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Green Bonds: emergence of the Australian and Asian markets

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The global market for Green Bonds continues to grow steadily, driven by strong investor demand and the continual need for capital to finance 'green' projects.

In this article, Partner **James Darcy** and Lawyer **Tristan Kelly** explore recent developments in the global Green Bond marketplace, including improvements in standards frameworks, the continued emergence of the Australian market. In addition, Partner **Jeremy Webb** and Solicitor **Jon Horan** of alliance partner Linklaters provide their thoughts on the development of the broader Asian Green Bond market.

Summary

- The global market for Green Bonds continues to develop strongly, led by Europe and driven by investor mandates to invest in environmentally and socially friendly products, with some investors publically committing to build multi-euro billion Green Bond portfolios.
- The incremental development of clearly measurable, robust standards against which Green Bonds can be verified (such as the revised versions of the Climate Bonds Standard and the Green Bonds Principles discussed below) supports the ongoing growth of the market, both for issuers and investors.
- The Green Bonds Principles have been updated to include a high level definition of Green Bonds and expands the coverage of eligible projects, while the revised Climate Bonds Standard includes an updated assurance framework and has codified the Green Bond Principles into a set of requirements which can be independently certified.
- We are seeing the Australian Green Bond market continuing to develop, with A$ issuances by two of the big four banks, and issuances by Australian corporates in the EMTN and USPP markets.
- Demand for Australian Green Bonds will be driven by investor mandates, tapping a sub-section of the large superannuation pool managed by Australian funds.
- The broader Asian market for Green Bonds is also developing with several issuers across the region this year, and has the potential to unlock significant amounts of capital to be utilised for 'green' investments. In particular, issuers from China, including the large PRC banks and State Owned Enterprises (***SOEs***) are expected to drive future green bond growth.

What are Green Bonds

Green Bonds represent a relatively new segment of debt capital markets aimed at connecting private-sector funding with 'green' projects that are set up to deliver positive environmental or social benefits.

'Green' projects supported through the issuance of Green Bonds typically include projects related to clean water, renewable energy, energy efficiency, development of waste management systems, food security, flood prevention or forest management – in essence, mitigation of climate change.

Green Bonds are generally issued off existing issuer platforms, with fairly vanilla terms which are assessed by investors against a variety of criteria, including the evolving standards described in 'Green Bonds Standards development' below.

To assist with standardising the Green Bond markets, the revised Green Bond Principles have adopted the following high-level definition:

> *Green Bonds are any type of bond instruments where the proceeds will be exclusively applied to finance or re-finance in part or in full new and/or existing eligible Green Projects and which follows the 4 Green Bond Principles. Green Projects are defined as projects and activities that will promote progress on environmentally sustainable activities as defined by the issuer and in line with the issuer's project process for evaluation and selection. The management of Green Bond proceeds should be traceable within the issuing organization and issuers should report at least annually on use of proceeds.*

Two aspects of this high-level definition are worth highlighting in particular.

- First, the definition contemplates both the financing as well as the refinancing of Green Projects. The reference to refinancing projects identifies the potential for corporates to access the Green Bond market for established projects that meet the green standards. This is an important feature, and a developed Green Bond market may assist sponsors in their efforts to refinance assets post-construction through the capital markets.
- Secondly, the definition makes express reference to ensuring the proceeds of the bond issue can be traceable, and a requirement to report at least annually on reporting the use of proceeds. As we have noted in 'Green Bonds Standards developments' below, matters such as transparency, assurance and certification are key elements in the evolution of a more standardised Green Bond market. Depending on the nature of the project, including whether it is in development or is an established asset, additional reporting requirements may add an element of cost which would need to be understood by the issuer. Issuers typically, however, are comfortable with reporting use of proceeds as part of their social responsibility reporting.

Green Bonds Standards developments

Since our last update,[1] there has been a continuing evolution of a consistent set of standards for determining whether the use of proceeds are sufficiently 'green' to be accurately labelled as a Green Bond, led by the Climate Bonds Initiative (***CBI***) and the Green Bond Principles.

