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California Wants to Know: What's Next for Green Bonds?

What's the best way to be green? California's treasurer, John Chiang, is trying to find out.

Mr. Chiang is meeting with bond investors this week in New York and Boston in what he calls a "listening tour" to discuss green bonds, which finance projects aimed at mitigating climate change or that have other environmental benefits. The market expanded quickly in recent years as concerns about climate change intensified, but the growth in green-bond sales slowed last year amid questions over how to define green.

Some projects, like a parking garage on a college campus in Massachusetts financed with green bonds, have come under scrutiny. Critics point out that it is largely up to an issuer, and the banks selling the bonds, to determine whether to market them as green. There are also questions over whether the development of green bonds has allowed new projects to move forward, or whether those projects would have been financed regardless through regular bond sales.

Mr. Chiang, who points out that rising sea levels in the coming decades could inundate California's valuable coastline, said the Golden State could become a major green-bond issuer. It already sold \$300 million in green bonds in 2014, much of which has gone to efforts to reduce air pollution. The California Infrastructure and Economic Development Bank is planning to sell green bonds in April.

"When you just think about the needs, the numbers would be large," said Mr. Chiang, who previously met with investors on the West Coast. He is considering a more regular green-bond sales program, but said, "We don't have anything immediately in place, because we want to do this correctly."

Some \$42 billion in green bonds were sold globally in 2015, according to the Climate Bonds Initiative, a nonprofit group in London that tracks the market, a figure that was shy of the group's \$100 billion goal. It was a 13% increase from the \$37 billion that were sold in 2014, but a slower increase than the roughly 220% growth seen from 2013, when \$11.5 billion were sold, to 2014.

So far in 2016, some \$14 billion have been sold, according to the Climate Bonds Initiative. Earlier this year, Apple sold green bonds as part of a larger corporate-bond sale. Whether the issuer is a corporation or a municipality, the bonds are paid back in the same way as regular debt.

Efforts are already underway to better define the market. The International Capital Market Association manages a set of voluntary guidelines called the green-bond principles that is overseen by an executive committee of investors, issuers and underwriters. The guidelines do recommend that issuers obtain "external assurance," such as an opinion from a third-party that certifies the environmental benefits of the project being financed.

Earlier this year, credit-rating firm Moody's Investors Service said it would look into providing opinions — separate from traditional credit ratings — on green bonds. The firm said the opinions would "assess the relative likelihood that bond proceeds will be invested to support environmentally beneficial projects as designated by the issuer."

Speaking from the New York office of law firm Orrick Herrington & Sutcliffe LLP, which has served as bond counsel for California, Mr. Chiang and other top officials in his office outlined other challenges tied to green bonds that they planned to explore.

Periodic reporting that details how bond proceeds have been spent are an added cost. There's still little evidence that issuers get lower interest rates on a green bond versus a regular bond, and rates on California's green bonds were comparable to other bond sales, officials said.

Climate change is a hot-button topic for younger Americans, but they generally haven't yet accumulated enough wealth to start investing in bonds, they said. And the green-bond market in other places like Europe is considered more robust than in the U.S.

A main question is "how do we accelerate the maturation of our market so that we can gain a new financing tool," said Collin Wong-Martinusen, Mr. Chiang's chief of staff.

The treasurer's office, which not only oversees bond sales but also invests public funds, has also purchased green bonds in the past from entities like the World Bank. Mr. Chiang, elected treasurer in 2014, appeared hopeful that California's green-bond efforts could help jump-start green-bond sales in other states as well.

"The states are very different," he said. "You will have progressive treasurers who are very excited about the prospects. Obviously they may have to do the political calculations within their state. But if California's successful, they will be very closely behind us."

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