From Climate finance to Green Bonds - Myths and realities of Financing Climate Change in African Countries

Mariama Williams

South Centre

Consultative Workshop on Finance and Development in Africa

TWN- Africa

Feb.19-21, 2019

GREEN BONDS DEFINITIONS & ORIGIN

- No specific market definitions of ‘Green bonds’ or regulatory reporting
- Issuer(s) can define what they think constitute the notion of GB…
- Environmental stewardship is a differentiating factor
- There does exists:
  - The Green bond principles (by the international capital market associations, 2014, updated 2018)
    - It faciliatates guidance and transparency of the market
      - Focuses on the ‘usuage of proceeds’, project evaluation and selection process and reporting management process
  - The Green Evaluation Analytical Approach (2017, April, Standards & Poor (S&P)--a point-in-time assessment of the relative environmental impact of financing transaction or portfolio.
  - There are now green loans and green CLO—collateratised loan obligations

Green Bonds Definition cont....

- fixed income debt instruments like any other bond. 'Offer a stated return, and a promise to use the proceeds to finance or refinance, in part or fully, new or existing sustainable projects.'
- Green bonds fund environmental, social and governance improvement or projects:

  renewable energy and energy efficiency projects, clean public transportation, pollution prevention and control, conservation, sustainable water and wastewater management, and green buildings that meet internationally recognized standards and certifications

Related concepts

- ESG (2006 UN Principles for Responsible Investment) Initiative (PRI—6 core principles to encourage investors to integrated environmental, social and governance into investment decision making and ownership practices)
- UN SDGs, 2015. 'bolstered the importance of ESG investing by providing a global framework for financing sustainable development' (p.45 S &P Global) also supported private sectors involvement to address funding gap.
- Green, Social and Sustainability Bonds market offer ways to capitalise on ESG trend and can add value to portfolio

➢ Offshoots of GB: forest bond, water bond

- Outstanding issues: comparability of data, reporting formats and contents, frameworks and impact reporting.
- Controversies: environmental and climate integrity of projects

Evolution of green Bonds…

Now around almost 20 years:

- Issued as a way for projects to raise finance with the goal of cut/reduce emissions… using green project finance covering...
    - Renewable Energy/Energy Efficiency/Low-carbon/ water efficiency

First issued by European Investment Bank (EIB), 2007 (Climate Awareness bonds, July 4 Euro 600 million)

World Bank 2008 (December)

Total yearly issuance $1 billion, 2007-2009.

Other early actors: EBRD, IFC, AB, AfDB, and a few Norwegian finance institutions since 2010

2014: Green Bond Principles (Jan 2014—4 banks—best practices in GB markets focusing on disclosure and transparency) – led to GB took off: total issuance $36 billion with addition of non-MLI: Bank, corporates, and local governments non

Note: Multilateral lending Institutions (MLI) aka ‘supranational institutions’ role continue in terms of off shoot development; but only a few dominate the GB sectors and their share is declining (now about 5% or $8.6 billion (of 167 million, 2017) with EIB is the largest issuer of MLI’ GB (S&P 2019).

Green bonds market characteristics…

- Still relatively small (but seem to be growing, S&P Global). Continuously developing and evolving: $160 billion (2017) and + 200b (2018), growing new asset classes and players in the de-carbonization of the global economy
- Climate Bond Initiative forecasts nearly $1 trillion in GB issuance by 2020
- Instruments:
  - Sovereign (17%)   Development banks ()   Financial Corporate (24%)
  - Local Government ()   Government-Backed Entity (10%) Non financial Corporate ()   ABS ()

  Source: California Statewide Communities Development Authorities, July 12, 2018

Impact: ‘modest and hard to discern’ (S&P Global 2018).

Driven by the Paris Agreement and the nationally determined contributions (NDCs)

Limited to industry under the scope of global carbon regulation

Green bond: Actors

The main actors in the market can be categorized as:

- issuers (entities with green projects needing funding or refunding),
- Underwriters (financial institutions arranging the issuance of the green bonds),
- External reviewers (verifying the "greenness" of the underlying projects)
- Intermediaries (such as stock exchanges)
- Investors (particularly those with a mandate to invest in green assets).

