

ESG In Credit Ratings Deep Dive

Governance Factors Underpin A Rising Share Of Actions In U.S. Public Finance

This report does not constitute a rating action.

Nov. 4, 2024

This analysis reviews environmental, social, and governance (ESG)-related rating activity between April 2020 (when S&P Global Ratings began specifically tagging ESG factors in its rating actions) and September 2024 for U.S. public finance issuers. We consider ESG credit factors as those that can materially influence the creditworthiness of a rated obligor and for which we have sufficient visibility and certainty to include in our credit rating analysis. They are not assessments of entities' sustainability profile or ESG performance.

Key Takeaways

- Rating actions:** 94% of ESG-related actions across U.S. public finance from April 2020 through third-quarter 2024 were negative. Of the total rating actions in U.S. public finance during the same timeframe, 10% were ESG-related.
- ESG factors:** Health and safety-related actions accounted for 62% of total ESG-related rating actions since April 2020, largely because of COVID-19. Excluding COVID-19-driven activity, the leading factors were governance-related, accounting for 69% of ESG-related rating actions since April 2020. Concerns around risk management, culture, and oversight were the reason for more than half of these.
- Rating action severity:** ESG-related rating actions have been overwhelmingly negative. This is in stark contrast with total rating actions in U.S. public finance, where more than half were positive. Furthermore, 44% of ESG-related downgrades have been two or more notches, compared with just 20% among total downgrades in the sector.
- Physical risks:** Environmental factors--predominantly physical risks--are behind 22% of ESG-related rating actions excluding COVID-19 since April 2020. Most of this activity took place in 2021, when severe drought and extreme cold hit U.S. public finance issuers. We believe more frequent and severe physical risks and other climate hazards could lead to more environmental-related rating activity.

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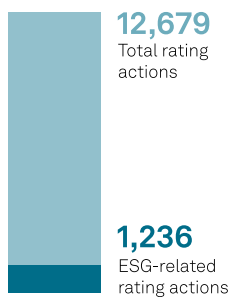
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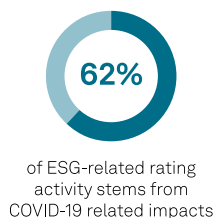
Temperature check:

Takeaways from a deep dive into U.S. public finance ESG-related rating actions

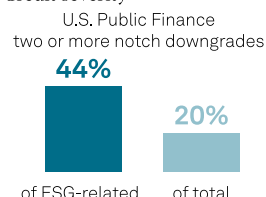
U.S. Public Finance rating activity



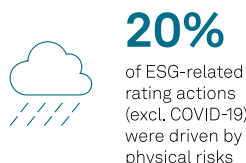
ESG-related rating activity



Credit severity



Looking ahead



By the numbers: USPF ESG-related credit rating actions

Between April 2020 and September 2024

Total ESG-related credit rating actions



1,236

Total ESG credit rating actions

70 Positive rating actions ▲
1,166 Negative rating actions ▼

Positive ESG-related credit rating actions



Key ESG dimension

39

Governance



Key factor

30

Health and safety



Key sector

43

State and local governments

Negative ESG-related credit rating actions



Key ESG dimension

782

Social



Key factor

737

Health and safety



Key sector

478

State and local governments

ESG-related rating actions are those where ESG credit factors were a key driver of the decision to change a credit rating, outlook, or CreditWatch status. S&P Global Ratings considers ESG credit factors to be those ESG factors that may influence the capacity and willingness of an issuer to meet its financial commitments. Rating actions include changes in ratings, CreditWatch placements, and outlooks, between April 1, 2020, and Sept. 30, 2024. ESG--Environmental, social, and governance. Source: S&P Global Ratings.

Key Rating Actions Trends

1. Social factors has been the primary driver, largely due to the pandemic

Approximately 10% of total rating actions across U.S. public finance were associated with ESG factors from April 2020 through September 2024.

Health and safety accounted for 62% of the ESG-related rating activity, which is no surprise given the influence of COVID-19-related risks. Of the total rating actions related to social risks, health and safety factors were cited in 94% of cases. Health and safety factors--most often cited due to COVID-19 lockdown measures and mobility limitations around the world--affected the transportation and higher education sectors most in U.S. public finance, with 96% and 92% of ESG-related rating actions, respectively.

Approximately 10% of total rating actions across U.S. public finance were associated with ESG factors since April 2020.

