UK GBC

The voice of our sustainable built environment

CLIMATE, GREEN & SUSTAINABILITY LINKED BONDS

PRACTICAL GUIDE

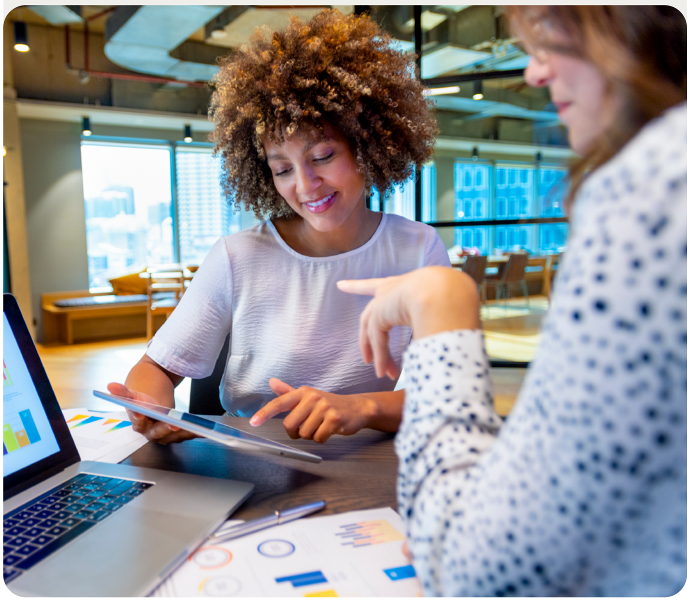
This guide provides a short overview of climate bonds, green bonds, and sustainability linked bonds (SLBs). It is one of a series of guides focused on finance products which can support the net zero transition.

IN A SNAPSHOT

A bond is a fixed-income instrument and investment product where individuals lend money to a government or company at a certain interest rate for an amount of time. Bonds are issued by companies, municipalities, states, and sovereign governments to finance projects and operations.

The terms climate bond and green bond are sometimes used interchangeably. A brief outline of key differences between the three types of bond in this guide is shown below:

- Climate bonds raise finance for projects that directly reduce carbon emissions or alleviate the effects of climate change.
- Green bonds raise finance for projects that are environmental, sustainable and socially responsible, focused on positive environmental outcomes.
- Sustainability linked bonds do not directly drive investment in green projects and can finance any corporate activity as long as there is a link to achieving predefined sustainability / ESG objectives.



TRANSITION FINANCE VS GREEN FINANCE

The European Commission defines sustainable finance in the following way: " Sustainable finance is about financing both what is already environment-friendly today (green finance) and what is transitioning to environment-friendly performance levels over time (transition finance)".

The increasing importance of sustainable finance

Sustainable finance increasingly rises on the international agenda. At Cop28 (2023), 13 national governments, including the UK, endorsed the Declaration on a Global Climate Finance Framework focused on making finance available, accessible and affordable and unlocking the investment opportunities associated specifically with climate related finance.

According to the Intergovernmental Panel on Climate Change's (IPCC) Sixth Assessment Report, annual climate finance flows need to increase by a factor of three to six to meet the average annual needs of all regions and sectors to align with the Paris Agreement.

Green bonds are one of the main mechanisms for sustainable financing with the global green bond market growing at an average annual growth rate of about 95% since the first green bond was issued in 2007.

SLBs first emerged in 2019. Since then the market has experienced huge growth globally from $9 billion in 2020 to $100 billion in 2021.

Investors, financiers and lenders have a crucial role to play in accelerating the transition to net zero carbon assets. Using climate bonds, they can direct investments towards technologies and projects that reduce emissions.

More about climate and green bonds and sustainability linked bonds

Climate bonds

Climate bonds are defined by the Climate Bonds Initiative as fixed-income financial instruments linked to climate change solutions. They are issued to raise finance for climate change solutions such as climate mitigation or climate adaptation related projects.