Source: http://ec.europa.eu/environment/enveco/pdf/potential-green-bond.pdf

Multilateral Lenders and green Bonds

MLIs Tend to be key innovators promoting expansion categories of Green Bonds

- Environmental Bonds—funds raised for clean environmental and climate purposes, the GB is the most common, include water bond (Asia), forest bond (IFC,2016, reducing emissions from deforestation and ecosystem degradation), blue bond (CBD– ocean based, coming soon!)
- Green infrastructure
- Prototype Social bonds (2014. $8.8 billion 2017): social issues for targeted populations: vaccine bonds--GAVI; IFFIm (GAVI)/IBRD pandemic bond 2017—catastrophe bond aimed at fighting major health crisis and epidemics. (International finance facility for immunisations is the largest social bond issuer in the MLI sectors)
- Social development and inclusion bonds: see for example, EYE bonds (education, youth and employment, issued by IADB); banking on women bonds (to support women owned small and medium-sized business)—ADB health and gender bonds, 2017; inclusive business bonds to support private enterprises that incorporate low-income people into their business models and supply chains—IFC.
- Major sectors and categories funded:
  - Solar, wind, hydro, EE (growing) , RE (most common), CC, Sustainable (low carbon) transportation (growing), green buildings and biogas
- Renewed role: mobilise private –sector lending (see IDB invest, 2018)

GB Initiatives and pledges

- Climate Bonds initiative (target of $1 Trillion green finance by 2020)
- Voluntary guidelines and standards

❖ Climate Bonds Standards and Certification

❖ The Green Bond Principles (GBP, 2014) - voluntary best practice guidelines (the International Capital Markets Association (ICMA)

❖ The Municipal Securities Rule-making Board (MSRB): seeks to protect investors, municipal entities, and the public interest by promoting a fair and efficient municipal securities market

❖ Independent Assurance: Several auditors as well as climate, environmental, social and governance institutions offer independent opinions on an issuer's green bond program .

❖ Third party verification: CICERO, Sustainalytics, Viego

GB and WATER

- Climate change and water risk
  - ➢Global water deficit my be 40% by 2030 (World Bank)
  - ➢Volatile agricultural commodity prices (and supply chain risks)

  - Water pattern more erratic
  - Depletion of ground water reserves→ increasing water related risks (freshwater scarcity, flooding(excessive precipitation, coastal, subsidence and salt water intrusions) and droughts)
  - Water stress: ratio of demand to annual renewable supply)
  - Impact production (esp. cotton/apparel) and industrial and agriculture and development

Challenges with Green bonds

- "Greenwashing risk": the risk that the proceeds of the sale of a bond that is marketed as a green bond will not be applied to appropriate projects
- No clear regulation or impact specification
- GBP/other focus on 'USE of Proceeds': providing clear environmental benefit which are defined ex ante but no guarantees that this will be the case ultimately.
- All is voluntary and not necessary for issuance
- Fiscal incentives??? Tax incentives (tax credit, direct subsidy or tax exemptions)
- Preferential treatment of green bonds in monetary regulation / central bank strategy ???

Africa and green bonds

- Relatively recent, small and thin market
- Mostly DFIs (AfDB (2013: Green bond programme), IFC, EIB and rand issuance)
- Countries: 2 Morocco, 2 South Africa,
- Take off in 2017 (possible linked to Paris Agreement and NDCs):
- GB segment on Johannesburg stock exchange

❖ Nigeria (GB guidelines 2016—aligned with GBP; issuance December 2017: CERTIFIED CLIMATE Bond--NGN 150 billion naira (anticipated USD 29.7 M; actual 10. b Naira so far) to support reducing emissions of its NDC green bond programme and first sovereign GB issuance in Africa) see pg. 12 *African GB market. (*First ever certified bond, first African sovereign bond, first Nigerian Green bond).