The Green Bond Principles (a set of voluntary guidelines for issuers of Green Bonds) is now into its second edition, having initially been established in January 2014. The second edition, launched on 27 March 2015, was developed in conjunction with the International Capital Market Association (***ICMA***), which brings together representatives of issuers, investors and market intermediaries and now acts as Secretariat to the Green Bond Principles.

The second edition Green Bond Principles are an incremental evolution of the original principles, which seek to:

- identify best practice in the Green Bond markets;
- recommend transparency and disclosure measures (including independent assurance) for issuers which investors, banks, investment banks, underwriters, placement agents and others may use to better understand the characteristics of any given Green Bond; and
- reflect the further evolution of the Green Bond markets globally, including encouraging initiatives to assist with establishing a model for impact reporting that others can

1 http://www.allens.com.au/pubs/baf/fobaf29apr14.htm

adopt or adapt to their needs, noting that there are no currently established standards for impact reporting on green projects.

The updates to the Green Bond Principles also:

- include a high level definition of Green Bonds (set out above),
- expands the coverage of eligible projects, including into areas such as sustainable water management, sustainable waste management and clean transportation; and
- continues to focus on disclosures against use of proceeds, process for project evaluation and selection, management of proceeds and reporting as a way of demonstrating the integrity of these issuances to the market.

Continuing this trend, CBI have identified that standards, assurance and certification are key to improved confidence, transparency and further strong growth of the Green Bond markets. The CBI Climate Bond Standard, originally established in 2011, provides clear mandatory requirements and eligibility criteria for low carbon projects and assets, combined with an independent assurance framework and certification by the independent Climate Bond Standards Board, which assists investors by reducing the subjectivity and due diligence required to confirm that Green Bonds are in fact 'green'.

An updated Climate Bond Standard, scheduled for implementation in October 2015, is currently undergoing consultation, with the key changes being:

- incorporation of the updated Green Bonds Principles, which has in essence converted these principles into a set of requirements capable of being independently certified; and
- updates to the assurance framework requiring mandatory reporting to the Standards Board prior to issuances and annual reporting to bond holders and the Standards Board for the life of the issuance.

Separately, the Climate Bond Standard has been incrementally extended to cover low carbon transport (Bus Rapid Transit) and low carbon buildings, with plans underway for the standards to be further developed to cover bioenergy, geothermal, water, other low carbon transport including rail, agriculture and forestry by the end of 2015.

As the market continues to grow, the ongoing development of clearly measurable, robust standards is critical for investor confidence in corporate issuances. There are now a number of second party reviewers who are regularly involved with, and developing significant expertise in, reviewing compliance under the Green Bond Principles and Climate Bond Standard, including ICERO, Vigeo and DNV GL, while additional verifiers such as Sustainalaytics, KPMG and Ernst & Young and others are emerging onto the scene.

Recent developments in the global Green Bond market

Deepening of the global market for Green Bonds

The global market for Green Bonds has gone from strength to strength since our previous update. As we previously flagged, private banks and corporations have increasingly become issuers in the Green Bond market across Europe and the US.

The CBI reported that Green Bond issuances globally for 2014 more than tripled that of 2013, with US$36.6 billion worth of Green Bonds issued by 73 different issuers, up from US$11 billion – a substantial increase. CBI figures show that Green Bonds now make up a market of over US$65.9 billion, with issuances across 23 currencies, driven by predominantly euro and US$ issuances.

Supranational entities, government instrumentalities and export-credit agencies have been key issuers of Green Bonds, led by the European Investment Bank (with US$11.6 billion in issuances to date), the World Bank (US$8 billion), and German development bank KfW (US$4 billion), as part of a push to drive the development of the Green Bond market globally.

Importantly, however, Bloomberg New Energy Finance reported that corporate issuers accounted for more than US$12 billion of issuances across a range of currencies in 2014. 2015 has also seen Green Bonds issuances by corporates expand beyond utilities and real estate, into the transport and waste sectors

Off the back of increasing issuances and the continual development of global markets for Green Bonds, CBI are predicting Green Bond issuances to increase to US$70 billion globally by the end of 2015 (with a stretch target of US$100 billion), which aligns with forecasts by Swedish bank SEB. Bloomberg New Energy Finance are tipping global issuances to reach US$80 billion this year.

