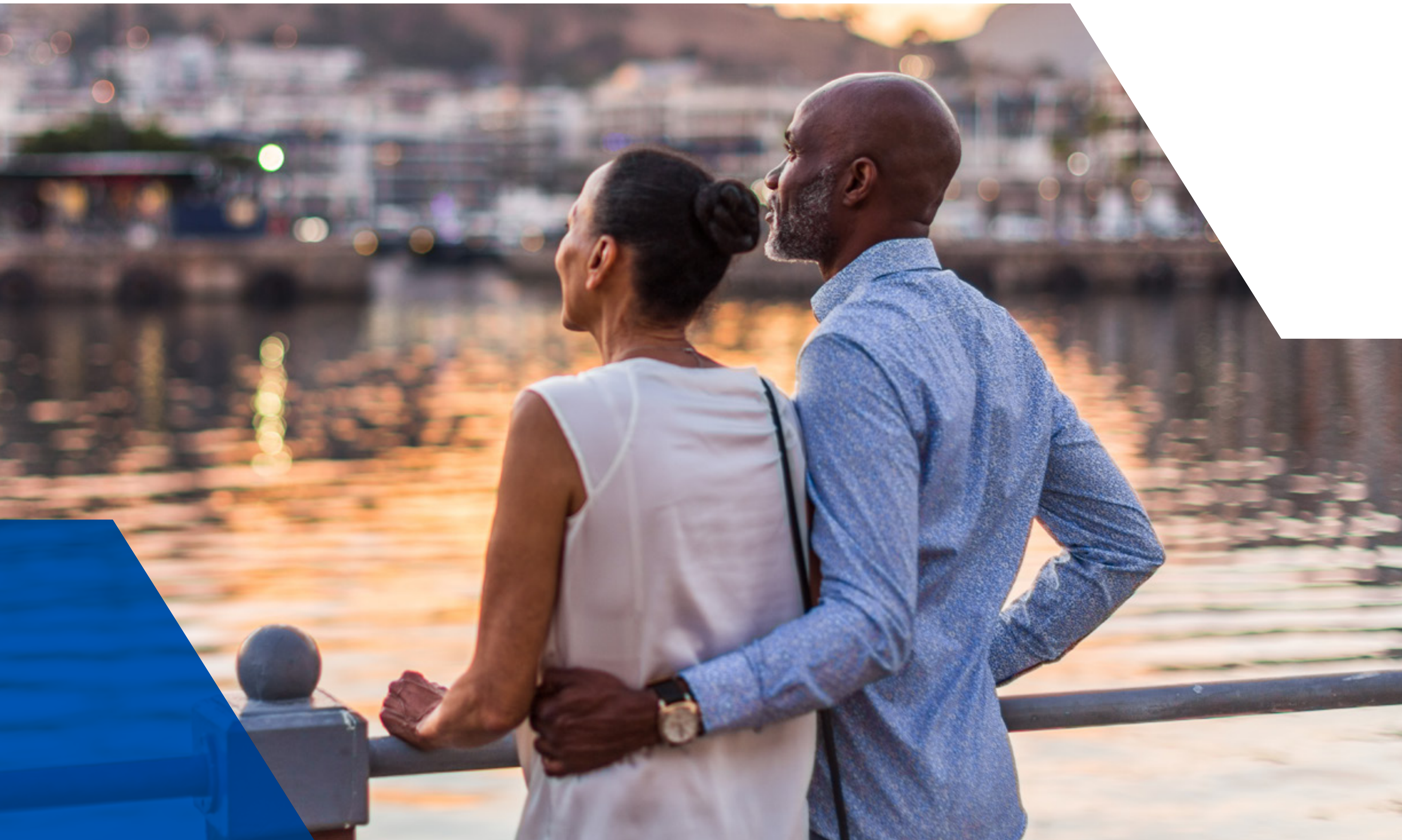
Racial Justice: The systematic fair treatment of people of all races that results in equitable opportunities and outcomes for everyone.[7]

