UNDERSTANDING THE AFRICAN GREEN BOND MARKET
1. THE GREEN BOND MARKET

The labelled Green Bond market has multiplied more than fivefold in size from 2013 to 2016, when it reached USD 81 billion in new issuances. The market grew by 92% from 2015 to 2016 and is projected to reach between USD 120 billion (HSBC) to USD 200 billion (Moody’s) in 2017. These figures exclude bonds that do not meet international green definitions, such as reduced-emissions coal or hydro and grid connection projects not linked to renewable energy (if these were included, it would bring 2016’s total issuances up to approximately USD 92 billion (Climate Bonds Initiative), and a total “climate-aligned”1 bonds universe of USD 694 billion.

Issuer type and geography have also greatly expanded in recent years, with Emerging Markets such as India and China joining the fray. A DFI dominated market until a couple of years ago, there is now a strong corporate presence, and growing municipal issuance market outside of the United States (where it is already well developed), including Johannesburg issuing a US$140mm Green muni in 2014. The year 2016 also saw Poland issue the first government Green Bond.

The value proposition of Green Bonds driving the rapid increase in participation is multi-faceted, as the “greenness” of Green Bonds adds value in several ways.

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1 These are bonds with environmental impact that are not labelled green bonds and not subject to the same scrutiny or voluntary reporting standards.

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GLOBAL GREEN BOND ISSUANCES

- Regulatory: e.g. mandatory reporting of carbon footprint of portfolio;
- Financial: e.g. use of stranded assets; reduced environmental disasters;
- Reputational: e.g. for companies with defined carbon goals, meeting ESG targets.

**RISK MITIGATION**

**INVESTOR/CAPITAL ACCESS**

By issuing green bonds issuers have been able to vastly diversify their investor pool, reaching asset owners who might not otherwise have invested in a traditional bond issued by the same firm.

**PRICE PREMIUM**

There is some evidence that there is a small Green Bond “price premium” in the secondary market, while some issuances have priced tighter than general bonds by the same issuer. However, the effect remains small and investors are reluctant to assign an explicit value to “greenness”. Market participants believe this will grow as interest rates pick-up.
2. GUIDELINES AND MARKET STANDARDS

The Green Bond market is not formally regulated, relying instead on compliance by issuers with voluntary guidelines and standards such as the Green Bond Principles (GBP) and the Climate Bond Standards (CBS). Both offer guidance on suitable use of proceeds for a green bond issuance, the process for project selection and evaluation, management of proceeds and reporting. Across the market, currently, the emphasis is on the use of proceeds: this being the main qualifier for defining a bond “Green”. However, there is an increasing pressure from investors on improving reporting and increasing transparency.

The move towards more transparent reporting is being led by a group of 11 DFIs which have agreed on a standard reporting format for Energy Efficiency and Renewable Energy projects financed through Green Bond issuances. However, a number of corporates also provide extensive reporting on impact and disbursement to projects, though the format and content are highly idiosyncratic.

The renewable energy and energy efficiency sectors are by far the most advanced in terms of available guidelines and reporting. These are the easiest technologies to assess for environmental impact and easy to justify as receivers of Green Bond proceeds, as a result these also constitute the majority of Green Bond-financed projects today.

The issuance and verification process as it stands today relies heavily on voluntary adherence to standards, reporting and use of a second opinion provider:

- The current “gold standard” for the green bond market is adherence to the Green Bond Principles or the Climate Bond Standards (closely aligned). Compliance with these can be certified or verified through a second opinion, provided by a dedicated (reputable) third party;

- Issuers are encouraged by the GBP to create a Framework for their Green Bond issuances, in which they define the eligible types of projects these might be used to finance. The framework is an umbrella for all the issuances and also outlines the processes for project selection, and the ring-fencing of Green funds. At each issuance, in theory, the specific projects to which the funds will be allocated should be indicated: these are “commitments”. In reality, a significant proportion of issuers do not point to specific projects for financing ex-ante, but rather disclose the receivers of the financing at a lag to issuance, in the relevant annual reports;

- The verification process of a green bond at the moment is heavily skewed towards a qualitative assessment of use of proceeds: GBP and CBS outline eligible technologies and activities for the issuance of a green bond (to greater or lesser degrees of detail), and outline the reporting requirements around the use of proceeds – including the creation of a “Green Bond Framework” by the issuer ahead of the bond issuance;

- The third party (CICERO, Sustainalytics, Vigeo, EY etc.) will assess the issuer’s Green Bond Framework, reporting process and the identified use of proceeds, and issue a statement/certification that gives investors confidence that the bond complies with the GBP/CBS guidelines;

- No hard impact restrictions or regulations currently apply to the market.
It is important to note that currently entities can issue bonds without obtaining a second opinion, or even creating a framework or producing reports. The transparency and detail around the issuance is very much voluntary. However, the degree of detail and compliance with standards does impact the credibility of the issuance as green, and as such the investor base it attracts.