Chart 1

ESG-related USPF rating activity by rating category

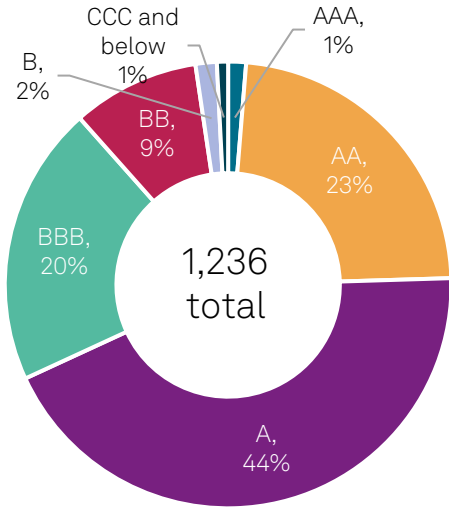
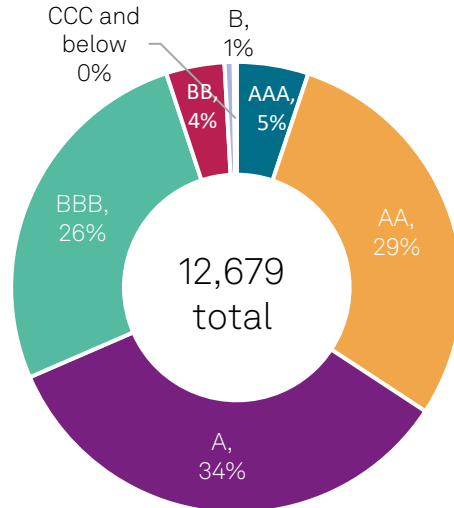


Chart 2

Overall USPF rating activity by rating category



We found that the distribution of rating actions--by rating category--for ESG-related U.S. public finance actions was largely aligned with that of overall U.S. public finance rating actions (see charts 1-2). However, 12% of ESG-related rating activity affected speculative-grade issuers, versus only 5% of total U.S. public finance rating activity.

By sector, the overall distribution of ESG-related rating actions resembles that of total actions (see charts 3-4). However, there is a smaller concentration of activity in state and local governments, the sector with most rated entities in U.S. public finance. This reflects the broad-based impact of ESG considerations on credit quality.

12% of ESG-related rating activity is on speculative-grade rated obligors, compared with 5% of total U.S. public finance rating activity.

Chart 3

State and local governments represent 42% of ESG-related rating activity

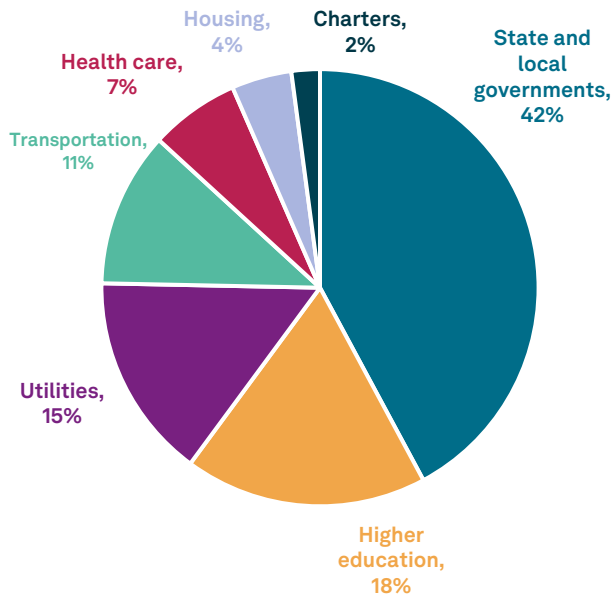
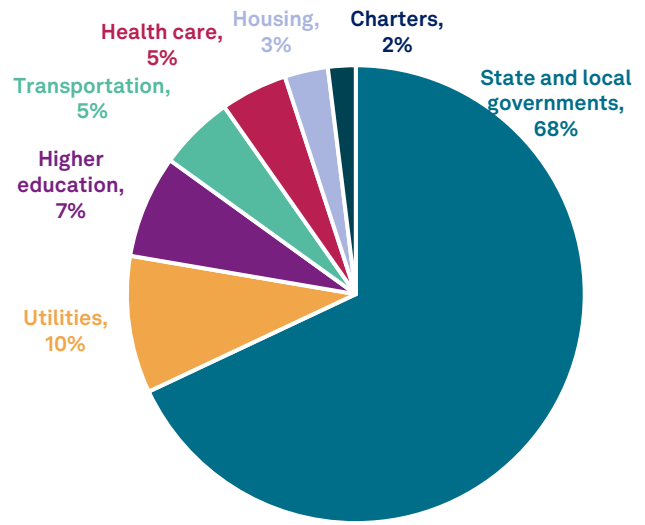


Chart 4

State and local governments represent 68% total rating activity



Data reviews rating activity between April 2020 and Sept. 30, 2024. Source: S&P Global Ratings.