Social Justice: A vision of society in which the distribution of resources is equitable and all members of a space, community, or institution, or society are physically and psychologically safe and secure.[8]

The resources and programs that we are creating reflect the definition of "racial equity" created by the Government Alliance on Race and Equity presented to the left. It holds that racial equity is achieved when "race can no longer be used to predict life outcomes and outcomes for all groups are improved." Racial disparities exist in every important aspect of life. We lead with race as opposed to other approaches because the data reinforces this fact: from infant mortality to life expectancy — race has the power to predict and even determine success. The history of racism in the United States makes clear the problems that have persisted for centuries to harm black, indigenous, and other people of color who have disproportionately faced discrimination or racism ("BIPOC") to this day. When we analyze health and career outcomes in the United States and control for all other indicators (i.e. age, income, education, employment), race continues to be the single most significant predictor of one's success.

Emerging Practices to Center Racial Equity in Bond Issuances

There are multiple ways that a municipality can secure funding for capital projects. This report examines the use of municipal bonds as a key avenue because it is one of the primary mechanisms municipalities in the United States use to raise money for infrastructure projects. The municipal bond market is host to a wide-ranging field of issuers and key stakeholders, reflecting immense variation in a highly fragmented market. In recent years, a growing number of municipal bond market issuers and investors have started to reflect equity, equality, racial equity, social justice and other social values as important factors in the context of a bond issuance, particularly those who participate in sustainable and impact investment. There has been a sharp rise in the issuance of bonds that are meant to achieve racial equity, equity, social justice or other positive social outcomes, and attention to addressing systemic inequities via other public finance practices is growing. We summarize noteworthy insights and trends that arose from our conversations with focus group participants below.



Integrating Racial Equity to the Proceeds of the Bond Issuance

Where issuers reported that they are successfully integrating racial equity, equity, social justice or other social values into the municipal bond issuance strategy, the predominant strategy is focused on the use of proceeds. The use of bond proceeds analysis is focused on assessing how and whether the project financed by the bonds will advance a clear racial equity, equity, social justice, or other social proposition of the issuer. The widespread focus on the use of bond proceeds aligns with broader patterns in the municipal market, including what investors often seek. A majority of bond issuers who seek to integrate equity, racial equity, equality, justice, or another socially focused principle in their bond issuance support that assertion by describing the use and management of the bond proceeds in alignment with the current leading principles articulated by the International Capital Markets Association.[9]

Issuers we encountered in focus groups also shared how they are taking a wider lens in centering racial equity, equity, and other social justice considerations in the proceeds generated by the issuance over time, in the form of investment earnings. The City of Las Cruces, New Mexico, for example, integrates an equity lens to guide how they spend the investment earnings generated from a bond issuance. Often bond proceeds are kept in interest bearing accounts, pending their use on the project (i.e. during a construction period, etc.) and subject to any restrictions under state law or the Internal Revenue Service. The City of Las Cruces manages a competitive process where they enable residents and organizations to submit applications to be awarded funding for programs that address resident needs from investment earnings. In the past, Las Cruces has funded shelters for homeless teens, purchased properties to address affordable housing for residents, and other purposes that further the city's values using investment earnings from bonds.[10]

Examining the Plan of Finance for Bonds with a Racial Equity Lens

The practice of examining the plan of finance for a bond deal with an equity lens interrogates how bonds are secured – meaning, the revenue sources that the issuer will tap to repay the bonds – and asks whether the way such revenues are assessed, collected, and administered pose disproportionate burdens on populations of color that might risk undermining equity or racial equity outcomes over time. By their nature, municipal bonds are multi-year securities. If municipal bonds are secured by revenues sources with inequitable characteristics, significant inequities could potentially arise within the populations of color who are disproportionately burdened by the revenue in the present day and for every year that the bond matures.

