Green bonds find their purple patch in golden era

By Stirling Larkin

In the last month, when the Australian carbon tax has been a subject of red-hot global debate, a far more important announcement out of London has, until now, gone unnoticed.

The world's first Green Bond Index was launched on July 1 by the British bank Barclays in conjunction with MSCI, one of the leading global financial services information providers.

This is a critically important milestone, as it finally brings Green and Climate derived investment products into the fold.

This development will also provide numerous opportunities for not only Institutional and Ultra High Net Worth (UHNW) investors but also, in time, for the broader investment community.

It appears that Green Bonds have found their purple patch and issuers are welcoming this new-found golden era.

According to the World Bank, global issuances are rapidly increasing from $US3 billion in 2012 to nearly $US50bn by the end of this year. Some also believe that Green Bonds will account for around 15 per cent of the entire global bond market by 2020.

We all know that the environment matters.

The important question then becomes whether so-called "Green" products actually help or do not.

This is the question, asked regularly but rarely answered and that, in itself, is what we now need to focus upon — the question of legitimacy.

The interim Murray Report, this week, highlighted that Australian SMSFs and retirees need a better pipeline of "mandated income products" and as bonds are the ultimate fixed income solution, this topic should be prioritised by Australian investors.

Alongside Green Bonds, Climate Bonds also appear to be rapidly increasing in issuance, acceptance and popularity. Several high profile global issuances of these bonds have been oversubscribed significantly in recent months.

Toyota, for instance, recently was twice oversubscribed for their $US2bn face value of bonds issued to help finance sales of zero-emission cars.

In April, the French regional government that oversees Paris, Ile-de-France, issued their second Green Bond, seeking €350 million but after one hour, closed with €750m of orders and ended up issuing €600m.

Whereas Green Bonds raise the finances for an environmental project, Climate Bonds raise finances for investments in emission reduction or climate changing adaptions.

Importantly, in attempting to answer the question of legitimacy in 2014, a vast majority of Green Bonds are still issued by the World Bank, compared to most Climate Bonds, which are issued by private sector corporations.

This becomes important because, even now, there is no unified agreement upon what constitutes a Green or Climate friendly product.

The World Bank's Green Bond eligibility framework does not currently extend to private sector issuances in either Green or Climate products.

As Australian SMSF portfolios are both directly and indirectly allocated greater exposures to this subcategory, so too is the importance of answering these concerns.

Australia's UniSuper has recently become the cornerstone investor in the World Bank's first Australian Green Bond issue and this highlights one example of why Australian investors need to pay more attention to this "thematic''.

Another interesting point to note is that the World Bank, for whatever reason, still publishes the names of all investors in their Green Bonds and these are publicly accessible via their website.

Albeit although many of us may like to be publicly recognised for supporting environmental causes, this practice appears inconsistent with 21st century privacy and professional standards.

As this subsector still appears to be largely self-regulated, another conundrum global investors face is whether buying a Green Bond from an oil company, for example, is appropriate or whether there are boundaries that both industry and investors should respect.

As North American and Chinese private companies dramatically increase their issuance of renewable energy focused Climate Bonds, without an agreed multilateral framework, the global investor will need to decide for themselves what meets their threshold for “Green” and what does not.

Many of the lessons learnt through the GFC subprime real estate product experience can now be called upon.

Some discerning global investors preceding the GFC learnt how to differentiate risk-adjusted subprime opportunities from those which were blatantly risky, in what was then an unregulated and non-standardised marketplace, just as the Green and Climate bond market is today.

Nevertheless, this month’s announcement of a standardised Green Bond international index finally helps put some structure around this investment theme.

Initially “bespoke” for institutional participation, it will, no doubt, in very due course, provide a benchmark for all.

As the Australian body politic endlessly debates the carbon tax issue, the global “realpolitik” moves towards these genuine market-led environmental solutions.

As investors, the time is now to alter our focus from domestic distractions and seek global ways in which we also can address these issues through our own investment decisions.

In Britain, Germany and France, almost all Climate Bonds issued have attempted to address transport and logistic efficiencies.

In the US and Japan, around half are for these issues and the remaining half focused on renewable energies and related efficiencies.

In contrast, it is said that nearly all of China’s Climate Bonds are fixed on energy investments with a particular focus on renewables.

The first yuan denominated Green Bond was issued last month and has already been very well received globally by institutional investors.

This, in itself, is an important development not only for Green products but also the internationalisation of China’s renminbi.

Wherever we stand on the question of climate change, one thing cannot be disagreed — that contributing to better efficiencies, smarter projects and clever processes that produce a lighter footprint on our surroundings is good business and smart investing.

As it is coincidently becoming clearer too that many Australians need to seek out more reliable income streams than solely playing potential ‘’Russian roulette’’ with higher dividend distributing Listed Equities, now is the time for Greenhorns to take the time to better understand Green and Climate products.

The Green and Climate bond markets appear to be enjoying bright blue skies ahead.

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