Bond Case Briefs

Municipal Finance Law Since 1971

Forever Green.

Green bonds proved to be more than a passing fad in the municipal market this year, as issuers tapped into demand for socially responsible investment.

As of Dec. 17, green bond volume has increased 48% to $4.27 billion from $2.88 billion in 2014 and $693 million in 2013, according to data from Thomson Reuters.

"It's a developing market, but we think it's here to stay and it has the potential to grow even further," said Jamison Feheley, head of banking and public finance at JPMorgan.

Environmental Finance Magazine ranked JPMorgan first globally as lead manager of green bonds through the third quarter. Feheley said that while green bonds are a global product, the U.S. municipal market has seen more growth in green bond issuance than anywhere else.

The green bond market is still relatively new, and subject to a learning curve, Feheley said.

"A lot of this past year was continuing to educate issuers on the green bond market generally, the fundamentals of the green bond principles and the developing market of socially responsible investors," he said. "As the market continues to develop, we expect many of the large bond funds to increase their allocations to green projects and other social responsible components."

The District of Columbia Water and Sewer Authority has been very active in the green bond market over the past few years. Back in July of 2014, DC Water came to market with a $350 million taxable fixed rate green bond with a 100-year final maturity, which was the first U.S. municipal water/wastewater utility to issue a century bond and the first U.S. green bond issuance to include an independent second party opinion.

The green bond mentioned above, financed a portion of the DC Clean Rivers Project, a $2.6 billion effort to construct tunnels that will transport combined sewer overflows to DC Water's Blue Plains treatment facility. In October of 2015, DC Water issued another $100 million of green bonds, which included a strategy of offering a priority order period for green portfolio and retail investors, which is believed to be the first issue to give green portfolio investors priority order status. The sale generated over $180 million in orders.

"The green bond market has represented a great opportunity for DC Water," said Mark T. Kim, DC Water's chief financial officer. "As an issuer, we are committed to the green bond market and have established a very robust program."

According to Thomson Reuters, DC Water ranks fifth since 2013 in green bond issuance with $450 million, behind the New York City Housing Development Corp. with $494 million; The New York State Environmental Facilities Corp. with $693 million:, the Central Puget Sound Regional Transportation Authority, with $942 million and the state of Massachusetts with $1.02 billion.

Although DC Water is not first in the rankings as far as total issuance, they are constantly pushing the envelope when it comes to best practices and standardization.

“We were the first issuer to have a second party opinion on a green bond and now we are looking to improve on our own best practices,” said Kim. “Right now, we are in the middle of doing a third party “attestation” on our green bond reporting and disclosures. The purpose of the attestation is to provide our investors with additional assurance on the core elements of our green bond program. Specifically, did we spend the money the way that we said we would? Did we meet all of the commitments we made to our investors to report on the environmental outcomes and metrics of the project? The hope is that this will establish a new best practice and investors will demand it going forward.”

Kim said that the hope is that the upfront investment in these best practices today will result in improved pricing for DC Water’s green bonds in the future. Kim also stated that because the municipal green bond market is so new and that issuance volume has only picked up in the last year or two, there are evolving standards and best practices that DC Water is trying to establish to prevent ‘green washing’, which is when issuers claim their bonds are green without offering any proof or evidence to back it up.

“The market is moving towards standardization, but it will be challenging to come up with a single definition of what a green bond is across all industries and sectors,” said Kim. “It would be great if we could reach consensus on a universal definition, but what should happen in my mind is that market discipline would help establish best practices. In other words, if investors simply refuse to buy less-credible green bonds and demand more rigorous and transparent reporting and disclosure practices from green bond issuers, then the expectation is that best practices will begin to emerge.”

Feheley agreed, saying that while the green bond principles are voluntary, market standardization is an important consideration in order to maintain the integrity of the green bond market.

“Not everything is green so a reasonably standardized framework for the offering of green bonds will enhance the overall market,” said Feheley.

While green bond sales have surged, issuers have yet to generate the expected advantage in financing costs due to demand from socially conscious investors. “In the market right now, we don’t see a significant pricing differential between green bonds and traditional bonds, but we expect this may change going forward as allocations to green projects increase,” Feheley said.

Kim agrees that the issue of cost of funds of green bonds versus “traditional” bonds has generated a lot of controversy as there has not been enough empirical evidence to establish whether green bonds offer a pricing benefit.

“I can say without a doubt that green bonds have diversified DC Water’s investor base, but I can’t say that green bonds have offered a definitive pricing benefit at this time” said Kim. “It is still a young market, still in its early days, but I don’t think anyone would claim that there is a pricing penalty associated with issuing green bonds, the real question is how much of an upside benefit is there from a pricing standpoint?”

David Goodman, partner, Squire Patton Boggs LLP, who has worked on green bond deals as a bond counsel, said the green bond market can reach its full potential, as green bonds come naturally to sectors like transportation, water and sewer, education and housing – all of which are in need of more new money deals.

“With all of the unmet demand for project demand for infrastructure and the opportunities within each of those areas to accomplish projects that are green friendly and sustainable, I don’t see why the trend would not continue to increase as there are financial and reputational benefits from green bonds," Goodman said.

Though growth in green municipal bonds may slow from this year's pace, issuers say green bonds are here to stay, and that efforts to educate the investors and increase transparency about the environmental benefits of projects will pay off.

"There is no question in my mind that there is a pool of capital in the market that is looking for sustainable green investments and when issuers can credibly come to market with green bonds, they can achieve investor diversification and successful bond sales," said Kim.

THE BOND BUYER

BY AARON WEITZMAN

DEC 22, 2015 12:13pm ET

Copyright © 2024 Bond Case Briefs | bondcasebriefs.com