Many municipalities are placing heightened attention on revenue structures that are highly dependent on criminal justice fines and fees, for example, and examining their inequitable characteristics. In some instances, property

taxes can perpetuate structural racism when coupled with inequitable assessments and appeals practices.[11] If inequities are present and ingrained in the revenues that secure the bonds, it could create a dangerous foundation for intergenerational inequities to result over time – as future residents of color of the community are disproportionately burdened by the revenue source when the incidence of payment falls on them. This takes on heightened concerns in cases where municipal bonds include covenants that require that revenues that secure the bonds be maintained at adequate levels to repay the debt over time, for the entire duration of the bond issuance.

Integrating Racial Equity Considerations in the Sales Strategy for Bonds

Focus group participants expressed an interest in examining if there is an opportunity to explore using bond sales to center equity, racial equity, or social justice considerations in novel ways that the market has not experienced.

Traditionally, when bonds are sold the issuer's goal is to sell the deal in a way that generates the lowest cost of capital. When bonds are sold via private placement the issuer will traditionally negotiate with one buyer – often a large institution with the capacity and expertise to buy the entire deal. When bonds are sold publicly the issuer often works with one or more investment banks who underwrite the offering and syndicate the deal to the widest number of investors. By marketing a deal to the widest number of investors, the investment bank seeks to generate a final pricing that results in the issuer raising the money they need at the lowest cost of capital. One focus group participant elevated the desire to consider a sales strategy where, in addition to considering the cost of capital, they also integrated an explicit focus on racial equity by earmarking a percentage of their bonds to be awarded to investors of color. Such strategy, they observed, could serve as one of many interventions they are pursuing to close the racial wealth gap within communities of color in their jurisdiction.

The Importance of Equity Frameworks

The presence of existing equity frameworks that are developed outside of the bond market in jurisdictions can also serve as an important enabling factor and catalyst for an issuer who wants to introduce equity principles in a municipal bond issuance. Focus group participants reflected a wide range of experiences and practices in this area.

As demonstrated by the select examples on the table that follows, equity plans, frameworks, policies, and strategies can take many forms, and jurisdictions may be at varying stages of maturity in their development and adoption of such resources:

TABLE 1: SAMPLE EQUITY, RACIAL EQUITY, SOCIAL JUSTICE, AND EQUALITY FRAMEWORKS AND POLICY STATEMENTS

MASSACHUSETTS HOUSING FINANCE AGENCY **Massachusetts Housing Finance Agency Racial Justice Housing Agenda**[12]	Articulates MassHousing's commitment to diversity, inclusion, and the commitment to investing in the development and implementation of strategies to address racial disparities in housing and the commitment to advancing wealth generating opportunities in communities of color. Strategies also encourage and support a racially diverse workforce within MassHousing and across the affordable housing industry.
CITY OF MADISON, WISCONSIN **City of Madison Racial Equity & Social Justice Initiative (Resji)**[13]	Adopted resolution establishing racial equity and social justice as core principles within the City. The city has trainings, tools, and teams to instill and operationalize these values across the institution. Foundational to this work has been a host of trainings on racial equity delivered to staff and policy makers to help staff and policymakers incorporate racial equity in policy making, project development, budgeting, hiring and public participation. Finally, the city is solidifying its Department Equity Teams to have to enhance equity and continues the work of its Neighborhood Resource Teams to stay abreast of the priorities of residents most impacted by racial inequities.
CITY OF GRAND PRAIRIE TEXAS **Grand Prairie Diversity, Inclusion, Justice and Equality Resolution**[14]	Adopted resolution establishing a comprehensive Diversity, Inclusion, Justice, and Equality principles that set a foundation for the future development of programs and services designed to explore, understand, celebrate and embrace the differences across the city's residents and to implement several programs to close racial equity gaps. Grand Prairie has also integrated equity practices to its procurement and contracting programs, with a targeted goal of increasing city contracts that are awarded to minority owned businesses.

Over 20 issuers who joined our focus groups expressed interest in enacting an equity framework within their community. Approaches under consideration are highly varied in their content and strategy for adoption. Some focus group participants noted that they were contemplating adopting a new equity, racial equity, or justice strategy via formal resolution of the city council or other governing body. Other focus group participants explained that they were in the process of building an equity framework with portions of equity statements or principles that were already communicated on the government entity's website, and which were undergoing active testing and implementation.

