Beyond going green

Green, social and sustainability bonds

Wealth Management

While environmentally friendly green bonds have been around for over a decade, the sustainable debt market has grown in recent years to incorporate debt supporting a variety of sustainability goals, providing responsible investors with a wider array of investment opportunities. Over the past decade, cumulative global issuance of green, social and sustainability (GSS) bonds totaled approximately $3.7 trillion, with $858.5 billion alone in 2022, according to the Climate Bonds Initiative.

What makes a bond sustainable?

The cornerstone of a green, social or sustainability bond is the use of its proceeds. Green bonds are those that finance environmental projects, social bonds finance projects with positive social benefits and sustainability bonds are those that finance projects that have both positive environmental and social benefits.

According to the International Capital Market Association's Green Bond Principles (GBP), Social Bond Principles (SBP), and Sustainability Bond Guidelines, there are four components with which eligible green, social, and sustainability projects must be aligned:

1. **Use of proceeds.** All designated projects should provide clear environmental or social (or a combination of both) benefits, which will be assessed and—where feasible—quantified by the issuer.
2. **Process for project evaluation and selection.** The issuer should clearly communicate to investors the sustainability objectives, how the project fits within eligible green or social project categories and related eligibility criteria-—including any possible exclusion issues associated with the project.
3. **Management of proceeds.** As long as the bond is outstanding, a high level of transparency by the issuer is necessary in tracking and verification on the allocation of issue proceeds.
4. **Reporting.** Issuers are expected to be able to make readily available up-to-date information on the use of the proceeds.

The following broad categories represent some of the most common types of projects represented in the GSS bond market:

- Renewable energy and energy efficient buildings
- Sustainable waste management and land use
- Biodiversity conservation
- Clean transportation
- Clean water and/or drinking water
- Affordable housing and socioeconomic development

The GBP and SBP represent voluntary guidelines, intended for broad use by the market, which are designed to aid in the continued development of the GSS bond market. These principles are designed to be beneficial to all stakeholders, including issuers, underwriters and investors. According to RBC Capital Markets, the adoption of responsible investing principles continues to grow among institutional investors. Responsible investing is increasingly considered to be a fiduciary responsibility, which helps drive the demand for GSS bonds.

Where's the issuance?

According to the Climate Bond Initiative, since 2007 a variety of supranational organizations, federal and local government agencies, commercial banks and private corporations have issued green bonds.

Sovereign governments are a powerful influence in the global GSS bond market, with $324.2 billion in cumulative issuance. As of 2022, 43 national governments issued GSS bonds, more than double the prior year. The Climate Bonds Initiative expects the number of sovereign GSS bond issuers to top 50 by the end of 2023 as the global energy crisis accelerates the transition to clean energy.

In the U.S., munis lead the way

While the U.S. Treasury has yet to issue any green, social or sustainability bonds, U.S.

municipalities are a large player in the space. According to the Climate Bond Initiative, 39% of cumulative global issuance of GSS bonds since 2012 has come from U.S. states and municipalities. RBC Capital Markets was a leader in the GSS municipal bond market in 2022, managing a total of 41 labeled-bond deals totaling over $3.8 billion, according to Bloomberg data.

U.S. municipal issuers were very active in the social bond sector in 2022. For example, the Minnesota Housing Finance Agency priced over 200 deals last year carrying the social-bond designation.

Additionally, the Climate Bond Initiative estimates that approximately $250 billion of outstanding bonds from specialized U.S. municipal issuers are climate-aligned in their use of proceeds but are not explicitly labeled green.

The RBC Wealth Management fixed income strategies group has a companion piece to this brief titled Municipal bonds and impact investing, in which **the firm states a belief there are abundant municipal debt financings that could be labeled green, with the biggest opportunities in the water and sewer and transportation sectors. Furthermore, the likely continued growth in municipal GSS bonds should, in our opinion, provide additional investment opportunities for the responsible investing community to branch into the municipal market.**

In turn, as they consider opportunities in the municipal bond sector, investors utilizing a responsible investing framework should benefit from asset diversification, high-quality credit characteristics and historically low default rates when compared to most corporate debt.

Bond investors should carefully consider risks such as interest rate risk, credit risk and market risk, including the possible loss of principal.

Due diligence processes do not assure a profit or protect against loss. Like any type of investing, ESG investing involves risks, including possible loss of principal.

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