As a result of the additional, though voluntary, requirements for issuing Green Bonds, the issuance costs also increase. Such costs arise explicitly in the form of third parties for the provision of a second opinion, and implicitly in the form of additional internal processes and administrative costs.

**GREEN BOND PRINCIPLES (ICMA)**

The Green Bond Principles (GBP) are voluntary guidelines for the issuance of green bonds, they cover use of proceeds, reporting, and process and are housed by ICMA. The GBPs encourage transparency and disclosure, by clarifying the approach for issuance of a Green Bond, including outlining the process for project selection and the creation of a Green Bond Framework by issuers.

**Use of Proceeds:** Green Projects should provide clear environmental benefits and be described on the bond’s legal documentation. When the proceeds are used for refinancing purposes, the share of refinancing vs. financing should be stated, as well as which investments or projects will be refinanced. It is expected that the use of proceeds is defined ex-ante with the expectation that these will be reported on further down the line by issuers.

The GBP outline the following eligible project categories:

<table>
<thead>
<tr>
<th>CATEGORIES</th>
<th>PROJECT EXAMPLES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Renewable energy</td>
<td>Production, transmission, appliances and products</td>
</tr>
<tr>
<td>Energy efficiency</td>
<td>New and refurbished buildings, energy storage, district heating, smart grids, appliances and products</td>
</tr>
<tr>
<td>Pollution prevention and control</td>
<td>Waste water treatment, greenhouse gas control, soil remediation, recycling and waste to energy, value added products from waste and remanufacturing, and associated environmental monitoring analysis</td>
</tr>
<tr>
<td>Sustainable management of living natural resources</td>
<td>Sustainable agriculture, fishery, aquaculture, forestry and climate smart farm inputs (e.g. biological crop protection or drip-irrigation)</td>
</tr>
<tr>
<td>Terrestrial and aquatic biodiversity conservation</td>
<td>Protection of coastal, marine and watershed environments</td>
</tr>
<tr>
<td>Clean transportation</td>
<td>Electric, hybrid, public, rail, non-motorized, multi-modal transportation, infrastructure for clean energy vehicles and reduction of harmful emissions</td>
</tr>
<tr>
<td>Sustainable water management</td>
<td>Sustainable infrastructure for clean and/or drinking water, sustainable urban drainage systems and river training and other forms of flooding mitigation</td>
</tr>
<tr>
<td>Climate change adaptation</td>
<td>Information support systems, such as climate observation and early warning systems</td>
</tr>
<tr>
<td>Eco-efficient products, production technologies and processes</td>
<td>Development and introduction of environmentally friendlier, eco labelled or certified products, resource efficient packaging and distribution</td>
</tr>
</tbody>
</table>
Process for Project Evaluation and Selection

Within their Framework, the issuer should outline a clear process for determining how the projects supported fit the categories defined by the GBP, and define the associated environmental sustainability objectives. The GBP encourage the use of a third party to provide a “second opinion” on the framework’s compliance with the Principles.

Management of Proceeds

The proceeds from Green Bonds should be ring-fenced from proceeds from other bonds. Additionally, the issuer should provide information on the intended types of temporary placement for the balance of unallocated proceeds. To increase transparency, the GBP encourage the use of a third party to verify the internal tracking method and allocation of funds.

Reporting

Issuers are advised to keep updated information on the use of proceeds, which should be renewed annually.

The GBP also defines four types of Green Bonds:

1. **Green Use of Proceeds Bond**: standard recourse-to-the-issuer debt obligation
2. **Green Use of Proceeds Revenue Bond**: a non-recourse-to-the-issuer debt obligation
3. **Green Use of Proceeds Project Bond**: for a single or multiple Green Projects for which the investor has direct exposure to the risk
4. **Green Use of Proceeds Securitised Bond**: collateralised by one or more specific Green Projects

CLIMATE BOND STANDARDS

The Climate Bond Standards (CBS) were produced by the Climate Bonds Initiative and are used for the Climate Bonds Standard & Certification Scheme, currently the only certification available for Green Bonds, created by the same institution. The CBS are similar to the GBP, but with more in depth information regarding the types of projects and technologies eligible for Green Bond financing, as well as recommendations in reporting and impact (currently only available in detail for Renewable Energy, Efficiency and Transport).

The CBS requirements are divided into pre-issuance and post-issuance requirements. Pre-issuance requirements include:
- Documentation on the bond’s environmental objectives and investment sectors,
- The determination of eligibility criteria for projects and assets to be funded, and
- Tracking and management of allocated and unallocated proceeds.

Post-issuance, the CBS focus on on-going reporting of the actual use of proceeds and eligibility of these under the relevant project categories.

Criticism of the GBP and CBS have been primarily around the lack of stringency for reporting on realised impact of the investments and on actual use of proceeds.
3. THE GREEN BOND MARKET IN AFRICA

The African Green Bond market is significantly underdeveloped. Most issuances in Africa have been from DFIs: the African Development Bank, IFC and EIB, as well as some foreign development banks issuing in South African Rand and targeting the Japanese Uridashi market. Only four local issuances have taken place to date: two in Morocco and two in South Africa, including a private placement.

