Going green for the right reasons

Wealth Management

Over the past decade, cumulative global issuance of green bonds totaled approximately $1.1 trillion, with $311 billion alone in 2020, according to S&P Global Market Intelligence. Consensus market opinion is that increasing investor demand for socially responsible investments will mean the green bond market will likely continue to widen by issuer type and geography going forward.

What makes a bond green?

The cornerstone of a green bond is the use of its proceeds. According to the International Capital Market Association Green Bond Principles (GBP), there are four components with which eligible green projects must be aligned:

1. **Use of proceeds.** All designated green projects should provide clear environmental benefits, which will be assessed and—where feasible—quantified by the issuer.
2. **Process for project evaluation and selection.** The issuer should clearly communicate to investors the environmental sustainability objectives, how the project fits within eligible green project categories, and related eligibility criteria, including any possible exclusion issues associated with the project.
3. **Management of proceeds.** As long as the green bond is outstanding, the GBP encourage a high level of transparency by the issuer in tracking and verification on the allocation of issue proceeds.
4. **Reporting.** Issuers are expected to be able to make readily available up-to-date information on the use of the proceeds.

The following broad categories represent some of the most commonly used types of projects represented in the green bond market:

- Renewable energy
- Energy efficiency (including efficient buildings)
- Sustainable waste management
- Sustainable land use
- Biodiversity conservation
- Clean transportation
- Clean water and/or drinking water

The GBP represent voluntary guidelines, intended for broad use by the market, which are designed to aid in the continued development of the green bond market. These principles are designed to be beneficial to all stakeholders, including issuers, underwriters, and investors. According to RBC Capital Markets, the adoption of responsible investing principles continues to grow amongst institutional investors. Responsible investing is increasingly considered to be a fiduciary responsibility, which helps drive the demand for green bonds.

Where's the issuance?

According to the Climate Bond Initiative, since 2007, several supranationals, federal and local government agencies, commercial banks and private corporations have issued green bonds.

As of November 2020, 22 national governments had issued sovereign green social and/or sustainable bonds totaling $96 billion, and at least 14 other sovereign governments have indicated their intention to issue GSS bonds, according to the Climate Bonds Initiative.

Consensus opinion is that going forward, growing issuer diversity should provide more choices for investors and diversification opportunities for portfolios.

Municipal bonds are relative newcomers to the space, and since the Commonwealth of Massachusetts issued the first muni green bond in 2013, many participants in the $3.9 trillion municipal bond market have recognized the opportunities with green bonds.

According to the Climate Bond Initiative, for the past decade, 175 U.S. municipalities had issued $66 billion in green bonds. The top municipal sector was mass transportation

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which accounted for 34% of total green issuance, followed by water and sewer utilities at 17%, and primary and secondary education at 9%.

In August 2018, California became the first state to pledge to use green financing to combat climate change, according to S&P Global Market Intelligence. A Climate Bond Initiative (CBI) study indicates there is “significant potential for green bond issuance from states already ahead in the market, but also from underrepresented ones, such as Ohio, Colorado, Texas.”[1]

Additionally, the CBI has conducted a scoping exercise and identified approximately $250 billion of outstanding bonds from specialized U.S. municipal issuers, which are climate-aligned, but not labeled green.

The Fixed Income Strategies Group has a companion piece to this brief titled Municipal bonds and impact investing, in which we state our belief there are abundant municipal debt financings that could be labeled green, with the biggest opportunities in the water and sewer and transportation sectors. Furthermore, the likely continued growth in municipal green bonds should, in our opinion, provide additional investment opportunities for the environmental, social and governance (ESG) community to branch into the municipal market. In turn, as they consider opportunities in the municipal bond sector, ESG investors should benefit from asset diversification, high-quality credit characteristics and historically low default rates when compared to most corporate debt.

1 https://www.climatebonds.net/files/reports/us_muni_climate-aligned_bonds_11-07-2018.pdf

Bond investors should carefully consider risks such as interest rate risk, credit risk and market risk, including the possible loss of principal.

Due diligence processes do not assure a profit or protect against loss. Like any type of investing, ESG investing involves risks, including possible loss of principal.

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