PARTNER CONTENT

Demand soars for new green bonds

As more investors seek to deploy sustainable capital, National Australia Bank says green bond issuers are being offered a golden opportunity

John Barry head of capital financing, Asia, Corporate & Institutional Banking

With international governments and business leaders focused on climate change, the financial sector has an important role to play in supporting the transition to a low-carbon economy. One of the ways the capital markets can embrace the challenge is through impact investment, and more specifically, the evolution of the green bond market.

Recent green bond transactions show the sophistication and size of the market is expanding rapidly as issuers tap into the strong appetite investors have for socially responsible assets. Oversubscription levels have been high as investors around the globe look to decarbonise their portfolios.

"The attractiveness and potential of green bonds is really starting to be recognised," said John Barry, head of capital financing Asia at National Australia Bank, a thought-leader in the impact investment space. "NAB is naturally excited to leverage and extend its position as Australia's leading financier of renewable energy, arranger of green bonds and securitisation house."

The latest figures from Bloomberg New Energy Finance ("BNEF") show $95.1bn of labelled green bonds were issued in 2016, up 100% from 2015 volumes, and bringing the total cumulative issuance of labelled green bonds to more than $215 billion since 2007. Of this 2016 issuance, use of proceeds were split more equally between sectors including 38% to energy, 18% to buildings and industry, 16% to transport, 14% to water, 6% to adaptation, 6% to waste management and 2% to agriculture and forestry according to the Climate Bonds Initiative.

"In 2016 financials were the largest issuers of green bonds for the first time, followed by corporations and then supranational, sovereign and agency issuers (SSAs). The predominant currencies are US dollars, euros and increasingly CNY," said Barry. "Looking at Asia for example, government agencies and state-owned entities in countries such as China, India and Korea are active market participants, along with some development banks and international financial institutions."

One of the latest issuers to tap the market is the International Finance Corporation (IFC) which raised $152 million from an innovative forestry bond in November 2016. The bond allows investors to be paid in cash or in carbon credits generated by the Kasigau Corridor project in East Kenya, or a combination of the two. BHP Billiton will provide a liquidity support mechanism, which will see it buy the carbon credits from IFC should investors opt to be paid in cash.

"Issuers are really starting to think outside the box in terms of how they can structure deals and which assets they should seek to finance via green bonds," said Barry, pointing to another recent deal for Bank of China which issued the country's first ever covered green bond on the London Stock Exchange in November.

"This is a rapidly evolving market. Every day there is a new announcement," said Barry.

In December, Poland became the first sovereign to issue a green bond. France quickly followed with the world's largest ever green bond issuance in January 2017, a EUR7 billion bond which attracted over EUR 23billion of bids. Other countries such as Nigeria, Japan, China, Canada, Kenya, Morocco and Sweden are expected to follow in the medium-term.

> **"Issuers are really starting to think outside the box"**
> –John Barry, NAB

AUSTRALIA'S IMPORTANT ROLE

In Australia, the domestic green bond market has grown from A$600 million issued in 2014, to A$1.2 billion in 2015, and A$905 million in 2016. (The 2016 figures exclude Monash University's A$218 million green bond, which was sold in the US private placement market.)

NAB has been developing the Australian green bond market since 2011 and became the first bank to issue a Climate Bonds Standard certified green bond globally and the first domestic green bond issuer when it completed a A$300 million bond in December 2014.

Since then NAB has arranged three other landmark deals for clients, including the A$205 million first USPP green bond for refinancing of Hallett Hill 2 windfarm, a world-first Climate Bonds Standard certified securitised green bond for Flexigroup, and a A$300 million Climate Bonds Standard certified green bond for the Treasury Corporation of Victoria (TCV) to be used for financing renewable energy, water treatment, and low carbon buildings and public transport.

David Jenkins director, investment grade originations, Corporate & Institutional Banking

"Each of these transactions has set a precedent in terms of bringing first-time issuers to market, promoting innovative deal structures or tapping into a new investor base," said David Jenkins, director of investment grade origination at NAB in Sydney.

The TCV deal could set a template for other bonds from state governments, after proving a hit with investors.

"The bonds were offered to investors with the confidence of a AAA-rated security," said Jenkins, who added that a number of other state governments in Australia are expected to follow Victoria's lead.