2. ESG-related rating activity has been predominantly negative, with a higher proportion of severe downgrades

Chart 5

No. of notch upgrades/downgrades
ESG vs. non-ESG-related rating actions

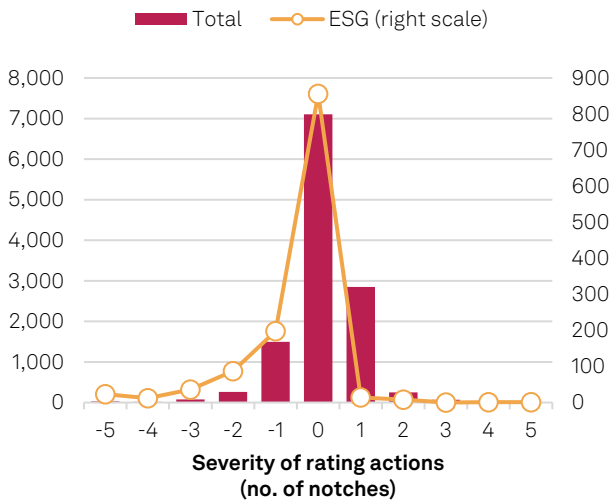
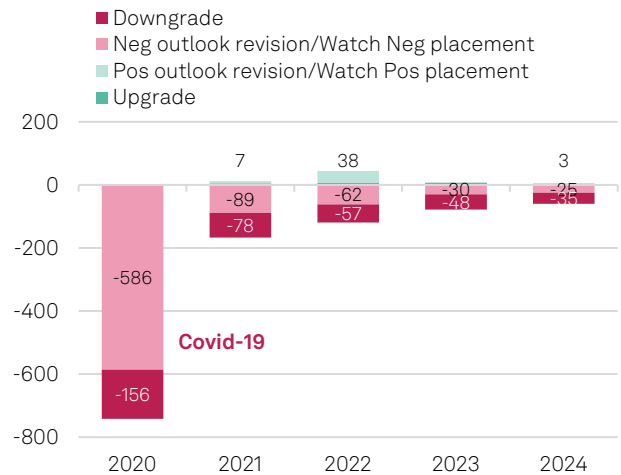


Chart 6

ESG-related rating actions by type and year



Data reviews rating activity between April 1, 2020, and Sept. 30, 2024. '0' represents rating affirmations with a positive or negative outlook revision. Source: S&P Global Ratings.

ESG-related actions in U.S. public finance have been predominantly negative (downgrades, negative outlook revisions, or CreditWatch negative placements). Looking at downgrades in particular, the distribution of ESG-related rating actions is similar to that of total U.S. public finance rating activity, albeit ESG-related actions included more severe downgrades. 44% of ESG-related U.S. public finance downgrades have been two or more notches, compared with just 20% among total U.S. public finance downgrades.

While negative rating actions influenced by ESG factors dropped significantly in 2021 from the prior year as the impact of the pandemic receded, the corresponding rebound in positive activity from 2021 onward has been limited. This contrasts with total U.S. public finance rating activity, which turned net positive in 2022 and remained so through September 2024.

Furthermore, while one-notch upgrades are more prevalent than downgrades among total U.S. public finance rating actions, there are very few ESG-related upgrades.

Even when excluding COVID-19-related rating activity (i.e., removing health and safety-related actions), 91% of ESG-related rating actions were negative. Governance is the only dimension with a noticeable share of positive rating actions, at 12%, while nearly all rating actions stemming from environmental or social considerations were negative.

There are very few ESG-related upgrades, illustrating the net negative impact of ESG considerations on rating actions.

