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Energy and Covid-19

The era of sustainable finance

Could Green Bonds & Social Bonds be the solution to South Africa's socio-economic woes?

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Climate change is undoubtedly one of the most pressing challenges faced by the global community. Its adverse effects are evident worldwide, with rising sea levels, shifting rainfall patterns and increasing frequency and intensity of severe weather events (OECD, 2018). It presents the single most significant threat to sustainable development and its widespread, unprecedented impacts are most burdensome to the poor and vulnerable (UN, 2016). If not tackled with haste, climate change will have detrimental social, economic and environmental consequences for us and future generations (Baehr, 2014).

Social and Economic Impact of Climate Change

The two most prominent global initiatives that seek to address climate change and environmental stewardship are the Sustainable Development Goals ('SDGs'), which form part of the United Nations' 2030 Agenda for Sustainable Development, and the Paris Agreement, which falls under the United Nations Framework Convention on Climate Change ('UNFCCC'). The SDGs are a set of 17 goals with aims to promote peace, eradicate poverty, realize prosperity for all humanity, and protect the planet by taking urgent action on climate change (United Nations, 2015). Unlike the SDGs which have a broad mandate, the Paris Agreement is primarily focused on climate change. Its overarching aim is to strengthen the global response to climate change by keeping the average global temperature rise well below 2 degrees Celsius through the reduction of greenhouse gas ('GHG') emissions and to reach net-zero emissions by 2050 (UNFCCC, 2020). The agreement also aims to help countries strengthen their abilities to deal with the impacts of climate change and to provide financial assistance to developing countries affected by a changing climate (Carlson, 2016).

"...it brings together 197 countries for a common cause..."

What makes the Paris Agreement monumental in the global fight against climate change is that it brings together 197 countries for a common cause (UNFCCC, 2020). At the heart of the agreement are nationally determined contributions ('NDCs') which represent efforts by each country to reduce national emissions and adapt to the impacts of climate change. In order to achieve their NDCs, governments need to make substantial investments into projects that will reduce GHG emissions and help their countries transition to low-carbon energy. Estimates indicate that around U$1.6 trillion to U$3.8 trillion is needed annually between 2016 and 2050 for investments into supply-side energy systems alone, in order to achieve the low-carbon transition envisioned in the Paris Agreement (CPI, 2019).

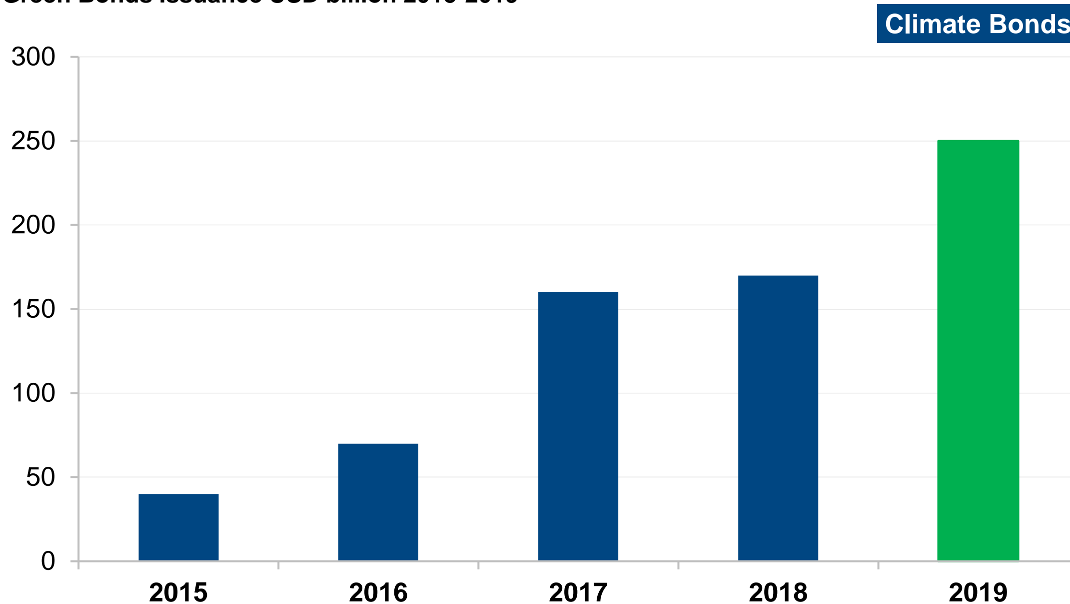
Investment to facilitate transformational change

Climate-related risks are far-reaching, and research indicates that they will impact all sectors (EY, 2016). Consequently, addressing climate change is no longer viewed as a "government issue", but rather a challenge that needs to be tackled using collective action and a collaborative approach involving both public and private sector stakeholders (EY, 2016). The last five years have witnessed more and more private capital being mobilised towards green investments. While climate-related finance is growing, the current levels of investment are nowhere near where they should be in order to facilitate transformational change and reach the globally agreed upon climate goals. There is an urgent need to address this funding gap and the mobilization of both public and private sector funding is of paramount importance in this regard.

