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Investors Warm to 'Green Bonds'

Popular in Europe, the do-good debt is growing in the U.S., too—part of the mainstream acceptance of sustainable investing

Some $150 billion of green bonds are expected to be issued this year, compared with just $3 billion 2012.

"Green bond" issuance is growing fast, part of the overall trend of do-good investments becoming more popular. And U.S. fund companies are looking to tap into investor demand for these bonds, which finance environmentally friendly projects from green infrastructure and real-estate development to energy-efficiency initiatives.

About $81 billion of green bonds were issued last year, according to the Climate Bonds Initiative, a nonprofit that promotes the debt market as a way to raise money for projects related to climate change. It expects $150 billion of green bonds to be issued this year, compared with just $3 billion were issued in 2012. These figures cover "labeled" green bonds, meaning they have been reviewed externally and meet certain definitions, including those of the Climate Bonds Initiative.

A range of private and government organizations have issued green bonds, from Apple Inc. AAPL 0.55% and Toyota Motor Corp. TM 1.86% to municipalities, New York's Metropolitan Transportation Authority and the governments of France and Poland. They have proved popular with investors, with most of the issues oversubscribed, according to the Climate Bonds Initiative. "These are no longer niche investments," says Neena Mishra, director of ETF research at Zacks Investment Research.

The growth of the market has sparked interest from fund companies, with the first U.S.-listed exchange-traded fund focused on green bonds—the VanEck Vectors Green Bond ETF (GRNB)—launched in March.

The ETF was launched to meet growing investor demand for environmentally focused products, says Edward Lopez, head of ETF product management at VanEck, an investment-management firm based in New York. The green-bond market has grown large enough in recent years to allow for an ETF to be listed, he says.

The fund tracks the S&P Green Bond Select Index, which was launched by S&P Dow Jones Indices last month to track the most liquid segment of the broader S&P Green Bond Index.

The S&P Green Bond Index had an annualized return of negative 0.81% over the five years through the end of March, compared with negative 0.39% for its parent index, the S&P Global Aggregate Developed ex-Collateralized Index, which tracks the performance of a broad range of investment-grade debt around the world.

The VanEck ETF was launched on the heels of the Mirova Global Green Bond fund (MGGYX), a mutual fund that launched in late February. Mirova, a subsidiary of Natixis Asset Management that focuses on sustainable investment, had already launched a green-bond fund in Europe, the Mirova

Green Bond-Global fund.

In demand

“Both institutional plan sponsors and wealth-management advisers are hearing demands from their participants and clients for investments with positive impact,” says Kenneth St. Amand, vice president and client portfolio manager at Mirova, explaining the impetus behind the Mirova funds.

The two new U.S.-listed funds join Calvert Green Bond fund (CGAFX), a $74 million mutual fund that was launched in October 2013 by Calvert Investments, one of the original sustainable-investing firms.

The Calvert fund takes a broad approach, investing both in labeled green bonds and in the bonds of companies it considers to be leaders on environmental issues. For example, the fund will buy any bond issued by Apple—even if a bond doesn’t finance an environmentally friendly project—because of the tech giant’s efforts to reduce its carbon footprint, says Vishal Khanduja, the fund’s portfolio manager.

However, the fund’s makeup has changed over the years, Mr. Khanduja says. The percentage represented by green bonds has increased with the growth in their issuance, so that they now account for more than half of the fund’s assets.

Bigger in Europe

The U.S. is behind Europe in the listing of green-bond funds; there are several in Europe that aren’t open to U.S. investors. That includes the Lyxor Green Bond UCITS ETF, launched in late February by Lyxor Asset Management, part of the Paris-based Société Générale Group , which just beat VanEck’s GRNB as the world’s first green-bond ETF.

There are numerous Europe-based mutual funds focused on green bonds, including the Allianz Green Bond fund, the AXA WF Planet Bonds fund and NN Investment Partners’ NN (L) Euro Green Bond fund. BlackRock Inc. BLK 1.27% launched a Europe-listed Green Bond Index fund in March, while State Street Corp.’s STT 1.53% State Street Global Advisors operates the State Street Global Green Bond Index fund in Europe.

Europe has shown greater interest in the green-bond market than the U.S., in terms of both issuance and investor demand, says Chris McKnett, head of State Street Global Advisor’s global environmental, social and governance, or ESG, investments business.

He points to several reasons, including the relatively early issuance of green bonds on the continent by organizations like the European Investment Bank in 2007 and the World Bank in 2008, which helped foster an investor base.

About 37% of the green bonds outstanding, by face value, are denominated in euros, according to the Climate Bonds Initiative, the most for any currency.

Mr. McKnett says that bodes well for the market’s further development there, because potential issuers will be confident the market can support new supply.

Still, the number of U.S. dollar-denominated green bonds has grown quickly over the past year or so, and they now account for 36% of the global total.

Mr. McKnett says State Street would consider launching a U.S. fund, “given the increasing level of awareness and burgeoning state of the market.”

Brown Advisory, an investment-management company based in Baltimore, is aiming to launch a mutual fund focused on green bonds before the end of this year, says Thomas Graff, head of fixed income.

Brown Advisory currently includes green bonds in a number of the accounts it manages for it clients. “I believe that more and more investors are going to be thinking about sustainability issues,” Mr. Graff says.

Broader choices

One potential drawback of mutual funds and ETFs focused on green bonds is that they still have a relatively narrow universe to choose from, despite the recent growth of the market, says Jon Hale, head of sustainability research at fund tracker Morningstar Inc.

There are other funds that take a broader approach and therefore have a greater range of bonds to choose from, while retaining an ESG theme, Mr. Hale says. He points to the TIAA-CREF Social Choice Bond Fund (TSBRX), a $1.1 billion fund that invests primarily in intermediate-term investment-grade bonds that meet certain ESG criteria, in areas from affordable housing to renewable energy.

Still, the green-bond market looks set to continue growing, and the new mutual funds and ETFs are crucial in opening access to individual investors, as well as raising the profile of climate change as an issue, says Sean Kidney, chief executive of the Climate Bonds Initiative.

“Once you own a green bond, you also start engaging with the whole issue,” he says. “You start thinking ‘There are solutions, I can do something.’ ”

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By Gerrard Cowan

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Mr. Cowan is a writer in Northern Ireland. He can be reached at reports@wsj.com.