The strategic focus areas present in equity, racial equity, or justice frameworks in development reported by our focus group attendees reflect a wide variation. Some issuers reported that they were integrating a racial equity lens with respect to their capital projects, others shared that they were beginning to integrate an equity lens to hiring policies and financial decision making, among others. In many cases, issuers expressed the sincere desire to evolve and expand their racial equity, equity, justice strategy, or framework, and enhance their practices over time across different functional areas of governance.

The presence of a strong pre-existing commitment to equity, racial equity or social justice was reported as a vital foundational element that could enable issuers seeking to integrate the noted values into their municipal bond issuances. A recent issuance by the City of Denver highlights how the presence of a pre-existing comprehensive equity strategy adopted city-wide can serve as an important element that creates an enabling environment to extend the equity concepts to the strategy for municipal bond issuances.

In Denver, equity considerations are a cornerstone of policy and practice across a number of functional areas– (1) equity is embedded within tracking of program performance; (2) the city established a comprehensive logic model to assess outputs and outcomes generated by each program with an equity lens; (3) staff from the Mayor's Office of Social Equity and Innovation review each agency's content and are empowered to make suggestions designed to align those objectives with the city's own community equity goals; and (4) equity considerations are embedded in the annual budget process, with staff trained to analyze how their funding proposals would impact marginalized groups and neighborhoods, what unintended consequences would emerge as result of the funding, and whether the request would lessen or exacerbate harms experienced by vulnerable communities, among other efforts.[15]

When cities like Denver take a comprehensive approach that interweaves equity across multiple domains of governance and finance, they create an enabling environment where new equity-focused practices can be adopted, informed by the pre-existing foundation. In the summer of 2022, Denver issued $366 million in voter approved "Elevate Denver and RISE Denver" Bonds to fund a wide variety of projects in neighborhoods across the city, as part of a financial plan focused on rebuilding an inclusive, sustainable, equitable economy. Funding is expected to support nearly 80 voter-approved projects including the addition of 188 shelter beds for people experiencing homelessness, improvements to cultural centers, new and improved parks and playgrounds, and accessibility, transportation, and mobility projects.[16]

Equity Centered Community Engagement Practices

Community engagement is a vital component of an equity strategy and can prove particularly meaningful when executed at two key levels of a bond issuance – when the bonds are authorized and for the project financed by the bonds. Issuers who joined focus groups from small to mid-size cities expressed concerns and challenges engaging the community and voters in understanding and supporting new bond issuances. The challenges focus group participants reported arise from the lack of staff capacity to host meetings with residents with respect to the infrastructure projects to be funded with the bonds, refining projects based on feedback, hosting continued meetings with updates as a plan for a bond issuance progresses, and then getting buy-in from residents to approve the borrowing via a vote. The time and staffing resources to host community meetings, extra funding for canvassing neighborhoods, and other costs associated with community engagement related to the project and bond authorization are not always accessible, according to focus group participants.

Despite the noted challenges, focus group attendees also reported a range of innovative and emerging community engagement practices integrating the voices and perspectives of residents in various stages of a bond issuance. Most notably, there was widespread consensus across jurisdictions with robust community engagement approaches that the processes for cultivating public feedback should best be done at the early stages of a project, to provide residents a meaningful window to comment on the strategic direction of the project, well before it is placed in service.

The City of Chandler, Arizona, serves as an example of how models of community engagement can be developed in targeted ways to elevate the voices of residents in major infrastructure improvements. Most recently, the city's volunteer committee supporting community engagement welcomed 49 participants representing diverse and unserved communities.
The volunteers carried out community engagement processes that sought to include and integrate public feedback at these levels: the authorization of the bond measures, feedback for infrastructure projects, and targeted feedback on equity needs. Subcommittees engaged in the noted work were also tasked with going into neighborhoods around the city to generate a conversation around the capital projects under consideration and gathering feedback from Black, Latino, Asian, indigenous and other populations of color and residents who historically had low rates of participation and engagement.