The Climate Bond Standard and Certification Scheme sets out criteria and a verification process for certifying climate bonds, based on the following principles: eligibility criteria, use of proceeds, certification process, verification, transparency and reporting, flexibility, alignment with climate goals, and market development.

Green bonds

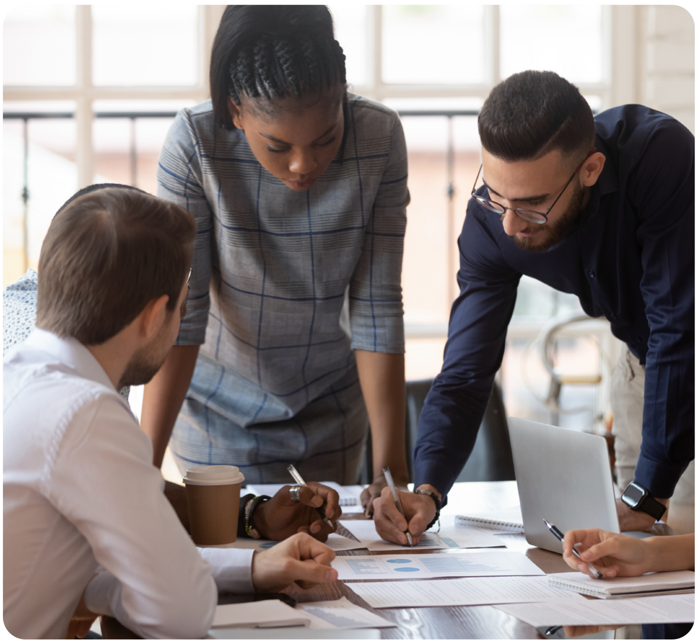
Green bonds are defined in The Green Bond Principles (GBP) as any type of bond instrument where the proceeds will be exclusively applied to finance or re-finance eligible green projects which are aligned with the four core components of the GBP.

The GBP is a voluntary framework that provides key recommendations to support issuers in financing projects that promote sustainability and have positive environmental impacts. It contains guidance on best practices when issuing bonds and promotes transparency and disclosure of the environmental and social impact of the project funding.

Sustainability linked bonds

Sustainability linked bonds are defined in the Sustainability-Linked Bonds Principles (SLBPs) as any type of bond instrument where the financial and/or structural characteristics can vary depending on whether the issuer achieves predefined sustainability / ESG objectives.

Similarly to sustainability linked loans (SLLs), SLBs are structured with specific financial characteristics. However, SLBs are typically bought by a diverse group of investors and traded on the bond market, due to being less constraining than green bonds.



Availability and application

Bonds are issued to raise finance, and investors invest in them to diversify their investor portfolios, receive a steady income stream of interest payments, and in the case of climate, green and sustainability linked bonds, they can help achieve sustainability / ESG objectives.

A variety of entities (sovereign governments, multi-national banks, corporations, supranational organisations (World bank, EU) etc) can issue climate, green or sustainability linked bonds.

Corporates, supranational organisations (World bank, EU) and sovereigns (governments) often have the necessary resources and capacity to issue climate or green bonds, funding projects such as renewable energy / energy efficient infrastructure, renewable energy projects, or sustainable supply chain investment. These organisations can benefit from the scale of climate / green bond issuances to fund substantial green projects and improve their environmental and social impact.

Small to medium - sized (SMEs) organisations face more challenges in issuing these types of bonds due to limited financial resources and expertise. They can participate in green bond offerings through partnerships, joint ventures, or green bond funds. SMEs can align their operations with sustainable practices, potentially attracting investors and customers supporting environmentally responsible business.

As long as it is aligned with the SLBPs, all types of issuers in the debt capital market can issue SLBs. SLBs allow for a wider range of issuers than green bonds because green bonds require heavy capital expenditures in areas like renewable energy, utilities and green buildings, which are inaccessible to many companies due to them lacking sufficient green assets. SLBs are emerging as a sustainable financing instrument for companies in hard-to-abate sectors.