Chart 7

No. of notch upgrades/downgrades by E, S, and G

Total ESG-related rating actions

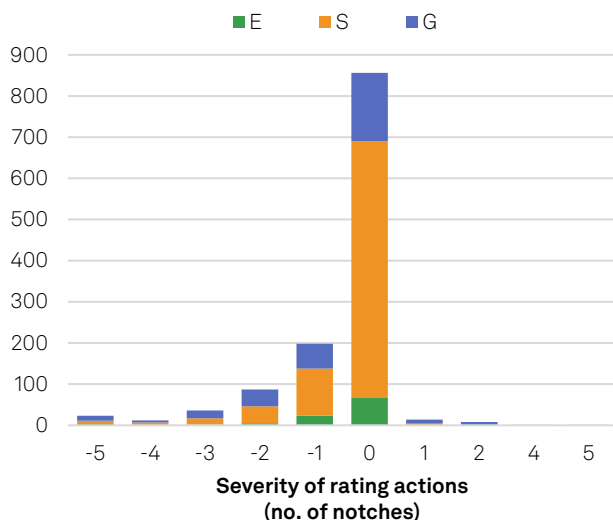
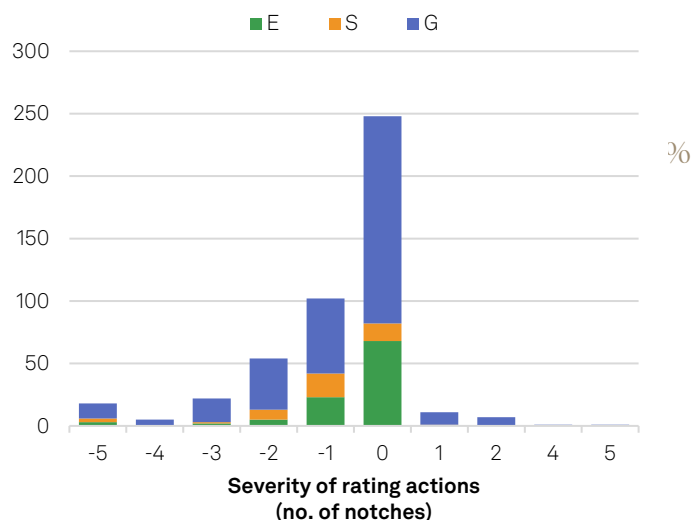


Chart 8

No. of notch upgrades/downgrades by E, S, and G

Excluding COVID-19



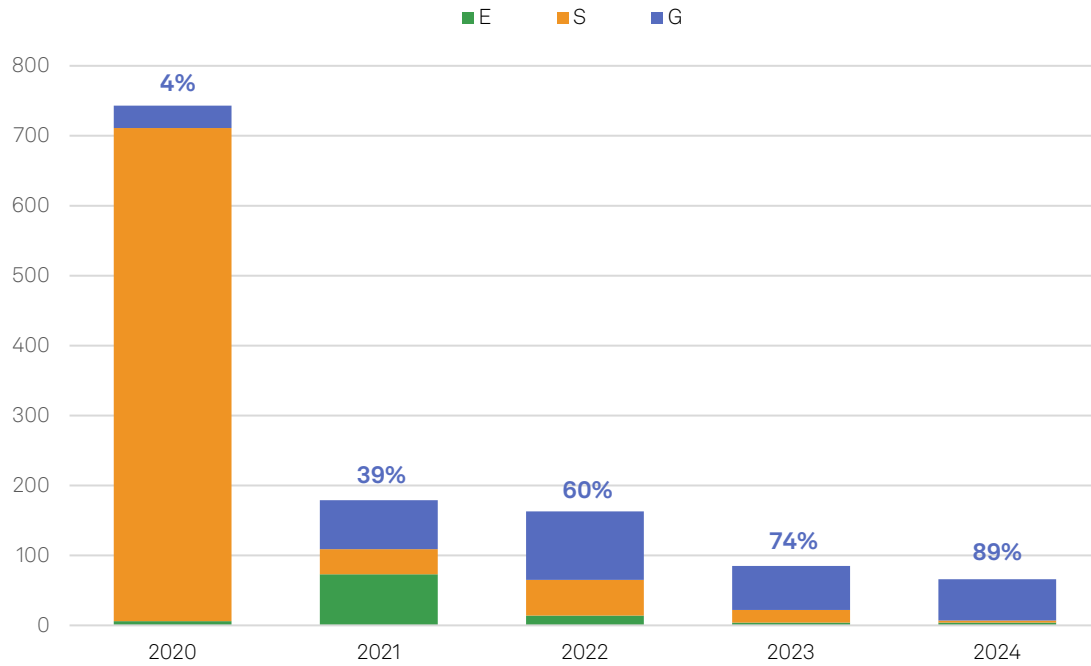
Data reviews rating activity between April 2020 and Sept. 30, 2024. '0' indicates a positive or negative outlook revision. Source: S&P Global Ratings.