Challenges Governments Face Centering Racial Equity in Municipal Bond Issuances

Capacity Challenges

Although municipal bonds are a predominant and long-standing funding source for many communities across America, the issuance process is complicated and often requires additional time and effort when equity, racial equity, justice or other social criteria are centered in the issuance. Staffing limitations, especially as it relates to finance department functions, were a prominent concern focus group attendees reported. Many city issuers expressed having limited staff resources within their finance departments, sometimes only one or two employees. The limitations on staff capacity were reported with heightened concerns where issuers had to prepare reports after the bonds have been sold reporting on non-financial social factors, in addition to traditional reporting that is necessary for an issuance.

To make this more challenging, many municipalities have faced staffing shortages throughout the pandemic. Experts at the National League of Cities found that "municipal employment fell by 300,300 jobs, driving municipal employment down by 4.48 percent." This, in comparison to the overall government labor loss of 3.48%,[17] puts municipalities in a higher need for filling vacant roles compared to other government sectors. In the study, Survey Findings – State and Local Government Workforce 2021 conducted by ICMA-RC 288 state and local government agencies were surveyed to discuss trends and challenges in the workforce. Government agencies found it difficult to fill in vacancies in the business and financial operations sectors- such areas were cited as the biggest challenge for 30% of respondents.

Many state and local governments facing staffing challenges also reported difficulties in competing with private sector employers. This affects both small and large cities across the nation.[18] In the face of these concerns, many focus group participants shared that they often choose to proceed with bond issuances that are familiar to their current staff as opposed to exploring new and novel elements to integrate into an issuance, particularly in areas that may be less familiar to them.

Challenges of Small & Mid-Size in Integrating Racial Equity in a Municipal Bond Issuance

Accessing the capital markets is a complex process, with a path to market that often requires the execution of many elements that can place unique challenges on smaller borrowers. It is vital to understand and be attentive to these considerations, particularly the unique challenges smaller borrowers may face when preparing to sell a bond deal that centers equity, racial equity, justice, and other social principles, and to create resources to support them in that process.

Many officials from smaller cities who joined our focus groups shared the sentiment that they are infrequent borrowers, meaning that they either access the market and do one bond deal only once per year (or every several years) or they borrow small amounts. In many instances, their market activity is aligned to what is known as "bank qualified issuers" – this is a special designation in the Internal Revenue Code for small borrowers. The special designation for bank qualified bonds was first created in 1986 to provide a class of municipal securities issued by small borrowers a special tax-advantaged status when purchased by commercial banks.[19]

The designation of "bank qualified" was, in essence, created to encourage banks to invest in tax-exempt bonds from smaller and infrequent municipal bond issuers, enabling those issuers to access the bond market with a lower cost of capital, recognizing the vital part that municipal bond funding plays in investments in schools, roads, bridges, and other infrastructure projects in small communities. Small issuers of bank qualified bonds may experience capacity concerns we discuss earlier in this brief to a heightened degree, and may lack resources to integrate equity, racial equity, justice, and other social criteria into an issuance. Furthermore, because such borrowers already have a tax preference that enables them to receive a lower cost of capital, they may lack an economic incentive to spend the extra time integrating the noted non-financial criteria in a deal if investors are not demanding such from the issuer for the issuer to achieve the cost of capital that they need to execute the deal successfully.

In addition, many small and mid-size cities (including bank qualified issuers) often also issue municipal bond deals for a range of blended purposes – rather than for one larger project. This practice, in some jurisdictions, is called a multi-purpose issuance or "municipal purpose loan bonds". When a bond issuance includes multiple projects, issuers shared that it is challenging and requires staff resources to create a comprehensive equity, racial equity, justice, or other social narrative for one deal, and to report on those outcomes.

