



Moody's Investors Service Rating Environmental, Social, and Governance

Why OCA did this project

Investors, regulators, and customers are increasingly interested in environmental, social, and governance (ESG) strategy. Because the City of Tulsa relies on investors to buy the bonds we use to finance capital improvements, OCA wanted to learn more about the effects of ESG on our credit rating.

Project Scope

ESG factors affecting City of Tulsa's rating from Moody's Investors Service ("Moody's")

How OCA did this project

Project procedures included:

- Discussing with a Moody's analyst how ESG risks were included in their assessment
- Learning how ESG factors impacted City of Tulsa's credit rating through analysis of Moody's *Credit Opinion*, dated February 1, 2022
- Researching impending changes related to ESG disclosures

Key observations

1. Moody's ESG Credit Impact Score for the City of Tulsa was Neutral-to-Low
2. Finding accurate and relevant information to form an opinion about ESG is challenging
3. Required ESG reporting will increase in the future

Audit Advisory

Moody's Investors Service Rating

Environmental, Social, and Governance

Introduction

What is ESG?

Environmental, social, and governance is a framework of factors that promote an organization's sustainability. Sustainability allows an organization to meet the needs of its current customers without compromising the ability to meet customer needs in the future. The ESG framework includes a set of nonfinancial performance indicators that can be used to measure how well the organization is meeting its sustainability goals. See Exhibit 1 for more information.

Why is ESG important?

Traditionally, potential investors have primarily relied on financial indicators for investment choices. Today, investors have an interest in looking beyond financial measures and have turned their interest to sustainability. Agencies that rate investment opportunities have begun taking an interest in and including ESG factors in their rating methods.

The City of Tulsa uses Moody's Investors Service and Standard and Poor bond ratings as operating indicators. Both these rating agencies now include ESG factors in rating evaluations. This project took a deeper look at how Moody's rated City of Tulsa ESG factors.

Observations

Observation 1 – Moody's ESG Credit Impact Score for the City of Tulsa was Neutral-to-Low

The City's annual FY22 consolidated financial report states:

"In their report dated July 21, 2022, Standard and Poor's assigned and affirmed an AA rating with a stable outlook to the City's general obligation bonds. **Moody's Investors Service assigned and affirmed the City an Aa1 rating with a stable outlook** in their report dated July 22, 2022."

Moody's ratings range from Aaa to C, with Aaa being the highest quality and C the lowest quality. Numerical modifiers range from 1-3, 1 being the highest quality. See Exhibit 2 for additional information.

Moody's ESG Credit Impact Score for the City of Tulsa was neutral-to-low. This means the ESG score did not have a significant effect on City of Tulsa's overall rating. However, Moody's attention to ESG measures will be increasing over time.

OCA interviewed a Moody's analyst who addressed ESG scores in an email dated October 7, 2021:

"The new scores are part of Moody's on-going commitment to demonstrate the systematic and transparent incorporation of material ESG issues into credit ratings. Over time, Moody's will be expanding ESG Investment Policy Statements and Credit Impact scores to an increasing number of issuers across sectors."

Observation 2 – Finding accurate and relevant information to form an opinion about ESG is challenging

Moody's publication, *General Principles for Assessing Environmental, Social and Governance Risks Methodology* states:

"The potential credit impact of many ESG considerations is challenging to assess because it must often be inferred or estimated from multiple sources based on reporting that generally is not standardized or consistent."

City of Tulsa has an opportunity to expand and improve the information it provides on ESG topics. For example, a Tulsa Urban Data Pioneers report dated May 28, 2020 described an opportunity that City of Tulsa has missed. The American Council for an Energy-Efficient Economy requests cities to complete its Clean City Energy Scorecard. This scorecard allows cities to report their progress on energy, greenhouse gas emissions, utilities, transportation, and beginning in 2019, metrics that measure investments in and engagement with low-income communities and communities of color.

The Urban Data Pioneers team learned City of Tulsa had not responded to the request for scorecard information. All the information used for Tulsa's scorecard was obtained from publicly available websites. In the latest scorecard, Tulsa scored 11 out of a possible 100 points, putting Tulsa near the bottom in the national ranking. See Exhibit 3 for additional information.

Observation 3 – Required ESG reporting will increase in the future

Activity by two key rule-making bodies indicate changes in ESG reporting.

- City of Tulsa voluntarily complies with Government Finance Officers Association reporting criteria and has continually earned its Certificate of Achievement for Excellence in Financial Reporting. The GFOA recommends and describes in the *Best Practices: Voluntary Disclosure* report that ESG risk factors should be provided in official statements when municipal securities are being offered for sale.

- The Securities and Exchange Commission issued a proposed rule, which is currently open to public comment. The proposed rule would require certain domestic and foreign registrants to include ESG information in financial reports. The City of Tulsa is not required to follow SEC rules but should consider the possibility of voluntary reporting. Many organizations have voluntarily included ESG information in financial reports because of increased investor and customer interest in this type of information.

City of Tulsa is becoming a data-driven organization. As our interest and capability grows for using data in decision making, our thoughts should also include deciding what ESG measures are best for us.

Exhibit 1 – ESG components



Environmental Example factors

- Energy efficiency
- Waste reduction
- Water management
- Physical climate risks
- Carbon transition risks
- Natural capital



Social Example factors

- Fair pay
- Equal employment opportunity
- Workplace health and safety
- Community engagement
- Human capital
- Affordable housing



Governance Example factors

- Organizational structure
- Risk management
- Ethical business practices
- Compliance management
- Financial performance
- Transparency

OCA compiled the example factors in this exhibit based on our research of ESG models.

