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Money On A Mission: Are Green Bonds Right For You?

The financial services industry is constantly developing new products to serve the ever-changing wants and needs of a diverse array of investors. While Wall Street financial innovation can lead to problems (e.g., the exotic mortgage debt instruments that helped fuel the 2008 financial crisis), investment banks occasionally launch new products worthy of investors' attention. I think green bonds are an interesting product that is worth considering for many investors.

Green bonds, like traditional bonds, are fixed income instruments that are used by governments, companies, and NGOs to raise capital through the debt markets. Their structure is not fundamentally different from the corporate bonds, government bonds, and municipal bonds with which many investors are familiar.

However, green bonds differ from traditional bonds in that the issuers of green bonds publicly state that the capital raised through the issue will fund projects, assets, or business activities with an environmental benefit. These activities might include renewable energy, sustainable forestry, or energy-efficiency projects, to name a few examples. Also, capital might be used to fund projects with social or community benefits, such as improving social services or increasing accessibility to healthcare.

In order to provide transparency to bondholders, green bond issuers typically provide periodic reporting on the use of funds and project success, though such reporting is not currently a requirement.

While green bonds are a relatively new phenomenon (the first green bond was issued in 2007 by the European Investment Bank), the global green bond market has grown from $810 million of new issues in 2007 to $155 billion worth of new issues in 2017. With new issuers and investors continuing to enter the market, the total value of green bonds outstanding was estimated to be as high as $335 billion worldwide as of the end of 2017.

While there is currently no standardized set of criteria for what qualifies a bond as "green," I expect this to change as the market develops. Several international organizations have developed guidelines that issuers are encouraged to follow in order to be able to label their bonds as "green." I expect that a single international green bond standard will emerge in the near future, which should only add to the credibility and size of the green bond market.

As an example, Apple (AAPL) entered the green bond market in 2016, issuing $1.5 billion in bonds, with the proceeds used to finance renewable energy, energy storage and energy efficiency projects, green buildings, and resource conservation efforts. Apple is undertaking these projects in order to reduce the company's carbon footprint and the carbon footprint of its supply chain. In issuing these bonds, Apple developed a green bond framework which was reviewed by a third party consultancy, while Ernst & Young was hired to conduct an annual audit to determine how the bond proceeds were used.

The increasing popularity of green bonds has coincided with the rapid development of the broader

sustainable investing space, which now comprises nearly $23 trillion in assets globally. The dramatic growth of sustainable investing (which encompasses ESG, impact, and socially responsible investing), is indicative of an important and accelerating trend in investor interest regarding the way in which firms are impacting and interacting with the environment and society as a whole.

While some might argue that this focus on corporate sustainability and responsibility does little more than make investors feel good, I would argue that it can reduce investment risk over the long term, and the research seems to agree with me. I believe it is important for investors to own investments which align with their personal values, but it is this potential for portfolio risk reduction that makes green bonds, along with other environmentally and socially conscious investments, especially interesting.

Given the multitude of risks that investors face nowadays, it can make sense to seek out investments in firms and projects which not only seek to minimize environmental, social, and governance risks but also actively pursue opportunities to make a positive impact in these areas. I believe green bonds represent such an opportunity, and I expect this to lead to continued growth of the space in the years ahead.

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