Reports from Bank of America Merrill Lynch have suggested that the global market for Green Bonds could push US$1 trillion in issuances by 2020. The challenge continues to be deepening the market and increasing liquidity to reach this estimate.

The Barclays MSCI green bond index, established in 2014 to track green bond issuance globally, is likely to be expanded to potentially include high-yield green products. MSCI/Barclays have explained that this expansion has been driven by investor interest in a wider and more diversified index.

Demand drivers – the global perspective

Green Bonds serve as a platform for helping to meet the need for capital investment in 'green' projects if, collectively, we are to meet the global greenhouse gas reduction targets set under the United Nations Framework Convention on Climate Change (***UNFCCC***). The World Bank has suggested that US$100 billion per year is required by 2020 to transition towards the low-carbon emissions framework currently agreed in order to meet the global 2ºC warming target. It is widely expected that the upcoming UNFCCC COP 21 in Paris will see political commitments to set even more aggressive emissions reduction targets. A deeper Green Bond market can play a substantial role in providing the necessary capital.

According to Clean Energy Finance Corporation (***CEFC***), superannuation and institutional investors are increasingly recognising that reducing greenhouse gas emissions exposures in their portfolios is a strategic investment priority. In fact, in 2015 Zurich Insurance, Deutsche Bank, KfW, Barclays and ACTIAM have each publically committed to build significant Green Bond portfolios, reflecting their strong underlying investor demand. The high level of oversubscription of Green Bonds compared with non-green issuances further highlights this rising interest in environmentally-conscious assets, with long-term investors such as insurers and superannuation funds playing a particularly active role.

In addition to public targets, some funds have gone further, establishing specific funds to invest in Green Bonds, including BlackRock, Shelton Capital Management and State Street, among others.

In the context of these global market developments, the Australian market has begun to mature.

Emergence of an Australian market

Since we previously highlighted the first Green Bond issuance in the Australian domestic bond market (the A$300 million 5-year deal mandated by the World Bank on 15 April 2014) the Australian market for Green Bonds has seen a formative development. From a low base, the market doubled in size in the first half of 2015, and the CEFC has predicted it will pass A$2 billion this year, spread across over 100 institutional investors.

To date, we have seen two of the major Australian domestic banks launch Green Bonds into the Australian market.

- On 4 December 2014, NAB launched a A$300 million seven-year deal placed with 15 investors including superannuation funds. The CEFC committed to providing a cornerstone investment of up to A$75 million, and the original target of A$150 million was far exceeded by strong investor demand. Proceeds will be used to fund 17 wind and solar farms.
- On 27 May 2015, ANZ launched a A$600 million five-year deal placed with a diverse range of investors. This issuance was placed under the bank's existing wholesale domestic issuance program, and will be used for its existing portfolio of low carbon industries, technologies and practices, including solar power and Green Star rated commercial property buildings throughout Australia, New Zealand and Asia. ANZ is considering expanding this program to geothermal and fuel efficient transportation.

The ANZ Green Bonds were independently certified to confirm they meet the CBI Certification, under CBI's Energy Efficiency – Commercial Property Standard. A certifier has been engaged to confirm this certification annually for the entire tenor.

In addition, German development bank KfW entered the Australian market with a A$600 million issuance in March 2015, which was double the minimum size of A$300 million sought, and sold to 28 different investors.

As the we have previously noted, Australian corporates are now also looking to attract investment from environmentally and socially orientated funds through entering the Green Bond market. While we are yet to see an Australian corporate issue a Green Bond into the Australian domestic bond market, we have now seen two Australian corporates launch Green Bonds globally, which could form the start of a wider trend.

- On 23 October 2014, Stockland became the first Australian corporate to enter the European Medium Term Notes market with a €300 million seven-year deal listed on the Singapore Stock Exchange. Stockland have noted that the debt cost was the same as for a regular EMTN issuance, and will enable it to invest in further leading edge sustainable projects, such as 4 Star Green rated buildings.
- In March 2015, Hallet Hill, a wind farm operating in South Australia, issued the first Australian Green Bond into the US Private Placement market with a US$205 million two-tranche 12-year deal (US$99 million and A$76 million respectively), becoming the first Australian wind project financed by US investors in the USPP market, and the first single asset project finance issuer across any market. Allens advised Hallet Hill on the issuance. Importantly, the Hallet Hill bond (which is rated by S&P) has been independently certified by DNV GL as compliant with the Green Bond Principles.