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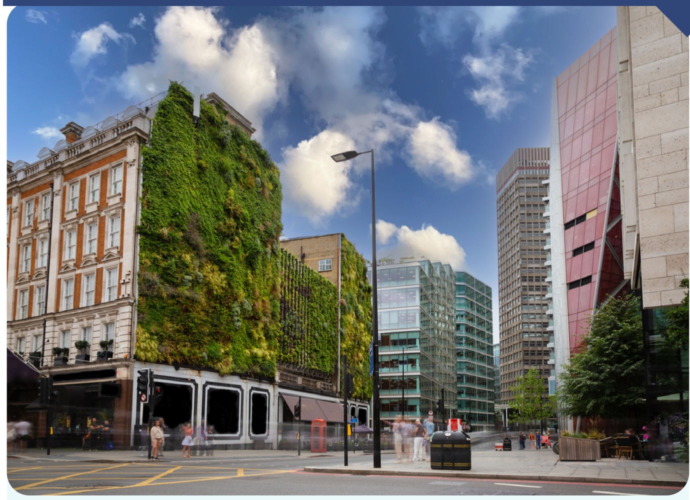

Examples:

Climate bonds

Local Climate Bonds (LCB) are regulated investment products launched by councils to raise funding for specific decarbonisation projects. Local people invest in their areas via a crowdfunding platform which is open for three months and investors can also donate some or all of their interest payments to specific council projects. There have to date been nine issuances of LCBs in the UK.

Westminster City Council issued an LCB in March 2023, raising £1 million in nine days to decarbonise council buildings and fund community projects and green projects including solar panels, LED lighting, insulation energy efficiency measures. The LCB had an investor return of 4.2%

Green bonds

In 2022, Just Group forward funded £27 million in investment into an NHS green bond. The Use of Proceeds was towards ensuring that a 144-bedroom student accommodation, academic learning hub and ancillary services targeted high sustainability standard certification.

In March 2023, Landsec updated their Green Financing Framework, which outlines how they will use the proceeds of green financing instruments to fund eligible projects. The updated framework aligns with both the GBP and the Green Loan Principles (GLP). It describes which projects are eligible, and how the proceeds will be managed and reported. A £400 million inaugural green bond has been issued under the Green Financing Framework.

Sustainability linked bonds

In 2021, British property development and investment company, Hammerson, completed its real estate €700 million SLB with a 6-year maturity period and 1.75% coupon.

The SLB requires that L&Q build 8,000 new homes of which 50% are affordable, reduce scope 1 and 2 emissions by 20% against a 2020 baseline, and achieve an average calculated Standard Assessment Procedure (SAP) score of 72 or above.

IN SUMMARY

Climate bonds, green bonds, and sustainability linked bonds are types of fixed-income instruments governed by their own set of principles and criteria. Climate bonds and green bonds are most similar with the only difference being that climate bonds raise finance for projects that directly reduce emissions, whilst green bonds raise finance for green projects more generally. SLBs can finance any corporate activities so long as the borrower meets key performance indicators and sustainability performance targets. A variety of entities can issue these bonds including real estate companies, local authorities and housing associations.

FURTHER RESOURCES

- Climate Bonds Initiative:
  What is a Green Bond?
- Climate Bonds Initiative:
  Understanding climate bonds
- RICS:
  Green bonds and risk perception on construction projects
- BDO:
  Green Bonds: leveraging sustainable finance to accelerate the net zero transition
- IFC:
  Green bond handbook: a step-by-step guide to issuing a green bond
- ICMA:
  Pre-issuance checklist for green bonds / green bond programmes
- ICMA:
  Sustainability Linked bond principles
- Climate Bonds Initiative:
  Sustainability-Linked Bonds: Building a High-Quality Market
- World Economic Forum:
  What are sustainability linked bonds and how can they support the net-zero transition?
- Clifford Chance:
  Sustainability - linked bonds - making sense of SLBs, KPIs and