"...a key solution in enabling the transition towards a low-carbon society..."

A financing mechanism that has gained momentum in recent years is the use of green bonds (Ngwenya, 2019). While there is no standard definition of a 'green bond', they generally refer to debt instruments that are exclusively used to raise financing for projects that have a positive impact on climate and the environment (JSE, 2020). Although the green bond market is still in its infancy and relatively small, accounting for less than 1% of the overall bond market issuances, it has grown significantly since the issuance of the first green bond in 2007 (IRENA, 2020). Over the last three years alone, the US dollar value of annual issuances of green bonds has more than doubled. In 2017, the World Bank (2017) reported U$100 billion in annual green bond issuances. In 2019, annual issuances hit U$257.7 billion, marking a new global record and representing a 51% increase from the prior year's U$170.6 billion issuances (CBI a, 2020). The cumulative green bond issuance sat at U$805 billion in February 2020 (CBI b, 2020). These are significant milestones, especially considering how the use of green bonds can potentially be a key solution in enabling the transition towards a low-carbon society.

Growth in Green Bond Issuances between 2015 and 2019



Source: Climate Bonds Initiative 2020

Green bonds can be greatly beneficial to both issuers and investors. For issuers, they send a strong signal to the market of their commitment to climate change. This can in turn strengthen their brand and attract a wider investor base (Amundi & IFC, 2019). For investors, green bonds provide a straightforward means of integrating environmental, social, and governance ('ESG') factors into fixed income portfolios, as such they have become particularly attractive to investors that are focused on sustainable and responsible investing (World Bank, 2017). Furthermore, they provide relatively long maturities and relatively stable returns for their given risk exposure (Amundi & IFC, 2019).

With emerging markets said to be most vulnerable to climate change-related impacts, it is crucial for these countries to rapidly ramp up their climate change adaptation and resilience measures. While regulators in emerging-market economies have started to recognize the transformative potential of green bonds and have increasingly put in place policies to encourage green-bond issuances (IFC & CBI, 2018), the green bond market remains nascent in these economies (Ngwenya & Simatele, 2020).

A deeper look into the South African green bond market

South Africa was the first emerging market to issue green bonds in 2012, followed by issuances from Brazil, China and Peru in 2014 (Amundi & IFC, 2019). The country's first green bond was launched by the Industrial Development Corporation of South Africa ('IDC'), a development finance institution set up to promote economic growth and industrial development (Fin24, 2012). The R5 billion bond was earmarked for investment in clean energy infrastructure (Green Climate Fund, 2018).

In 2014, the City of Johannesburg became the country's first municipality to list a green bond on the Johannesburg Stock Exchange ('JSE') – an issuance worth R1.46 billion designated for initiatives that reduce GHG emissions and contribute to the city's sustainability, such as the Bio Gas to Energy Project and the Solar Geyser Initiative (Joburg, 2014). The City of Cape Town followed suit with a R1 billion green bond issuance in July 2017 to fund projects aligned with the city's climate change strategy (CBNC Africa, 2017). The success

of Cape Town's green bond issuance led to it being certified by the Climate Bonds Initiative and being awarded an excellent GB 1 rating by international ratings agency, Moody's (JSE, 2017).

In October 2017, the JSE launched a Green Bond Segment – a platform for companies and other institutions to raise funds exclusively for initiatives that have positive environmental and/or climate benefits, and investors to invest in securities that are truly "green" (JSE, 2017). A key differentiator between South Africa's green bond market and other markets is the binding nature of the International Capital Markets Association's ('ICMA') Green Bond Principles on corporations that list their bonds on the JSE (Bowmans, 2018). In other markets, the Green Bond Principles are merely voluntary guidelines, whereas on the JSE they are mandatory due to their incorporation into the JSE Debt Listings Requirements.