❖ Kenya – guidelines? 3yr Green bond programme (supported by IFC, Kenya, Nairobi stock exchange, gov. Kenya, bankers' association & the Climate Bonds Initiative)

  ❖ Nigeria and Kenya both seeking to have GB market (policy & sovereign issuance)

❖ Municipalities: Cape Town (1 billion Rand, mid 2017 for water infrastructure and transport) second (Johannesburg was first $140 million to finance climate mitigation strategy)

❖ Afri-exim bank $850 for 5 years: low carbon technology RE and transport

❖ Some competition to become Africa GB hub: AfDB $500m, South Africa Industrial development corp. $700m; Nedbank $409 m

❖ Little corporative activity

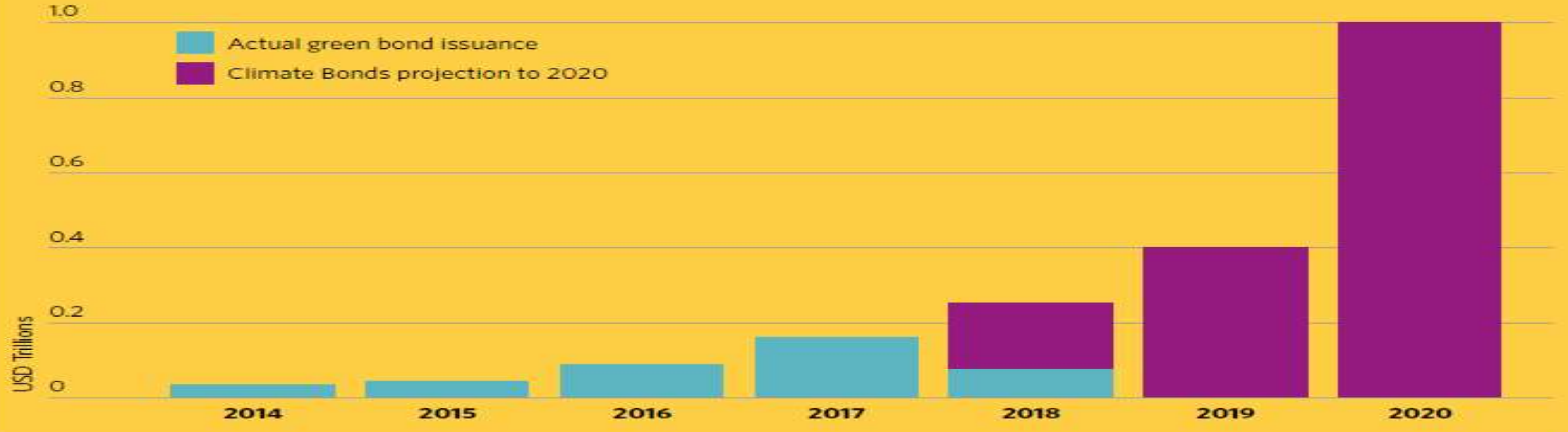
The drive to have government enable GBs: meeting the temperature guardrail: 2C/1.5C

Are we nearly there yet? Towards USD1 trillion a year of green bond issuance by 2020

We estimate that the global green bond market would significantly boost progress on Nationally Determinted Contributions (NDCs) in connection with the Paris Agreement and the implementation of country climate plans if it reaches USD1tn per annum by 2020.

This report identifies USD1.45tn of climate-aligned bond issuance currently outstanding which have been issued since 2005. Meanwhile the labelled green bond market reached USD162bn of issuance in 2017.

The growth is encouraging but there is still a long way to go with global GHG emissions on track to far exceed 2 degrees of warming. Over the coming decade, much stronger action from government and the private sector is needed to ensure there is a pipeline of low-carbon projects sufficient to meet the Paris Agreement targets.



Source: CBI, Bonds and climate change: The state of the market, p. 31

Climate bonds

Climate (or climate-aligned) bonds refer to labelled and unlabelled bonds for which proceeds are intended to finance projects and activities that contribute to a low-carbon and climate-resilient economy (UNPRI.org).

