

»» Market for Green Bonds – huge potential or just "nice to have"?

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Green bonds are bonds which are used to finance climate and environmental protection projects. A specific characteristic of the bonds is that investors are able to understand which project categories the funds will be channelled into at the time that the bonds are issued.

The *Green Bond Principles* (GBP) represent the first step towards standardisation of this emerging market. These principles consist of voluntary guidelines which are intended to ensure the transparency of the financing instrument. Transparency is particularly required with regard to (i) the use of the funds, (ii) the selection of projects to be financed, (iii) the management of the proceeds as well as (iv) regular reporting. In addition to this, the GBP recommend obtaining a second opinion, which is considered as an indicator of reliability in the Green Bond market. Further initiatives such as the *Climate Bond Initiative* (CBI), which certify Green Bonds, support the market and help to make the product more trustworthy for investors.

Rapid growth

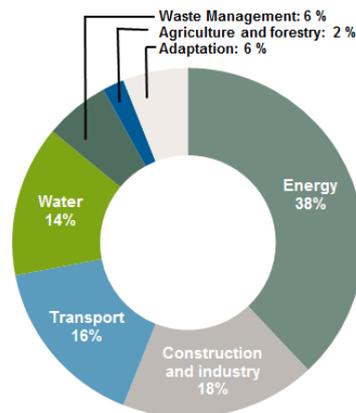
2016 was by far the most successful year since the first *Green Bonds* were issued by the European Investment Bank (EIB) in 2007. The volume of new issues has more than doubled to EUR 68 billion in comparison to the previous year. According to the report from the CBI, there were over 90 new issuers last year, including more and more cities and local authorities, as well as private sector companies.

Development banks continue to be important agents in the market. For governments, *Green Bonds* also represent interesting financing options in order to fulfil their pledged contributions to combat climate change in view of the

Paris climate agreement. In December, Poland issued its first *Green Bond* as a government bond; France followed in January this year.

The use of funds in 2016 was as follows:

Graphic 1: Use of funds



Source: Climate Bond Initiative, 2017

Many experts anticipate that the market will continue its dynamic development, both in terms of new agents entering the market and the volume of new issues. The British bank HSBC is predicting a total of up to USD 120 billion in new issues worldwide in 2017. Other forecasts predict an even higher amount.

Share of the bond market still extremely small

However, this is not a reason for unbridled euphoria. *Green Bonds* currently only have an approximate 0.2 % share of the global bond market. Obstacles include

- the as yet general lack of interest-rate advantage of the issues compared with standard bonds,
- the increased preparatory work,

- limitations with regards to refinancing measures as well as
- the absence or only partial availability of guidelines adapted to country contexts.

Furthermore, only a few investors can invest in more risky bonds, which inhibits the expansion of the market, especially in developing countries.

Green Bonds: emerging financial product with a great deal of potential

Green Bonds are a promising instrument for financing a growing proportion of necessary climate investments. The global bond market offers a great deal of potential for mobilising private capital for "green projects". The bonds could represent a particularly suitable financing option for developing countries, where climate-friendly investments are most needed. However, in order to make *Green Bonds* scalable, even in developing countries:

- The costs associated with issues must be reduced,
- local capital markets must be expanded, and
- more suitable projects related to climate and environmental protection must be developed.

Public institutions such as development banks have a key role to play in this respect. They could function as cornerstone investors in less developed contexts or get involved in very innovative projects, therefore leveraging private capital.

Green Bonds could potentially play an important role in helping to attain the climate goals agreed in the Paris agreement. However, it remains to be seen whether they can make the jump from niche to mainstream. ■