"…Standard Bank Group's South African unit made history by selling a U$200 million green bond to the IFC – Africa's largest green bond issue and South Africa's first offshore issuance…"

The formation of the Green Bond Segment was an effective tool in boosting green bond issuances by private sector companies in South Africa. In 2018, Growthpoint Properties Limited became the first corporate company to issue a green bond on the JSE Green Bond Segment, with the issuance valued at R1.1 billion. Growthpoint Properties (2018) reported that the proceeds would be towards sustainable developments and green buildings. In 2019, Nedbank became the first South African bank to list a green bond on the JSE with proceeds earmarked to fund renewable energy projects (Nedbank, 2019). The bond was initially placed at R1.7 billion but received overwhelming support, with bids totaling R5.5 billion (JSE, 2019). In March 2020, the Standard Bank Group's South African unit made history by selling a U$200 million green bond to the International Finance Corporation (Bloomberg, 2020) – Africa's largest green bond issue and South Africa's first offshore issuance. The bond listed on the London Stock Exchange and its proceeds will be used to finance projects in water & energy efficiency, renewable energy and the development of green buildings (Bloomberg, 2020).

In July 2020, Nedbank listed a first of its kind R2 billion Renewable Energy SDG-linked bond on the JSE (Nedbank, 2020). This was following the expansion of the JSE Green Segment to a broader Sustainability Segment in June 2020. According to the JSE (2020), the expansion is aimed at encouraging the issuance of Sustainability Bonds and Social Bonds in addition to Green Bonds, thus continuing in the spirit of making the markets work to support sustainable development.

Covid-19 and sustainable investing

Covid-19 has drastically changed the socio-economic landscape of many countries, including South Africa. Governments worldwide have been required to increase expenditure, while revenues have decreased due to reduced economic activity (Theobald and Montalto, 2020). While some battle with overstretched healthcare systems, ensuring food security as well as protecting businesses and families from bankruptcy has become particularly crucial in the global south (Hammer and Hallegatte, 2020). The crisis has exposed the fragilities of nations and has necessitated innovation and change across both health and economic fronts.

One of the major shifts caused by the pandemic has been the rise of social bonds. Similar to green bonds, social bonds are a type of sustainable debt instrument used to fund defined projects. While green bonds are used to finance projects that have a positive impact on the environment, social bonds are used to finance projects with positive social outcomes (ICMA, 2020).

Before Covid-19, social bond issuances were extremely small: they accounted for only 5% of the sustainable bond market in 2019, while green bond issuances made up 80% of the market (BNP Paribas, 2020). By April 2020, the sustainable bond market significantly shifted, seeing social bonds account for 28% of market

share while green bonds constituted 50% of the market (BNP Paribas, 2020). The increased volume of social bonds has primarily been driven by Covid-19. Supranational institutions and national development agencies, including the International Finance Corporation ('IFC'), the African Development Bank ('AfDB') and the European Investment Bank ('EIB'), have been the main issuers of these social bonds with funds aimed at addressing social issues that have emanated as a result of the pandemic.

While it may appear that green finance has taken a backseat for now, it is highly unlikely that the pandemic will completely shift allocations from environmental to social initiatives (Oliphant, 2020). A more probable scenario is a rebalancing of the components of sustainable investing, where environmental, social and governance ('ESG') factors are equally considered by investors unlike in our pre-Covid-19 world, where there was a greater focus on the 'E'. This rebalancing of ESG factors might just be what countries need to help them meet their SDGs and ultimately deliver peace and prosperity for people and the planet. How it will actually play out is however yet to be seen.

As the South African government seeks funding to deal with the health crisis caused by Covid-19 and to stimulate the country's anaemic economic condition, it would be amiss not to consider the sustainable finance avenue. According to National Treasury (2020), the country faces a large funding gap with the consolidated budget deficit estimated at R761.7 billion, which translates to 15.7% of gross domestic product in the 2020/21 year. This is more than double the 6.8% shortfall that was projected before the crisis (National Treasury, 2020). Given the government's long commanded global respect for its bond issuance and financial transparency (Theobald and Montalto, 2020), it is well-positioned to issue sovereign social and green bonds in order to help the country with its funding requirements. Not only should this source of finance be an immediate consideration for purposes of responding to the Covid-19 crisis but should also be taken into account post Covid-19 as more and more investors seek to incorporate ESG considerations into their investment decisions. This ought to bode well for a country that is challenged by the effects of climate change and also struggles with poverty, unemployment and high inequality.

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