3. Governance factors dominate ESG-related rating actions in U.S. public finance

Governance factors accounted for nearly 69% of ESG-related rating actions between April 2020 and September 2024, when isolating the impact from COVID-19. By comparison, 22% of rating actions were influenced by environmental factors, and 10% by social factors. The number of environmental rating actions peaked in 2021, accounting for 41% of ESG-related rating actions in that year. Physical risks were a major cause of ESG-related rating activity in 2021 as a result of drought and extreme cold. Acute climate hazard events have had less of an impact on U.S. public finance issuers since then, and the share of environmental factors declined while that of governance factors increased.

Chart 9

Following the pandemic, governance factors have become the leading ESG driver



Data reviews rating activity between April 1, 2020, and Sept. 30, 2024, 2023. Source: S&P Global Ratings.

Chart 10

ESG-related rating actions by factor and year

Excluding COVID-19

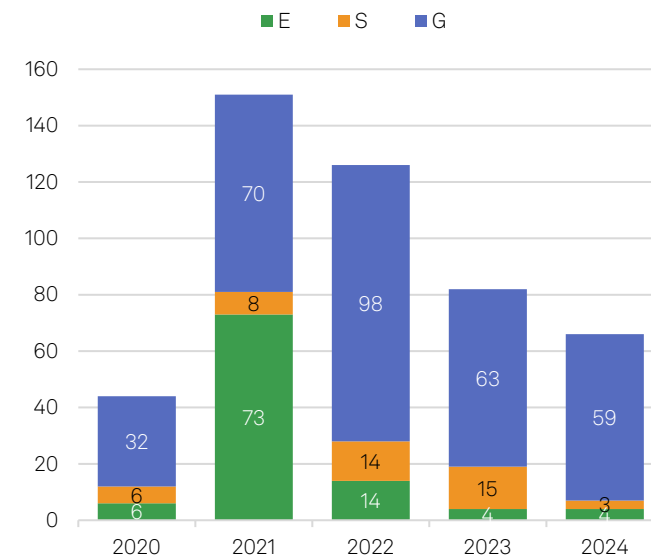
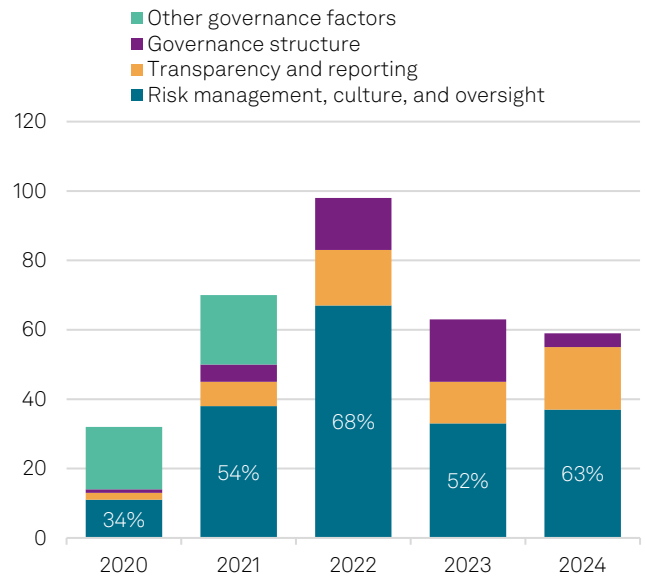


Chart 11

Governance rating activity by year and governance factor



Data reviews rating activity between April 1, 2020, and Sept. 30, 2024. Source: S&P Global Ratings.

Given the recent trends (see charts 9-11), we expect that governance factors will remain the main driver of rating actions, followed by environmental.

4. State and local governments and utilities are the most affected sectors

For the transportation, higher education, and health care sectors, social factors have accounted for the largest proportion of each sector's total ESG-related rating actions, mainly owing to health and safety concerns linked to the pandemic (see chart 12). Utilities were most affected by environmental factors (notably physical risks), accounting for 46% of the sector's ESG-related rating actions between April 2020 and September 2024 (see chart 13).

Utilities were most affected by environmental factors, accounting for 46% of the sector's ESG-related rating actions.