Leaders who joined from small and mid-size cities shared that a pre-condition for them to be able to integrate equity, racial equity, justice, or other social justice criteria in multi-purpose issuances would be the jurisdiction having a pre-existing comprehensive framework that encompassed and guided all infrastructure projects. With such a framework in place, it would enable the jurisdiction to then have a clear equity, racial equity, or justice focused strategy that it would apply to all infrastructure projects which it would potentially select as projects to be funded with a multipurpose municipal bond issuance. An example of jurisdictions that serve as successful models of this concept in practice are visible in the case of the City of Denver, described within this brief.

Challenges & Restrictions Grounded in Law

It is well settled that tax-exempt municipal securities can only be issued if they are properly and validly authorized by three bodies of law – state law, federal tax, and any relevant local laws of the jurisdiction. The state and local laws that govern the authorization of municipal bonds vary state to state, but often regulate and govern the following common elements:

- the **types of projects** that can be funded with the **proceeds from the bonds**
- the **way bonds must be authorized** – whether by voter approval, city council approval, board approval, or other methods
- the **public process** surrounding the authorization of the bonds
- the way the **plan of finance** for the bonds can be structured

Issuers who joined us elevated many restrictions in the laws of their jurisdictions that often created unfavorable or challenging enabling environments that impacted their decision to issue bonds. As one example, several focus group participants elevated challenges arising under the Colorado Taxpayer Bill of Rights (TABOR), an amendment to the Constitution of the State of Colorado adopted in 1992, that impacts the path to market when municipal bonds are issued in Colorado. In Colorado, TABOR generally limits the amount of revenue governments in the state can retain and spend. Absent voter approval, it requires excess revenue to be refunded to taxpayers. TABOR also requires voter approval for certain tax increases and requires that bond issuances must be subject to voter approval in a general election defined as either Federal or Statewide races, municipal or special elections.[20]

A novel potential challenge grounded in law is also arising due to anti-ESG (Environmental Social and Governance) preemption legislation arising in several states.[21] Preemptive environments are growing across the country in a variety of policy arenas.[22] Texas, for example, passed a law that bans its municipalities from doing business with banks that have ESG policies against fossil fuel and firearms. This potentially prohibits municipalities in Texas from using banks with the noted policies as underwriters – including, for example, Goldman Sachs, Bank of America, JPMorgan Chase, Citigroup and Fidelity Investments. A study done by the Wharton School at the University of Pennsylvania highlighted the early effects of lowering competition among underwriters in the state and estimated that in the first eight months of the law being enacted municipalities were estimated to pay an additional $303 to $532 million in interest costs for the issuance of $32 billion in bonds. With larger investment banks leaving, cities in Texas had to negotiate borrowing terms with a smaller pool of investment banks, leading to an increase in cost of approximately "40 basis points for jurisdictions that previously relied on the exiting underwriters for the majority of their issues."[23]

Several jurisdictions are currently considering changes in laws that are similar to the law in Texas.[24] In such jurisdictions, it will be important to consider whether the restrictions banning municipalities from engaging in business with banks that have ESG policies will be more expansive and change or preempt local control and the autonomy of the municipality to center ESG principles – including equity, racial equity, justice and other social principles in a bond issuance of the municipality.

Creating a New Framework

Municipal bonds serve as the predominant funding source for public infrastructure investments in America and can play a critical role in creating access to transportation, affordable housing, education, schools, water systems, sewers, and other infrastructure drivers of environmental justice, health, education, and well-being. Integrating a racial equity lens to municipal bond investments that fund infrastructure at scale can potentially serve as a powerful intervention for historically underserved groups—especially residents of low-income communities and racially and ethnically diverse neighborhoods.

In the course of our focus groups one guiding element became clear – issuers of all sizes and varying levels of market participation expressed the need and desire for a framework that could serve as a roadmap to help them understand what it means to center values in a financial process of accessing the capital markets, in ways that are attuned and attentive to the range of challenges they are experiencing.