Demand drivers – the Australian perspective

To date, all Australian Green Bonds issuances have been fully subscribed, and usually strongly oversubscribed, which highlights the strong demand among investors. The CEFC, which is tasked with helping to drive the establishment of the Australian market for Green Bonds, notes that investors are heading towards cleaner investment options.

However, it is not just the purpose for which the funds are used which is driving this strong demand. Investors remain drawn to the strong credit metrics, as Green Bonds have largely been issuances by highly-rated institutions who have been able to achieve similar pricing to their almost-identical vanilla bond issuances. A number of other key demand drivers have also been in play.

- Reflective of the fact that European pension funds and US insurance companies are the biggest purchasers of Green Bonds in Europe, Australian superannuation funds (who collectively manage the fourth largest pool of superannuation globally at A$2 trillion) have been investing into this space. In fact, 51 per cent of purchasers of Australian Green Bonds are asset managers, predominantly on behalf of superannuation funds, driven by members pushing funds to adopt mandates supporting clean investment. By way of example, UniSuper purchased one-third of the World Bank A$ Green Bonds, and intends to make A$100 million in Green Bonds available to institutional investors through its Socially Responsible Balanced plan option.
- The Australian Federal Government has recent legislated a 33,000 GWh renewable energy target by 2020, which the CEFC predicts will require between A$10-15 billion of investment over the next five years. CEFC predicts that Green Bonds will be a key driver of the new investment required in the renewables space in order to meet that target, which requires doubling Australia's current large-scale renewable energy output.
- Shareholder activism is helping drive a broader range of entities into 'green' investment. State and local governments are increasingly showing interest in financing low-carbon projects in order to reflect the views of their constituents, consumers are demonstrating a willingness to pay more for 'green' power, and financiers are facing increasing pressure from shareholders over new investments in fossil fuels, such as the backlash faced by the Commonwealth Bank of Australia over investing the potential Adani Carmichael coal mine.

Challenges

The development of the Australian Green Bond market is not without challenges. Investor reports note that regulatory and political uncertainty are hindering the ability of Australian corporates to enter this market, while at the same time hampering Australia's attractiveness as a destination for foreign green investment.

The varying political discourse around climate change and renewable energy saw CEFC's mandate altered such that it was restrained from investing in new wind and small-scale solar projects, however it remains to be seen whether this position will continue, or whether the discourse will trend in the opposite direction and move towards driving the development of Green Bonds. Options include offering tax offsets for genuine 'green' bonds, as is the case in the US and, potentially, China.

For issuers considering issuing Green Bonds into the Australian Green Bond Market, cost remains a factor. As there is currently no (or limited) price differential between Green Bonds and ordinary Kangaroo bonds, some issuers may not see the benefit in incurring the additional costs involved in verification and regular reporting.

In addition, the issuances have been offered at an institutional level with a minimum initial hold of A$500,000. It remains to be seen whether a domestic retail bond market will develop for Green Bonds, or whether access to Green Bond investments will remain through institutional investors.

Overall, the Australian Green Bond market continues to trend upward, and the potential remains for highly-rated Australian corporates to look to issue Green Bonds both globally and locally.

Emergence of the Green Bond market in Asia

The development of the Green Bond market across Asia has been more fragmented, however it is showing signs of strong development. While in 2014 Asia accounted for only 1 per cent of global Green Bond volumes, so far in 2015 Asian issuers account for 11 per cent of global volumes.

A quick snapshot of issuances reflects these figures.

