RBC Capital Markets

Takeaways from 2019 Green Bond Conference

APRIL 2019

TAKEAWAYS FROM 2019 GREEN BOND CONFERENCE

RBC Capital Markets hosted its 6th annual conference on green bonds. Held in Toronto, Canada in late April 2019, the forum offered a power-packed lineup of industry leaders and experts, who shared their insights on the green bond market, drivers of growth and future opportunities in both green and broader sustainable investing.

It's been over a decade now since green bonds entered the capital markets. Starting with the European Investment Bank and its Climate Awareness Bond in 2007, supra-nationals led the first wave of green bond issuance. Businesses came to the table much later, with the first corporate green bonds emerging in 2012. Today, organizations spanning sectors and geographies are issuing green bonds, with annual issuance reaching a record $168.6 billion in 2018.

RBC Capital Markets hosted the 2019 Green Bonds Conference to explore these now-mainstream investments that are reshaping the financial markets, as well as paving the way to a more sustainable, lower-carbon economy. Here are eight of the big ideas and revelations from the event.

THE GREEN BOND MARKET REMAINS A HOTBED OF ACTIVITY AND OPPORTUNITY. KEY DRIVERS WILL SUSTAIN THIS GROWTH.

1 MOMENTUM REMAINS STRONG

- Globally, 2018 was another milestone year for green bonds, with issuance up by a healthy 7%. This performance was nowhere near the stellar 87% growth rate experienced in 2017 and 90% in 2016. This is partially attributed to a maturing market, whilst Vanilla primary volumes in developed markets were also down last year.
- While the pace of green bond issuance slowed last year, the trend has been to increasing issuance, with total annual green bond issuance growing more than fourfold in the past five years.
- The outlook was unanimous: 2019 will see new highs for green bond issuance, expected in the range from $180 billion to $250 billion.

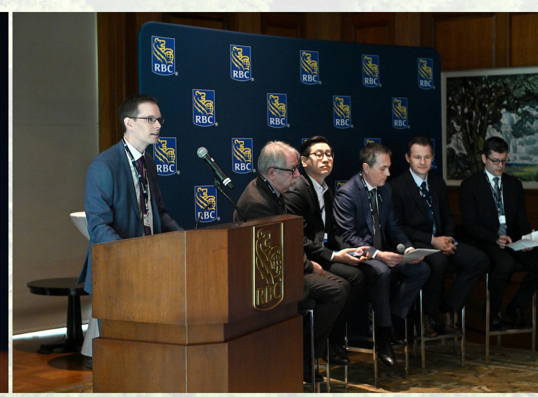
2 THE GREEN BOND MARKET CONTINUES TO DIVERSIFY

- Amid the continuous flurry of activity, the green bond market is expanding across geographies, currencies, sectors and projects. It also continues to deepen – with repeat issuers, larger tranches and a growing base of institutional investors.
- Geographically, Europe remains the largest market for green bond supply, with Asia-Pacific jumping into second place. In the latter region, the top three countries for green bond issuance in 2018 were China, Australia and Japan.
- The “green bond parade” also continues to expand in terms of issuer diversity. Pioneered by development banks, today green bonds are issued by a growing range of entities – including national governments, municipalities, businesses and even academic institutions.
- Corporate bonds represented 48% (vs. 33% in 2017) of green bonds issued in the global market last year. Financial institutions, in particular, have enlarged their share of the pie: green bond issuance from the financial sector more than doubled to $49.7 billion in 2018, with more than 75 financial institutions active in the green bond market (with 100+ offerings). This growth is expected to continue as financial institutions are viewed as pivotal players in the push to a low carbon economy.

- Despite global expansion, green financing in emerging markets remains scarce. This geographic gap is a concern. As one presenter observed, “emerging markets are where the need is, but the money isn’t.”
- The growing number of players participating in the green bond market is helping accelerate cleaner economic growth and a more sustainable future. Much more work and capital is needed to make a difference: the Climate Bond Initiative is of the view that global green bond issuance needs to reach at least $1 trillion per year (compared to $168.5 billion in 2018) to achieve a substantial impact on climate change.

3 CLIMATE ACTION EFFORTS A CATALYST FOR GREEN BOND GROWTH

- There are a plethora of national and global initiatives aimed at tackling climate change and mobilizing stakeholders to adopt an environmentally-friendly agenda. These efforts are proving a major stimulus for the green bond market.
- Many countries, including Canada, keen on meeting Paris objectives and other climate aspirations have developed or are working on climate action plans and guidelines to encourage green investment. Governments are increasingly looking to infrastructure investment, in particular, to spur economic growth and improve the climate. In a September 2018 OECD report titled Financing Climate Futures, Rethinking Infrastructure, the OECD estimates that approximately $6.9 trillion of investment in infrastructure is needed each year to 2030 to meet the goals of the Paris Agreement and deliver on the UN’s 2030 Agenda for Sustainable Development.
- The Canada Infrastructure Bank (CIB) is a Crown corporation created by the federal government, with a $35 billion budget to invest in infrastructure projects, including $5 billion for green infrastructure projects that reduce GHG emissions, deliver clean air and promote renewable power. CIB is financing green transactions that would not be able to come to market fruition without support, with funds serving as “seed capital” to bring projects to scale.
- Additionally, there are multi-stakeholder efforts like the United Nations Sustainable Development Goals, in which climate change is a focus, and the European Commission’s new plan for sustainable finance, which recognizes a global need to direct more capital to build a greener economy.