Climate bonds are used to finance – or re-finance - projects needed to address climate. They range from wind farms and solar and hydropower plants, to rail transport and building sea walls in cities threatened by rising sea levels (Climatebond.net.

The Climate Bonds Initiative: an international not-for-profit which promotes the development of climate bonds. It raises awareness about the existence and benefits of climate bonds and promote investments in them; proposes standards that establish what a green bond is, helping identify and label green bonds so that they may be recognized as such; and develops project models in areas such as energy efficiency, forestry and other climate sectors. (ClimateBonds.net)

- The Climate Bonds Initiative has developed environmental standards with which projects must comply in order to achieve the corresponding Certification mark. Investors of these approved programs are therefore assured that their funds are being used for projects which support climate change; and the green bonds associated with these projects are easily labelled and identifiable,(climatebonds.net).

- CB for Climate change adaptation: information systems support such as climate observation and early warning system
- Climate Bond standards (The Climate bonds Initiative)

Financing climate change action in Africa

Myths and realities:

- $ trillion for climate change by 2020 in order to maintain 2C/1C
- Climate finance principles and architecture under the global regime
- ODA and Climate: re-orienting aid flows/greening aid
- The Paris Agreement and Climate Change Adaptation & mitigation
- The Green Climate Fund, the $100 billion and the NDCs
- Green Bonds/Climate finance: shift of actors from MOE to MOF (AMCEN and ???)
- Challenges with climate bonds for
    - Financial and climate related additionality
    - Debt accumulation/ fiscal measure
    - IDA support of GB in poor countries in SSA?
    - Adaptation (borrowing for adaptation)
- Whither Africa and the GCF?

African Nationally determined contributions

- 54 African countries signed the Paris Agreement
- 43 have ratified it and 53 (the exception being Libya) have submitted their NDCs
- 85% of these NDCs are conditional upon financial aid from abroad and only 15% are on the basis of domestic budgets.

- US$ billions will be required to implement the NDCs.
- Accessible, clean energy in Africa – Cote d'Ivoire, Kenya, Nigeria, and South Africa's total investment potential is nearly $783 billion, which is spread across renewable energy generation ($123 billion) and buildings and transportation ($652 billion).

Source: AfDB

GB, Climate investment &Climate Finance

NDCs show strong need for billions of dollars for climate action. Amount of climate finance on the table currently is the $100 billion per year by 2020, with the deadline pushed to 2025 by the Paris Agreement. Commitments by developed countries to seek to mobilise climate finance from the $100 billion floor for the post 2025 period.

Climate finance under UNFCCC is to be new and additional (no diversion of ODA to climate actions). But $100 billion is surely inadequate to the need even if it was flowing adequately.

GCF is the main mechanism for the $100 billion but it has only received $10 billion (now minus the US renegading on $2 billion from the Obama pledge amount).
Yet developing countries have obligations under Paris and there is a push to ratchet up ambitions in order to maintain the 2C and 1.5C temperature guardrail. In this context, green bonds seem like a good alternative or complementary sources of financing. Hence, many sovereigns are issuing such bonds.
Yet, it is not clear that such bonds are good fit for climate adaptation financing, which really should be granted funded?

GCF and Africa

How well are governments taking advantage of GCF's resources, in particular for adaptation planning and readiness, with or without Green bonds?

According to the GCF:

- Africa is one of its core priority regions. Over USD 2.3 billion, half of all GCF funding, have been channeled to 36 projects in Africa, 15 of which are already under implementation.
- Readiness programme (<u>$1 million per year</u> available to each developing country to, helping boost the capacity of public institutions and enable them to prepare high-quality and scalable funding proposals. Additionally, each country has <u>one time access to $3 million</u> for national adaptation planning.)

- According to GCF, to date, 76 readiness grants worth USD 39.4 million have been approved in Africa. But since 2015, it it is not clear that any African country has ever exhausted its $1 million dollar per year availability. This money does not accumulate; it is on a come first basis.