This lag in uptake is likely largely due to the nascent stage of African capital markets (although to a lesser degree in South Africa). However, the associated explicit and implicit costs of issuing a Green Bond could also prove a hurdle if the upside of the effort is not fully understood or not sufficient, this is particularly true of smaller issuance sizes (part of the rationale for ALCB Fund in general in Africa).

As shown in this section, the current landscape is highly heterogeneous, with none of the bonds representing the market “gold standard”:

- Listed;
- Framework available and easily accessible;
- Second opinion available and easily accessible;
- Post-issuance reporting available and easily accessible.

Each issuance ticks one or more but not all of these boxes. This is to be expected of a market that is just starting to develop, however experience from more sophisticated Green Bond markets has shown that trail-blazing top of the class issuances initiates a virtuous circle of improved transparency and reporting driven by investor demand.

Supporting the development of the African Green Bond market at this early stage could be an opportunity to set the bar for process and disclosure standards. In catalysing market development, the uptake of internationally recognised standards should be encouraged and will lend credibility to issuances – thus attracting a wider investor pool. This however should be balanced with the current level of market sophistication.

4. ISSUERS

The Green Bond market in Africa is nascent. A number of multilateral institutions such as the IFC, the AfDB and the EIB have issued green bonds in South African Rand. They are not, however, relevant for the purpose of this document. Green Bonds issued in Africa by non-DFIs have focused primarily on “blue chip” credits:

<table>
<thead>
<tr>
<th>Issuer</th>
<th>Size (USDm)</th>
<th>Issue date</th>
<th>Maturity</th>
<th>Issue type</th>
<th>Country of domicile</th>
<th>Second Opinion</th>
<th>Framework</th>
<th>Main Investors</th>
</tr>
</thead>
<tbody>
<tr>
<td>City of Johannesburg South Africa</td>
<td>136.9</td>
<td>6/2014</td>
<td>6/2024</td>
<td>Listed</td>
<td>South Africa</td>
<td>No</td>
<td>No</td>
<td>Stanlib Asset Management, Old Mutual PLC, Sanlam LTD, Boutique Collective Investment</td>
</tr>
<tr>
<td>Nedbank</td>
<td>297.2</td>
<td>8/2012</td>
<td>8/2017</td>
<td>Retail Bond</td>
<td>South Africa</td>
<td>No</td>
<td>No</td>
<td>Retail</td>
</tr>
<tr>
<td>BMCE Bank</td>
<td>50.1</td>
<td>11/2016</td>
<td>11/2021</td>
<td>Unlisted</td>
<td>Morocco</td>
<td>No</td>
<td>Yes</td>
<td>N/A</td>
</tr>
</tbody>
</table>

Sources: Bloomberg and Climate Bonds Initiative (as of 31/01/2016).
City of Johannesburg Municipal Green Bond

The City of Johannesburg Green Bond programme was the first emerging market municipal issuance, and was 1.50 times oversubscribed. The proceeds will finance projects that reduce greenhouse emissions and contribute to a “resilient and sustainable city” (City of Johannesburg) such as the Biogas to Energy Project, the Solar Geyser Initiative. The bond has not been through an independent review and no Green Bond Framework is available for this issuance.

BMCE Bank Green Bond

BMC issued a USD50.5m Green Bond to finance renewable energy and energy efficiency projects in Morocco over the next 5 years. Interestingly, the BMCE has specified minimum energy savings and avoided emissions amounts for energy efficiency projects to be eligible under their framework. Though BMC issued a Green Bond Framework, no second opinion is available.

MASEN Green Bond

The issuance will be used to finance three solar energy projects in Morocco (Noor Laayoune, Noor Boujdour, and Noor Ouarzazate IV) and will benefit from a sovereign guarantee from the Kingdom of Morocco. A Green Bond Framework is available and Vigeo Eiris acted as the second opinion provider on the issuance, which has been certified under the Climate Bonds Standards.

3 CONCLUSIONS

The African Green Bond market is largely underdeveloped, with very few non-sovereign risk and non-supra issuances taking place. Even in South Africa, issuance is very low given the relative sophistication of the market: despite local and international investor appetite there have been only two non DFI issuances, a local retail bond and a municipal issuance. Where other markets in Africa may be further from being obvious candidates for a corporate Green Bond issuance, South Africa has the potential to grow this sector quickly.

Providing anchor investment for Green Bond issuance in Africa, starting with South Africa, is consistent with the ALCB Fund’s mandate to promote capital market innovation and primary issuance. South Africa has the potential to pilot Green Bond transactions for the Continent, with investors such as Stanlib and Sanlam already articulating green investment strategies (and investing in SA Green Bonds). The Fund also has the potential to promote offshore investment in African Green Bonds. Although there is no universal rulebook for the issuance of Green Bond, and the adherence to “best in class” guidelines is not mandatory, the fund could play a significant role in guiding the market to a reasonable level of transparency.

Please note that some issues have been raised regarding the location of the projects funded by the MASEN Green Bond, as they are located in the politically disputed Western Sahara.