Chart 12

Health and safety lead factors in all sectors but utilities and housing

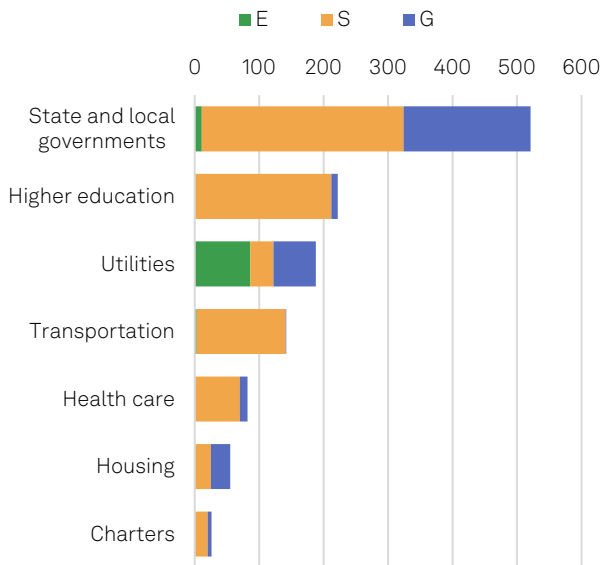
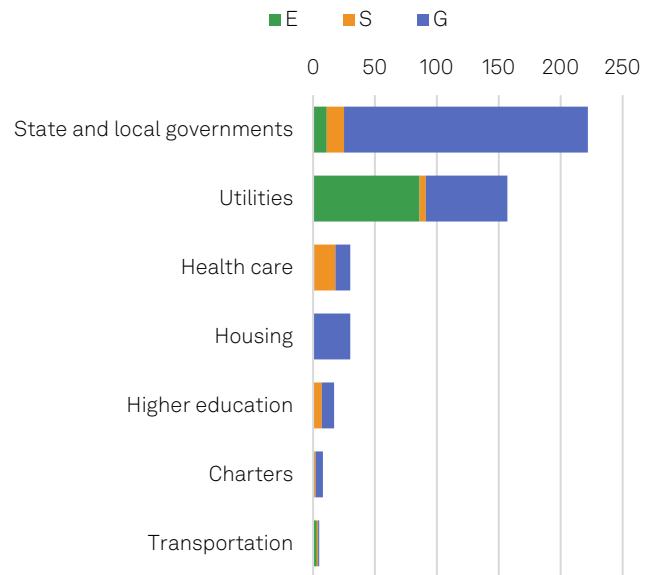


Chart 13

Utilities were most affected by environmental factors

Excluding COVID-19



Data reviews rating activity between April 1, 2020, and Sept. 30, 2024. Source: S&P Global Ratings.

In Comparison

5. How ESG-related rating actions in U.S. public finance and global corporate and infrastructure compare

While governance factors lead ESG-related rating actions (excluding COVID-19) for both U.S. public finance and global corporates and infrastructure, the share is more pronounced in U.S. public finance (see chart 14). In turn, environmental factors drove a significantly higher proportion of ESG-related rating actions among global corporate and infrastructure issuers. Looking at the type of rating actions, less than 6% of ESG-related rating actions in U.S. public finance were positive (upgrades, positive outlooks, or CreditWatch placements). Among ESG-related rating actions on global corporates and infrastructure issuers, this share is 24% (see chart 15).

Less than 6% of ESG-related rating actions were positive in U.S. public finance, compared with nearly 24% among global corporate and infrastructure sectors.

Chart 14

Governance factors led ESG-related rating actions in both U.S. public finance and global corporates and infrastructure

Excluding COVID-19

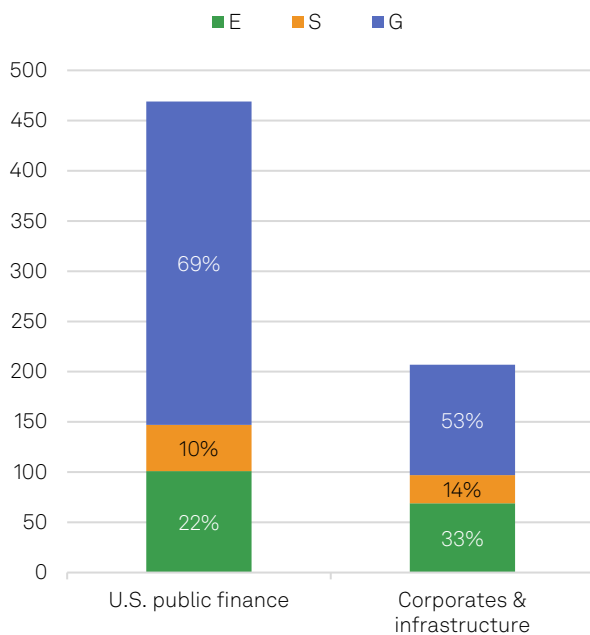
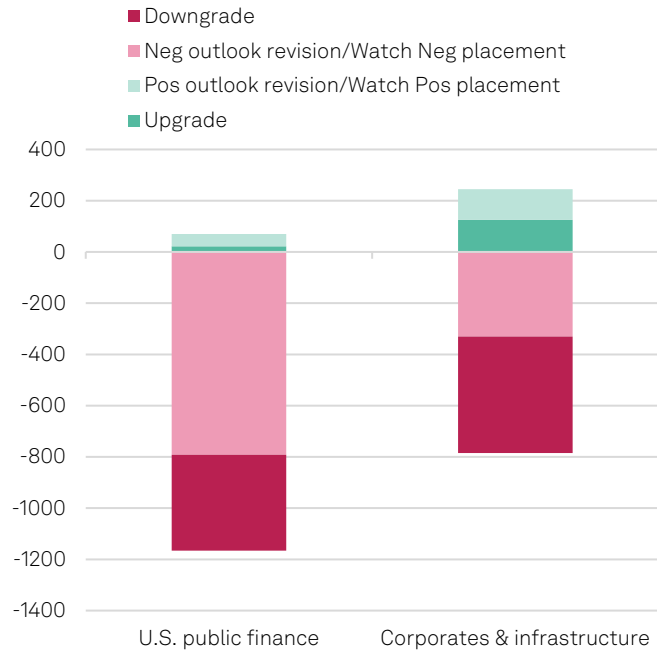


