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DCM Watch

What does it mean to be green?

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As an Australian green bond market develops, the key challenge will be creating enough standardisation to evaluate "green value" to enable comparative pricing and promote real liquidity. With the release of the latest International Capital Market Association Green Bond Principles we may finally have a framework for commoditisation.

Climate Bond Volumes

GLOBAL	AUSTRALIA	GLOBAL	AUSTRALIA
2014	2014	Q1 2015	Q1 2015
US$ 36.6 BILLION	AU$ 870 MILLION	US$ 7.2 BILLION	AU$ 807 MILLION
73 ISSUERS	3 DEALS	44 DEALS	2 DEALS

Over 2014 a new market emerged in the Australian fixed income universe – green bonds. The product has long flourished offshore, in response to the emergence of socially responsible investment (SRI) mandates. However a key and ongoing issue has always been how to determine the 'green value' of securities that fund very different projects and initiatives and how to create a standardised approach to 'green value' that gives the market true integrity.

Australian issuers and investors will now be part of this vital conversation.

With some A$870 million equivalent issued over the course of the year following the World Bank's debut $300 million green Kangaroo bond, it's fair to say it was a year of rapid maturity for the green bond market Down Under. Even more interesting was the range of issuers – a multi-lateral development bank (World Bank), a domestic financial institution (National Australia Bank) and a corporate (Stockland).

Each had different documentation – World Bank issued a Kangaroo bond, National Australia Bank a $300 million seven-year vanilla bond and Stockland a EUR300 million Euro medium term note to be listed on the Singapore Stock Exchange.

Fresh momentum

It's clear that 2014 wasn't a one-off; we're already building on the momentum and diversity of this nascent market. In 2015 $806 million equivalent had already been issued in the year to 30 April. And once again, the two deals that have come to market have been very different.

Hallett Hill No.2 Wind Farm owned by Infrastructure Capital Group (ICG)'s Energy Infrastructure Trust (EIT), priced the first-ever green bond in the US private placement (USPP) market in the third week of March – a dual tranche US$98.8/A$76.0 million 12-year transaction.

German agency KfW Bankengruppe issued the largest Australian dollar green bond to date – a $600 million Kangaroo that priced in March. The size of this deal and the ease with which it was priced really demonstrates the growing maturity of this market.

While the buying base has typically been domestic, there has been international investor participation. KfW's transaction had a large international investor base, with 36 per cent. of the deal sold onshore in Australia.

Growing investor interest

The potential of the market is still an unknown, however, there's certainly a growing need for assets that will appeal to SRI mandates. According to the Responsible Investment Association Australasia's 2014 Benchmark Report, responsible investment assets managed by asset managers, super funds, banks and advisers continued to grow strongly due both to strong performance and increasing fund inflows.

Investments in core ethical, socially responsible, impact investments, community finance and sustainability themed investments grew in Australia by 51 per cent. year on year to just over $25 billion in assets under management (AUM) as at 31 December 2013. Investment in broad responsible investment – which integrates environmental, social and governance practices across investments in Australia and New Zealand – have grown by 13 per cent. year on year to $153 billion in AUM.

What's even more interesting is the already diversifying nature of the green bond investor base. While generally touted as an investment for pure SRI investors, the larger deal size of the KfW deal attracted a broader mix of SRI and other non-SRI investors.

Sticking to the principles

As issuers look to build liquidity in their bonds and assess the potential size of this market, a key issue will be the ability to benchmark comparable deals in terms of their "greenness". The global green bond market has struggled with a lack of standardisation to determine this value, with different views emerging about what constitutes a green bond.

In response to this, the International Capital Markets Association (ICMA) has issued a set of Green Bond Principles as voluntary process guidelines for issuing green bonds. The purpose, says ICMA, is to promote the integrity of the market and increase capital allocation to the market.

"They (the Green Bond Principles) provide issuers guidance on the key components involved in launching a credible green bond; they aid investors by promoting availability of information necessary to evaluate the environmental impact of their green bond investments; and they assist underwriters by moving the market towards standard disclosures which will facilitate transactions," says ICMA.

In March 2015 ICMA updated the guidelines to emphasise transparency and accuracy around the environmentally sustainable information to be disclosed by issuers and released four guiding principles:

- **Use of proceeds:** the utilisation of proceeds should be appropriately described in legal documentation. All designated green project categories should provide clear environmentally sustainable benefits that will be quantified or assessed by the issuer.
- **Process for project evaluation and selection:** the issuer should outline the decision-making process it follows to determine eligibility, including:
  - A process to determine how projects fit within the eligible green projects categories;
  - Criteria that makes projects eligible for using green bond proceeds; and
  - Environmental sustainability objectives.
- **Management of proceeds:** proceeds to be credited to a sub-account and attested to by a formal internal process that will be linked to the issuer's lending and investment operations for green projects. Balance of proceeds should periodically be reduced by amounts matching eligible green investments or loan disbursements. Use of an auditor to verify tracking and allocation of funds is encouraged.
- **Reporting:** issue should provide at least annually a list of projects to which green bond funds are allocated, including a project description, amounts disbursed and expected environmentally sustainable impact. Use of qualitative performance indicators is encouraged, as is quantitative performance measures of expected sustainability impacts, where possible.

The principles are voluntary, but they do create a basis for standardisation that could help stimulate even more growth in this market.

Ashurst advised the Clean Energy Finance Corporation as the cornerstone investor to National Australia Bank's $300 million seven-year green bond, the first such bond issued by an Australian company in the Australian market.

For more information about green bonds, please contact us.

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