Cameron Hume

Fixed Income Specialist

Green Bonds and Impact Investing

Impact investing is an example of the 'Doing Well by Doing Good' approach to responsible investing: investors hope to profit by promoting investment in projects that will also produce a societal good. Green bonds and Social bonds are examples of Sustainability bonds, which are a form of low risk impact investing. All types of Sustainability bonds have similar objectives, but the funds they raise are applied to different environmental or social goals. The European Investment Bank (EIB), working with other international financial institutions, stated[1] the goal of the green bond market as:

"...to help mobilize private sector financing for sound climate - and environmentally - sustainable investments and help enhance transparency of environmental finance."

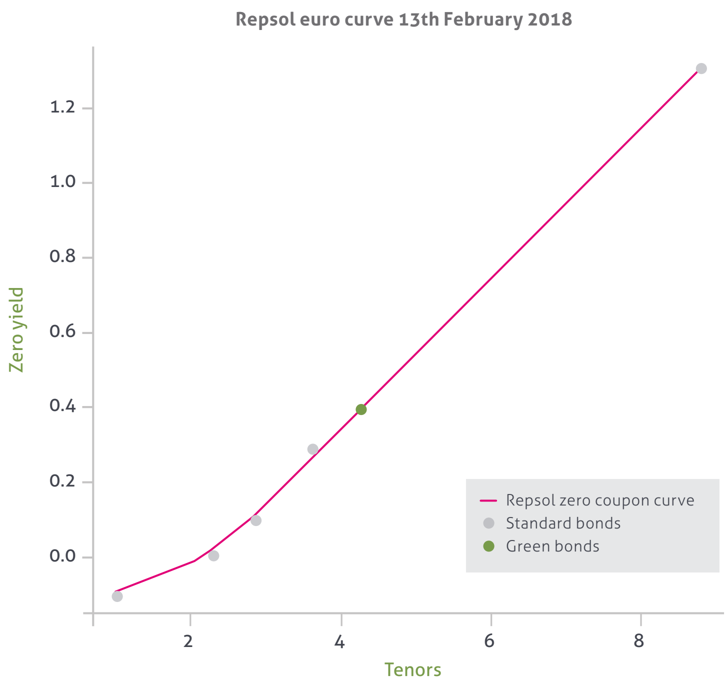
To the same end, the International Capital Markets Association (ICMA) publishes the Green (GBP[2]) and Social (SBP[3]) Bond Procedures, which are annually updated voluntary process guidelines. These guidelines make explicit that the bonds proceeds are to finance particular projects that will have an expected and measurable environmental or social benefit and that the issuer should take steps to ensure that the use of proceeds is adequately governed.

The funds raised by Sustainability bonds are intended for particular types of project, but the cash flows to service the bonds come from the issuer's general resources and not from the projects specifically financed by the bond. This distinction can leave investors conflicted; there can be a tension between the 'green' projects ostensibly financed by the green bond and the issuer's other activities which produce the cash flows to meet the entailed obligations.

A recent example is a green bond issued by the Spanish Oil company, Repsol. Although Repsol and the green bond satisfied the Green Bond Procedures, the incongruity of an oil company issuing a green bond was too much for many investors and market observers. Possibly as a consequence, the pricing of Repsol's green bond is indistinguishable from its other obligations, as seen in Figure 1.

An alternative explanation is that for a traditional credit investor, there is nothing to distinguish a green bond from any other bond obligation of the issuer. The EIB is largely seen as an uncontroversial issuer and yet Figure 2, which shows a scatter plot of their euro-denominated bonds with five of their green bonds highlighted, suggests that their green bonds are priced on the same basis as their other obligations.

Figure 1



[1] http://www.eib.org/attachments/fi/informationonimpactreporting.pdf

[2] https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/GreenBondsBrochure-JUNE2017.pdf

[3] https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/SocialBondsBrochure-JUNE2017.pdf

[4] https://www.climatebonds.net/2017/05/oil-gas-bond-we-knew-would-come-eventually-repsol-good-gbps-not-so-sure-green-credentials

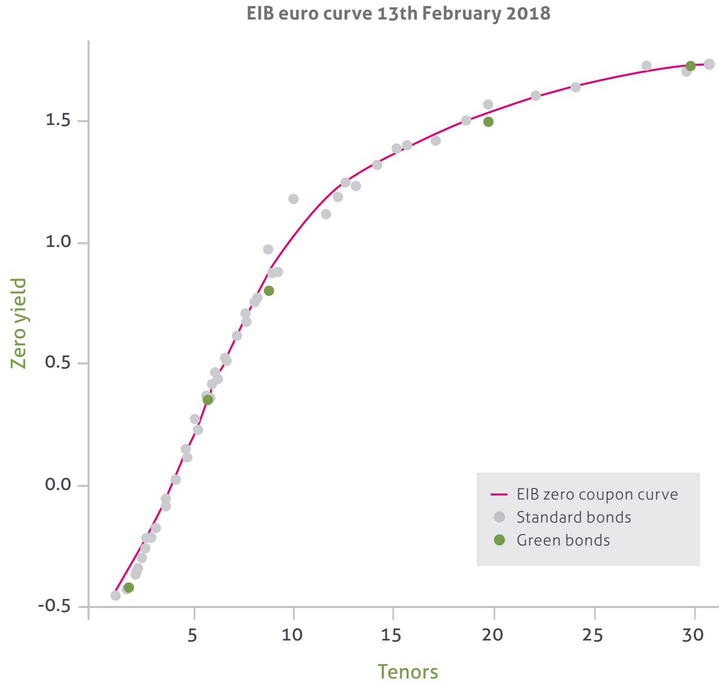
Cameron Hume
Exchange Place 1, 1 Semple Street
Edinburgh EH3 8BL
www.cameronhume.com

The green bond market requires issuers to provide additional information and to devote the proceeds only to investments that are expected to yield environmental benefits. These requirements impose additional costs on the issuer for which one might expect them to be compensated. If Sustainability bonds are to fulfil their objective, then one might expect green bonds to offer the borrower cheaper finance, which is not the case for EIB at present.

To date there is little evidence that the green bond market has provided a materially cheaper source of finance for green projects. This suggests that for now the benefits of green bond issuance are reputational rather than financial. Whether this is sufficient to sustain the green bond market is questionable.

On the other hand, as green bonds appear to be priced indistinguishably from other obligations of the issuer, they represent an opportunity for those investors who wish to engage in impact investing. First, it is easy to determine a fair value for the bonds, by making a comparison to other obligations of the issuer, and secondly the disclosure required of Green bonds makes it possible to assess the impact of the investment.

Figure 2



Contact

Keith Logan
keith.logan@cameronhume.com
T +44 (0) 131 603 6988
M +44 (0) 7860 925 131