The framework we are creating in response to what we have learned is being developed with one guiding purpose: To enable municipal bond issuers to leverage markets as a catalyst for changing racially inequitable conditions in their communities, resulting in the improvement of material conditions for populations and the enhancement of material risks in their jurisdiction.

To create our framework, we began by listening to issuers via the focus groups described in this brief, and we also listened to investors, rating agency leaders, investment bankers, financial advisors, and other municipal bond market stakeholders in focus groups across the country that we convened with our partners and collaborators. We also conducted extensive research on the current state of market practices. The noted avenues, and others, helped us understand perspectives and the current state of practice across a range of market stakeholders integrating race and other social considerations into bond financings.

The range of practices we identified comprise the heart of our framework and endeavor to present a potential paradigm shift for how racial equity considerations can be integrated into a municipal bond strategy at multiple entry points of the issuance, comprehensively, and informed by the leading voice of issuers and other market participants.

Acknowledgements

The authors thank and acknowledge the collaboration of The Government Finance Officers Association, The PFM Group, and the Lincoln Institute of Land Policy in convening several of the focus groups described in this brief.

APPENDIX

Focus Group Approach, Composition & Attendance

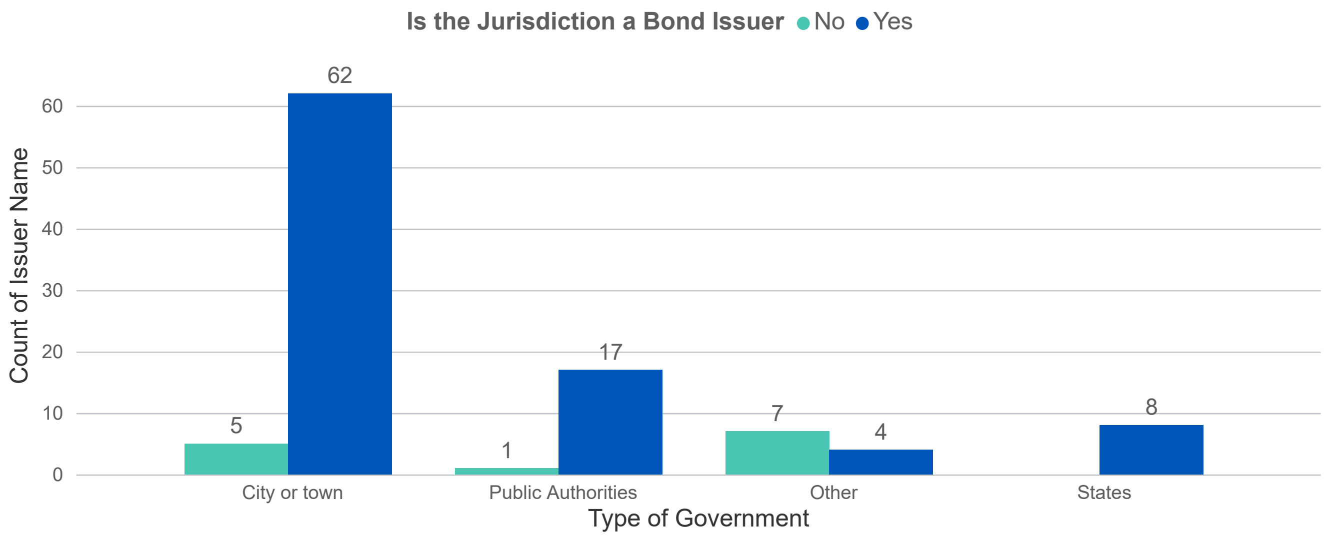
Our focus group effort was designed to engage municipal bond issuers from the United States, that met the following target criteria:

- The government entity was eligible to issue tax-exempt municipal bonds pursuant to the U.S. Internal Revenue Code;
- The government entity had sold a municipal bond issuance with an explicit focus on social, economic, racial equity, or other equity-focused criteria in the past three years, or
- The government entity had a documented plan, framework, or strategy that reflects attention to equity, racial equity, equality, or social justice in the context of fiscal and infrastructure investment and capital planning decisions.

