Climate Leadership in Action

Green Bonds Learning from action

At a Glance

- A Green Bond is a financial instrument that helps support climate-related projects. All proceeds of the bonds are set aside in a designated account for investing in renewable energy, energy efficiency and other climate-smart projects in developing countries.
- Green Bonds provide investors with access to green investments that are portfolio-friendly in large, well-understood capital markets and provide issuers with access to new sources of capital.
- At Davos in January the World Bank President called for a doubling of the market by the Summit. The market has responded - as of early September US$24 billion in Green Bonds has been issued in 2014, more than double 2013's record US$11.4 billion.

THE CHALLENGE

Green Bonds have been an important first step in linking climate funding needs directly to capital markets.

The US$80 trillion global bond market is familiar to institutional investors. Bonds are used for a variety of purposes by issuers ranging from federal and sovereigns to municipal and corporate; from project developers to financial asset managers. Green Bonds have successfully created a first bridge between the investment community's day to day activity and the climate investment sector.

This year has shown remarkable growth with more than US$35 billion of Green Bonds currently outstanding in the market. More Green Bonds were issued in the 12 months to June 2014 than in the eight years since the concept first emerged with EIB's climate awareness bond and IBRD's green bond in 2007/8.

There is strong demand from investors for green/climate investments which are appropriately structured. Green Bond issues this year routinely have been scaled up due to demand and/or oversubscribed by factors of two or three.

A functioning market requires scale and diversity.

The largest (> US$1 billion) Green Bonds such as those from EDF, IFC, IBRD and EIB create benchmarks necessary to creating liquid markets. Green Bonds, which in 2014 have been issued in 12 different currencies and with credit profiles ranging from AAA to BBB, offer diversity to investors. The largest issue to date was a €2.5 billion offering in May 2014 by French electric utility company GDF Suez, which was three times oversubscribed.

Public authorities ranging from the cities of Gothenburg and Johannesburg to the states of New York and Massachusetts have made important steps in issuances of Green Bonds by the public sector. These have generally been smaller (<US$200 million) but innovative in their character – for example, Washington DC had the first "century green bond" (100 years tenor).

The funds raised are supporting a wide variety of climate activities.

Green Bonds are attractive to a wide variety of companies that use the funds for diverse activities:

- Energy-efficient plants from consumer goods company Unilever and utility GDF Suez
- Climate-friendly buildings for property developers like Vasakronan and construction companies like Skanska
- Financing greener cash flows for Toyota with their energy-efficient cars

Funds from Green Bonds are leveraging additional sector capital. Export Development Canada used the proceeds of its Green Bond in financing Europe's largest offshore renewables project earlier this year. All of the Multilateral Development Banks attract multiples of the funds they deploy themselves to their project portfolios.

As Green Bonds evolve, there is increasing need for issuers to quantify and monitor the commitment that issuers are making. The ability to compile such information appropriately for investment purposes is growing and being refined both within the issuers and in the investors and their service providers.

Moving Forward

The Green Bond market is young and very promising but to sustain it activity is required on several fronts:

Maintaining the simplicity of concept in the short to medium term.

An important attraction for first-time Green Bond issuers and investors is the simplicity of taking a well-known product and refining it for this purpose. As issuers put the systems in place, repeated and more tailored issuances will follow.

It is likely that issuers who are already proven entities and can demonstrate suitable pipelines of investments at scale will continue to be the dominant issuers in the immediate future. This is a large group ranging from federal authorizes to cities, from corporations to MDBs and local and regional development entities.

Some more complex Green Bonds - project bonds such as TDA's bond and Hannon Armstrong's asset backed bond – have begun to appear. MDB and private sector entities are looking at credit supporting structures such as guarantees. As the track record of performance of green investments grows, more complex issuances can be expected.

Maintaining integrity of "green"

Investors want the flexibility to choose the type of Green Bond that meets the needs of their own stakeholders. While they want to be sure there is transparency, clarity and monitoring of the use of the funds, they also want to have flexibility to move within those parameters.

The technical community is working to provide expertise to the necessary frameworks focusing on transparency for diverse investment opportunities with input from issuers, arrangers, investors and the technical community:

- MDB are looking to harmonize metrics and develop reporting models;
- Initiatives such as those Climate Bonds Initiative and its partners are looking into the potential for standards;
- Investment advisers, auditors and an expanding group of technical verification entities such as CICERO, DNV and Vigeo are providing a range of specialist services to issuers and investors.

As issuers, investors and service providers build their systems for Green Bonds, they are integrating the measurement and monitoring systems that can be applied to other types of green investments.

Supporting new entrants to the bond markets

Bond markets are not uniformly developed, even in OECD countries.

Participants in both the public and private sectors are looking at credit enhancement products such as guarantees to support access to the bond markets.

Initiatives such as the City Creditworthiness Academy program led by the World Bank Group to develop local markets and enhance access to international markets will play an important role in expanding Green Bond deployment and access for corporations, municipalities and sovereigns.

Examples of Leadership

The MDBs provided a strong foundation for Green Bonds, paving the way for corporates which will primarily take the lead in the future. So far the World Bank has issued more than US$6.4 billion equivalent in Green Bonds, the IFC has issued US$3.7 billion, the EIB €4.3 billion and AfDB US$1.3 billion.

Investors want to be confident on how the proceeds of the Green Bonds will be used and a high level of credibility is crucial for the green market to grow and make a difference over time. To address this challenge, the financial industry in January launched the Green Bond Principles, in consultation with the World Bank Group. They have the support of major financial institutions including Bank of America, Merrill Lynch, JP Morgan, Credit Agricole and Citibank.

The Principles are voluntary guidelines that recommend transparency and disclosure and promote integrity in the development of the market by clarifying the approach for issuance of a Green Bond. More than 50 entities ranging from market participants to observers have joined.

References and suggested reading

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