Bond Case Briefs

Municipal Finance Law Since 1971

Bonds to Save the Planet.

Eco-friendly fixed-income funds can help create a stronger market for securities that back environmental projects.

Green bonds could be a key tool to finance the fight against climate change. But good luck getting your hands on one, or figuring out exactly what it's worth.

The securities are just like regular bonds, except their proceeds are earmarked to fund projects that have positive benefits for the environment or climate. Countries including Poland and France have issued them to support renewable energy. Companies may use bond proceeds on projects that reduce emissions or enable funding for electric vehicles. Municipalities are also big issuers of green bonds. More than $600 billion in green bonds have been issued worldwide in the past decade, according to BloombergNEF.

The bonds have something of a built-in customer base of socially conscious investors including pensions and nonprofits. These investors tend to snap them up—most new green bond issues are oversubscribed—and hold them until they come due. This has put the market in a somewhat awkward spot: The bonds are clearly popular, but since they don't trade much, it's hard to get a precise view of their market value at any given moment. That could be keeping companies from issuing more of them.

Green bond issuance might grow faster if companies could see environmentally friendly bonds commanding a premium price on the secondary market, according to Daniel Shurey, head of green finance at BNEF. Since higher bond prices imply lower financing costs for issuers, that could "incentivize reluctant first-time issuers," Shurey says. Selling a green bond typically brings higher costs because issuers have to certify their projects are green, but that could be offset if issuers get to pay a lower rate. In other words, green bonds might be an even bigger deal if they traded more often—but to do that, they'll need to find a bigger audience.

They may be about to get one. Big asset management firms have been introducing green bond funds aimed at making the market more accessible to average investors. About 20 mutual funds and exchange-traded funds currently say they focus on green bonds, representing about $2.8 billion in assets combined, according to data compiled by Bloomberg. Roughly half of those have come on line in the past two years.

"Green bonds are something retail investors wouldn't necessarily have access to by themselves," says Stephen Liberatore, co-manager of the TIAA-CREF Green Bond Fund, which launched late last year. Mutual funds have to buy and sell green bonds more frequently than, say, a pension fund would to meet inflows and outflows from investors, he says, "though that should be manageable as long as we keep seeing continued expansion of the investable universe." BlackRock Inc., the world's largest asset manager, also started a green bond ETF in November.

Trading will also be helped as companies and governments sell more green bonds. The average size of a green bond deal has more than doubled, from about $120 million in 2015 to $261 billion in

2018, and there are more billion-dollar green bonds on the market. “More deals that are green bonds are larger and index-eligible, so they’ll trade more frequently,” Liberatore says.

Still, the market is far from mature. Most green bond funds have to buy additional bonds that meet sustainability criteria—but aren’t specifically green—because those are easier to trade and use to meet redemption requests. Green bonds represent just a little more than 1 percent of the $53 trillion global bond market. But to meet the goal of limiting global warming to 2C (3.6F), about $90 trillion of investment is needed by 2030, according to the Climate Bonds Initiative. That leaves plenty of room for green bonds to grow.

Bloomberg BusinessWeek

By Emily Chasan

April 23, 2019, 3:00 AM PDT