When inviting issuers to the focus groups, we also wanted to achieve a diverse geographic and demographic distribution from all regions of the U.S, reflecting a wide range of population sizes. We also tracked and analyzed demographic indicators of economic and racial diversity for residents of each jurisdiction. In addition, our invitation process also included targeted outreach to issuers from the NLC Race, Equity and Leadership (REAL), membership, members of NLC's Strong Southern Cities Initiative (SSCI), and issuers convened by several external organizations and practitioners in the field.

Over 100 attendees joined our focus groups representing cities, public authorities, states, and other municipal market stakeholders from the private sector that support the bond issuance process, such as bond counsel, financial advisors, and others, visualized in figure 3. While most focus group attendees were issuer officials charged with leading the capital markets process, participants also joined our focus groups who held roles in other functional areas of government, including urban planning offices, chief equity offices, and the city council. Several participants also joined our focus groups who held executive level roles with respect to the issuer, including Mayors and executive directors of public authorities.

FIGURE 3: FOCUS GROUP DATA BY POPULATION AND BOND ISSUER* **



* Public authorities on their own are not jurisdictions with populations, and populations reported include city, state and any other jurisdictions served by the public authority.

** Information provided by focus group participants to NLC in 2022 and 2020 Census Data.

Endnotes

1 Lourdes Germán. (January 2022). Leveraging Municipal Bond Markets to Disrupt Systemic Inequities.

2 City of Detroit. (May 2021). DWSD invested $240M in water and sewer upgrades the past two years; outlines 2021-22 projects at an additional $200M.

3 National League of Cities. (July 2022). Managing and Mitigating Threats & Harassment Against Local Election Officials.

4 Source: The Government Alliance on Race & Equity

5 Source: The Annie E. Casey Foundation

6 Source: The Government Alliance on Race & Equity

7 Source: The Annie E. Casey Foundation

8 Source: Brandeis University

9 International Capital Market Association. Social Bond Principles.

10 Investment earnings on the bond proceeds are generated in the period often known as the construction period when the project has started and the bond proceeds are placed in the issuer's bank account, pending their use, and are potentially invested in accordance with the issuer's investment policy. There are many potential legal restrictions on the use of investment earnings generated for tax-exempt bond proceeds that must be carefully analyzed under Internal Revenue Code guidelines.

11 Urban Institute. (December 2021). More Than Fines and Fees: Incorporating Equity into City Revenue Strategies.

12 Mass Housing. Racial Justice Housing Agenda.

13 City of Madison. (January 2018). City of Madison Racial Equity & Social Justice Initiative.

14 City of Grand Prairie. A Resolution of the City of Grand Prairie, Texas for Community Diversity, Inclusion, Justice and Equity.

15 The United States Conference of Mayors. (June 2022). The American Rescue Plan Act Promoting Equity Through ARPA Implementation.

16 Denver Perfect 10. (April 2022). City Accelerates Economic Recovery with $366 Million General Obligation Bond Issuance.

17 The National League of Cities. (July 2022). The Municipal Workforce Through the Pandemic: Where Are We Now?

18 Mission Square Research Institute. (May 2021). Survey Findings State and Local Government Workforce 2021.

19 Government Finance Officers Association. Bank Qualified Debt.

20 Colorado Secretary of State. December 1992). Constitution of the State of Colorado.

21 Reuters. (August 2022). The Challenge of Investing in the Face of State Anti-ESG Legislation.

22 National League of Cities. (February 2020). Home Rule Principles Report for the 21st Century.

23 Knowledge at Wharton. (July 2022). Texas Fought Against ESG. Here's What It Cost.

24 States with current anti-ESG legislation making its way through their governments: Texas, West Virginia, North Dakota, Oklahoma, Kentucky, Utah, Minnesota, Idaho, South Carolina, Louisiana, Wyoming, Arizona, Indiana, Missouri, Ohio, and South Dakota. Reuters. (August 2022). The Challenge of Investing in the Face of State Anti-ESG Legislation.