Exhibit 2 – Moody’s Long-Term Obligation Ratings

Moody’s long-term obligation ratings are opinions of the relative credit risk of fixed-income obligations with an original maturity of one year or more. They address the possibility that a financial obligation will not be honored as promised. Such ratings reflect both the likelihood of default and any financial loss suffered in the event of default.

Aaa Obligations rated Aaa are judged to be of the highest quality, with minimal risk.

Aa Obligations rated Aa are judged to be of high quality and are subject to very low credit risk.

A Obligations rated A are considered upper-medium-grade and are subject to low credit risk.

Baa Obligations rated Baa are subject to moderate credit risk. They are considered medium-grade and as such may possess speculative characteristics.

Ba Obligations rated Ba are judged to have speculative elements and are subject to substantial credit risk.

B Obligations rated B are considered speculative and are subject to high credit risk.

Caa Obligations rated Caa are judged to be of poor standing and are subject to very high credit risk.

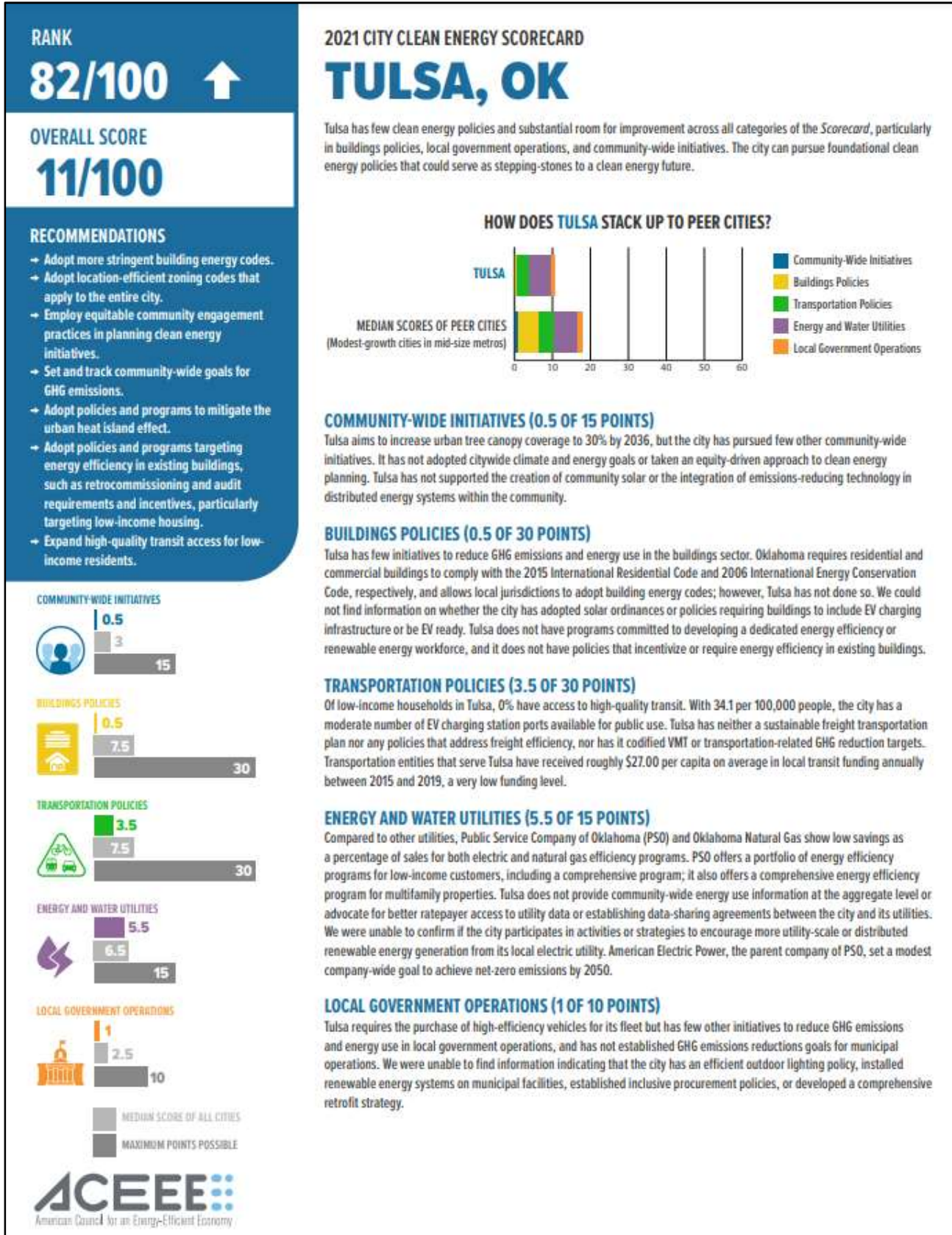
Ca Obligations rated Ca are highly speculative and are likely in, or very near, default, with some prospect of recovery in principal and interest.

C Obligations rated C are the lowest-rated class of bonds and are typically in default, with little prospect for recovery of principal and interest.

Note: Moody’s appends numerical modifiers 1, 2, and 3 to each generic rating classification from Aa through Caa. The modifier 1 indicates that the obligation ranks in the higher end of its generic rating category; the modifier 2 indicates a mid-range ranking; and the modifier 3 indicates a ranking in the lower end of that generic rating category.

Source: <https://www.moodyanalytics.com/-/media/products/Moodys-Rating-Symbols-and-Definitions.pdf>

Exhibit 3 – City of Tulsa’s 2021 Clean Energy Scorecard



Source: https://www.aceee.org/sites/default/files/pdfs/2021_CityScorecard_OnePagers/CS_2021_Tulsa.pdf