4 DEMAND > SUPPLY

- The demand for green bonds among institutional investors with “green” mandates continue to grow meaningfully, as awareness around climate and other environmental risks heightens. Retail investors are expected to play a significant role in the growth of this market, however, we have not yet seen the strong level of interest that we expect from these investors
- Demand for green bonds is currently outstripping supply. And in a 2018 Responsible Investing Survey by RBC Global Asset Management, only 14% of respondents felt there is enough green product in the market. The report also highlights that responsible investing is increasing and is considered to be a fiduciary responsibility, with 72% of institutional investors and consultants surveyed using ESG principles as part of their investment approach.
- Harmonizing the measurement and reporting of green bonds remains a key challenge. Several agencies including Moody’s and S&P have developed green methodologies to assess bonds on their greenness. There is consensus that more standardization and green “scoring” is needed to enhance green bond investing and comparison.

5 CANADA’S GREEN BOND MARKET CONTINUES TO RAMP UP

- In Canada, we saw record green bond issuance in 2018, with 11 deals totalling $6.3 billion (vs. $1.9 billion in 2019), accounting for 3% of green bond volumes globally.
- The breadth of the Canadian market has improved in the past two years, with more organizations recognizing the opportunity and business case in green bonds. As a young and growing market, there is considerable potential, but issuance must keep up with investor demand – or investment dollars will go abroad.
- The Canadian green bond market for non-financial corporations went mainstream in 2018, with inaugural green offerings by two established bond issuers: Brookfield Renewable Partners and Ontario Power Generation (OPG). The latter was the first non-bank corporate issuer in the country.

- Another major highlight last year, the Canada Pension Plan Investment Board was the first pension Investment Board in the world to issue a green bond (C$1.5 billion).
- The pace of activity has continued in the first few months of 2019 , with notable green bond offerings by Ontario Power Generation and Algonquin Power as well as RBC, which launched its inaugural EUR500 million 5-year green bond offering the same day as the conference.
- According to one expert, Canada should have its own green bond taxonomy that reflects the country's economic and social backdrop.

6 A CLEAR NEED FOR "ADAPTATION FINANCING"

- The overwhelming majority of green bond proceeds are supporting projects designed to mitigate climate change – such as energy efficiency and renewable energy projects. Without question, investment in green bonds is viewed as a powerful platform for financing and accelerating the global energy transition – from fossil fuels to clean energy solutions – and sustainable practices more broadly.
- Few green bond proceeds, however, are supporting "climate adaptation" – that is, projects focused on helping people, organizations and communities adapt and build resilience to extreme weather events and other impacts of a changing climate. According to the Climate Bonds Initiative, "only 3-5% of green bond proceeds globally go to adaptation and resilience."
- As the costs of extreme weather continue to rise, harnessing green bonds to finance more climate adaptation projects represents an opportunity. One presenter put forth for consideration the idea of issuing pan-Canadian climate adaptation bonds.

7 ISSUERS HAVE VALUABLE LESSONS TO SHARE

- The maturation of the green bond market, with broader acceptance among investors is prompting more organizations to leave the sidelines and step into the game. Some delegates indicated that their organizations watched the green bond space for several years, waiting until it became a "well-trodden path" before taking action. As one speaker explained, "a growing body of precedents and examples have given us the comfort and confidence to execute our own green bond framework".

- Several delegates who have been involved in green bond issuances and frameworks emphasized the value of learning from their experiences and those of others in the space, highlighting the multiple steps and level of effort involved. Key lessons include allowing adequate time for research and development, engaging internal teams, clearly defining the right criteria, and obtaining third-party support and verification.
- While organizations are driven by different motives in issuing green bonds, it is clear they are increasingly viewed as a golden opportunity to broaden the organization’s investor base.
- Reporting and transparency are crucial to earn stakeholder confidence and trust. According to several presenters, “greenwashing” is a major concern expressed by investors, who want to see robust metrics and information on how green bond proceeds are being used.

8 MOVING FROM E TO S AND G

- While green bonds aren’t the only game in town, they do make up a sizeable chunk of the ESG investing space.
- Beyond the green bond market, the issuance of broader sustainability-themed bonds aimed at addressing social and governance issues is picking up pace. For example, last year Concordia University became Canada’s first post-secondary school to issue a sustainability bond. The $25-million, 20-year investment will help finance the new LEED-certified Science Hub while generating social and environmental benefits. CIBC recently launched a women in leadership bond framework and Sun Life Financial unveiled a framework to issue its own sustainability bonds.
- Sustainability bonds are expected to multiply as more issuers and investors enter the space, explore new financing opportunities and link their strategies to the UN’s 17 Sustainable Development Goals. One issuer noted that their organization’s recent social bond issuance is tapping into the SDGs because they are a well-known “brand”, thereby making it easier to sell and market to investors.

05/19 19-055A