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Green Bond Market Heats Up.

Issuance of the bonds has reached record levels this year and looks set to accelerate, market watchers say.

Issuance of so-called green bonds reached a record $110 billion through mid-October this year, according to a recent report, signaling the fast-growing popularity of an asset class that was created just a few years ago.

The report — released by Scandinavia's SEB, a leading global green bond underwriting institution — revealed that this figure topped the $97 billion in total issuance last year. SEB predicts that total issuance for the full year could reach $125 billion.

Though the concept is only about a decade old, green bonds — corporate or government-issued debt that is used to finance various environmental or climate-related projects — are becoming a credible asset class as more asset managers are increasing portfolio allocations to them.

Take, for instance, AMP Capital, a leading Australian fund management firm with A$179 billion ($138 billion) in assets under management. Lydia Serafim, a senior portfolio manager with AMP Capital, says the Sydney-based firm takes environment, social and governance investing seriously — so seriously that managers decided last year their $180 million Responsible Investment Leaders Diversified Fixed Income Fund must have a 15 percent allocation to green bonds.

"Green bonds are a small part of the overall bond market, but it's a growing area," Serafim said in an e-mail to Institutional Investor. "As the investment metrics around 'what is a green bond' become more standardised and refined, investment in the area will increase as the benefits become more transparent to clients."

AMP Capital's decision to include green bonds in its portfolio undoubtedly pleases Christopher Flensborg, the head of climate and sustainable financial solutions at SEB. Flensborg has been called the father of the green bond because he proposed the creation of one to the World Bank back in 2007.

Since then, he has worked with many issuers around the world to launch such bonds. According to SEB, the U.S. has been the top green bond market in 2017, with $25.4 billion in issues through Oct. 10, while China came in No. 2 with $19 billion in issues. France came in at No. 3, with $17 billion in issues.

"In the coming four to five years, I see 10 percent to 20 percent of all new issuance having the 'green' label," Flensborg said in a phone interview. He expects global issuance to top $300 billion by 2020. "We're taking about trillions of dollars a year sometime in the future."

Matthew Kuchtyak, a New York-based analyst specializing in project and infrastructure finance at Moody's Investors Service, also thinks the sector has room to grow.

"Although green bonds will remain a niche segment of the global fixed income market for the foreseeable future, we expect robust issuance growth as market awareness increases and issuers seek greater investor diversification," he said in an e-mail to Institutional Investor. Moody's expects global green bond issuance to top $120 billion in 2017, a 24 percent year-on-year increase.

Many of the 2017 issues came from utility companies. Take U.K.-based water treatment company Anglian Water, which in October issued a £250 million ($336 million) green bond to finance a range of projects in some of the driest regions of the United Kingdom.

Will Oulton, the global head of responsible investment at Australia-based First State Investments, which is a substantial shareholder in Anglian, says he expects that green bonds will become a key feature of the asset manager's portfolio allocation strategy in the future.

"We are watching the development of the market and are always seeking a competitive market return as well as assurance that the proceeds are being utilized for the environmental purposes as stated and not for other non-environmental projects," he said in an e-mail to Institutional Investor.

SEB's Flensborg says he believes that China will become the world's largest green bond market in a few years. Chief among the major global partners who worked with him in designing policies that support green bonds have been policymakers at China's central bank.

Laurence Brahm, a Beijing-based American lawyer who acted as an adviser to China's Ministry of Environmental Protection, says the nation is in the process of changing its power grid away from a reliance on fossil fuels. Officials are determined to reduce coal and fossil-fuel-generated electricity from 70 percent of the power grid supply to 50 percent in the coming decade, Brahm says.

In addition, according to Brahm — who helped the government draft its green investment policy known as "Ecological Civilization" — the government is determined to promote electrical vehicles so that 30 percent of all vehicles on the road will be electric by 2025. By 2030, all new sources of energy will be green, he says, adding that by 2050, 80 percent of China's national grid will be green.

"That kind of scale of transition in a nation of 1.3 billion people can only happen if the financial services sector drives it," Brahm said in a phone interview. "Green finance is critically important, as it is at the core of determining future infrastructure away from fossil fuel economies."

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