- The Export-Import Bank of Korea launched the first Asian Green Bond issuance in 2013, a US$500 million placement, which was followed up by a US$300 million issuance by Advanced Semiconductor Engineering, a Taiwanese semiconductor packaging producer, both placed in the US market.
- Yes Bank issued the first corporate Green Bond in the Indian market in February 2015, with an INR 10 billion issuance to finance renewable projects, followed up by the Export-Import Bank of India with a US$500 million issuance in March 2015 to finance renewable energy and transport projects. Indian power company CLP Wind Farms became the first non-bank corporate Green Bond issuer in South Asia with a INR 2 billion issuance in 2015 used for capex and refinancing wind power assets.
- In April 2015, the Export-Import Bank of India launched a US$500 million green bond with the proceeds to be invested in eligible green projects in the region, including Bangladesh and Sri Lanka.
- The Asian Development Bank has placed US$500 million and ZAR25 million issuances in 2015, while the Development Bank of Japan launched the first Japanese Green Bond issuance of €250 million.
- Xinjiang Goldwind Science and Technology, a wind turbine producer, became the first Chinese entity to issue a Green Bond with a US$300 million issuance in July 2015 for capex and refinancing purposes.
- Bangchak Petroleum Public Company Limited became the first oil company to issue a corporate Green Bond, with a Baht 3 billion issuance in February 2015 to be used for its expanding renewable energy operations. However, Bangchak elected not to have the Green Bond independently verified against either standards framework, despite media queries over their 'green' credentials as an oil company.

Most recently in October 2015, Agricultural Bank of China issued the first Green Bond issued by a PRC Bank with a multi-currency bond of US$1 billion, including a CNY600 million 'dim sum' tranche. The ABC Green Bond will be used for lending in support of environmental protection, energy conservation, greenhouse gas reductions and specified eligible green projects. Deloitte provided an assurance report on the Green Bond Management Statement and ABC have committed to releasing an annual Green Bond Report to disclose allocations and projects.

Demand drivers – an Asian perspective

Delving into the growth drivers for the Asia market shows alignment with global trends.

The People's Bank of China has recently released a report outlining steps to create a green finance system, which includes support for the green bond market. The government is expected to provide various levels of support to green finance issuers including through tax breaks and procurement benefits. Further, estimates of the investment required for China to meet their pollution reduction targets are for investment of over US$300 billion each year. With such substantial investment required and clear government support, the market expects the ABC green bond to mark the start of a ramp-up in Chinese issues with other major PRC banks and SOEs likely to follow similar structures.

Similarly, in India estimates of US$70 billion of investment is required to meet the government's target of 165GWs of renewable energy capacity by 2022.

On the buy side, while the prevalence of investors driven by environmental and social considerations is not as large as Europe or the US, there is a growing pool of Asian investors who are interested in this space (evidenced by the fact that Asian investors purchased about a fifth of the €1.5 billion KfW issued Green Bond this year) which has the potential to expand dramatically as markets develop.

The development needs for sustainable infrastructure and energy markets across Asia, especially China and India, is vast. With substantial investment requirements across the region, market participants see Green Bonds as a significant source of future funding.

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Challenges

For issuers in the region considering issuing Green Bonds, cost remains a key factor. With currently no (or limited) price differential between Green Bonds and normal bonds, some issuers do not see the benefit in incurring the additional costs involved in verification and regular reporting.

Potential investors have voiced concerns over transparency and corporate governance with Asian issuers. Some of the Green Bonds issued to date (including the Export-Import Bank of India issue) have been criticised for a lack of transparency and no third-party assurance opinion. Overtime, this is likely to lead to clearer standards for verification and use of proceeds restrictions or ring-fencing. As a result, independent review and verification from experts is likely going to remain a key factor, providing investors with greater assurances.

Continual development

The growing demand for investments in environmentally and socially friendly products should continue to drive new issuances of Green Bonds, including in the Australian and broader Asian markets. These same forces are likely to continue to drive the development of standards in providing more detailed and uniform information to investors, to facilitate corporate issuances.

Contact

James Darcy
Partner
Allens, Melbourne
T +61 3 9613 8516
James.Darcy@allens.com.au

Tristan Kelly
Lawyer
Allens, Melbourne
T +61 3 9613 8029
Tristan.Kelly@allens.com.au

For enquiries on Asia/China opportunities, contact:

Jeremy Webb
Partner
Linklaters, Hong Kong
T +852 2842 4870
jeremy.webb@linklaters.com

Jonathan Horan
Solicitor
Linklaters, Hong Kong
T +852 2901 5318
jonathan.horan@linklaters.com