"Investors liked the idea that the Victorian government had identified a series of assets and infrastructure projects with green credentials and decided to earmark them as part of a low carbon, green bond eligible portfolio. This type of transaction, where an existing and future green bond eligible portfolio is earmarked for green bond financing, has a lot of potential."

The Flexigroup deal, which was awarded FinanceAsia's Best Debt Finance Deal in 2016, was novel in that it comprised a A$50 million green bond tranche within a A$260 million general asset-backed deal. The proceeds of the Climate Bonds Standard certified green tranche were linked to the funding of solar PV systems used on residential buildings, and the strong investor appetite for the green bond tranche meant that Flexigroup benefitted from price differentiation for the green tranche.

DEMAND/SUPPLY IMBALANCE

One of the major constraints hindering the development of the green bond market is the lack of supply. Many potential issuers remain hesitant about taking the leap, partly because the traditional bond markets are flush with liquidity, and partly due to the perception that issuing a green bond is time-consuming and costly.

Jenkins expects more issuers will be drawn to the market as it becomes price competitive. "At the moment green bonds price in line with straight bonds, but over time we expect this to change and turn into a pricing advantage, particularly as the market matures and liquidity improves."

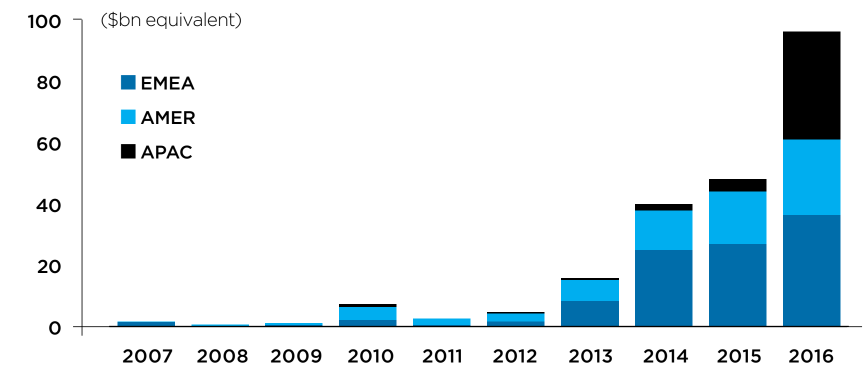
He adds that the steps involved in preparing a green bond have become more streamlined and the costs reduced.

When NAB talks to issuers about how to prepare a green bond, the bank breaks it down into five steps. "First you have to identify potential green bond eligible projects and assets within your business or portfolio and then develop a green bond framework that can be communicated to investors," he said.

The third step is to appoint a verification agent and then implement any additional reporting required to meet green bond certification. "Finally there is an audit process to ensure that the assets comply with recognised green bond standards or guidelines such as the Climate Bonds Standard or Green Bond Principles," he said.

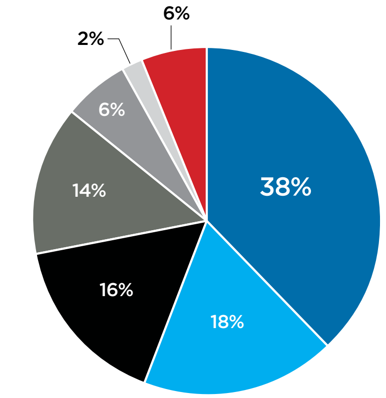
There is still no universal market standard to define green bonds and some have criticised the industry for promoting 'greenwashed' products. "Not all green bond issuers around the globe have sought third-party verification or been transparent around the use of proceeds," said Jenkins. ■

GREEN BOND ISSUANCE BY REGION



Source: Bloomberg New Energy Finance

GREEN BONDS USE OF PROCEEDS 2016



Energy
Building & industry
Transport
Water
Waste management
Agriculture & Forestry
Adaptation

Source: Climate Bond Initiative

A DEBT TO SOCIETY

The International Energy Agency estimates that an investment of $53 trillion will be needed to limit global warming to the two degree target set at the Paris accord in 2015. By comparison, the global bond market is currently worth about $90 trillion, suggesting it will be an essential tool in ensuring a sustainable future.

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