Chart 15

The share of positive ESG-related rating actions in global corporate and infrastructure is nearly four times that in U.S. public finance



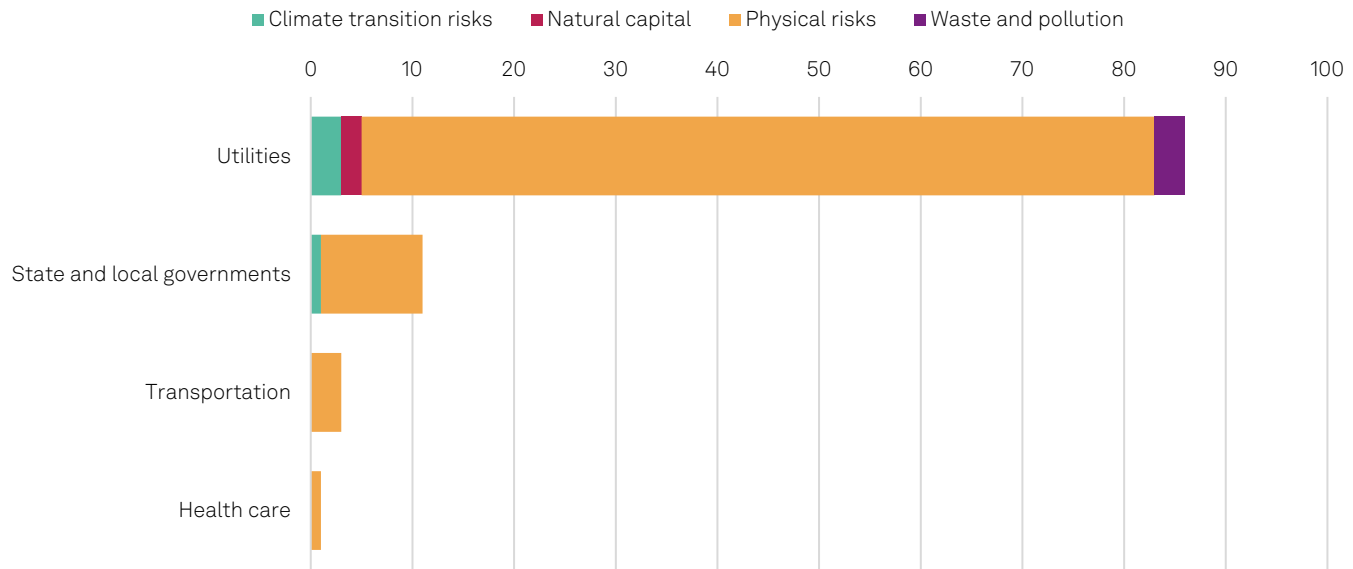
Data reviews rating activity between April 1, 2020, and Sept. 30, 2024. Source: S&P Global Ratings.

Looking Ahead

6. Environmental factors may become more prominent

Chart 16

Physical risks influenced 20% of ESG-related rating actions excluding COVID-19



Data reviews rating activity between April 1, 2020, and Sept. 30, 2024. Source: S&P Global Ratings.

Chart 17

After peaking in 2021, utilities remain the key sector affected by environmental-related actions

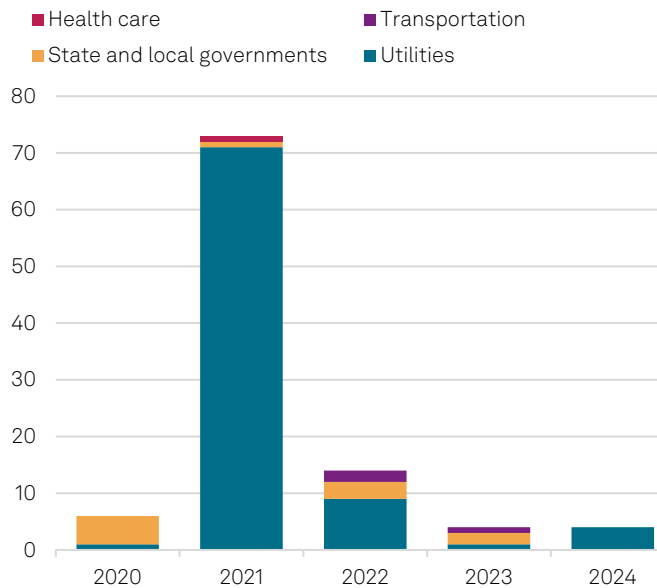
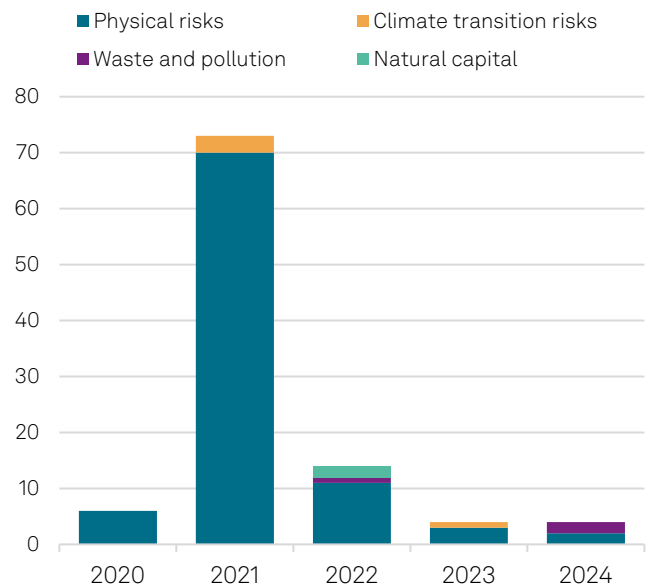


Chart 18

Physical risks dominate environmental-related actions



Data reviews rating activity between April 1, 2020, and Sept. 30, 2024. Source: S&P Global Ratings.

The impact of physical risks on rating activity was most important in 2021, reflecting the impact of climate hazards on U.S. public finance issuers--especially from the utilities sector. In spring 2021, a winter storm hit public power and electric cooperative not-for-profit utilities in Texas. In October, a severe drought in the western U.S. put pressure on the credit quality of waterworks, sanitary sewer, and drainage utility systems of municipalities and political subdivisions.

More recently, hurricanes Helene and Milton caused substantial inland damage in September 2024. In S&P Global Ratings' view, a shift to inland damage from where the storms make landfall could require greater storm preparedness in such areas, adding to the region's need for storm hardening. Although federal and state disaster relief funds may partly offset the expenditures, costs for infrastructure investments could require additional debt and pressure issuers' fixed costs. Furthermore, where damage to infrastructure and core services is catastrophic, or where property insurance becomes unaffordable or unavailable, some entities could see lasting declines in population and economic activity that hurt revenue generation.

Physical risk events might increase as climate change continues to have an impact, reflected in the number of environment-related rating actions.

Related Research

- [ESG In Credit Ratings Q3 2024: Negative Actions Outweigh Positive By Four To One](#), Oct. 21, 2024
- [Hurricanes Helene And Milton Add To U.S. Public Finance Issuers' Climate And Financial Challenges](#), Oct. 15, 2024
- [ESG In Credit Ratings Q2 2024: Governance Factors Drive Quarter's ESG-Related Rating Actions](#), July 18, 2024
- [Sustainability Insights Research: Navigating Uncertainty: U.S. Governments And Physical Climate Risks](#), April 23, 2024
- [ESG In Credit Ratings Deep Dive: ESG Factors Drove 13% Of Corporate And Infrastructure Rating Actions Since 2020](#), March 13, 2024
- [North American Wildfire Risks Could Spark Rating Pressure For Governments And Power Utilities, Absent Planning And Preparation](#), Nov. 29, 2023

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