

Developing green bond markets for Africa

A joint FSD Africa- ODI research program for financial sector development in Africa

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Key messages

Sub-Saharan Africa urgently needs to mobilise \$50bn annually to address climate adaptation and green economic growth in agriculture, power and urban infrastructure.

Regulatory and market frameworks for domestic green bond markets has progressed need to be taken to the next level.

Green bond issuances by national governments and supranational bodies should be the immediate priority to build market momentum as well as direct financing of climate investments.

Building the investor base amongst domestic institutional investors and specialist 'green' international investors is critical.

Supporting new issuers through anchor capital and technical support for meeting green bond certification and listing requirements are key areas for donor interventions.

Acknowledgements



The joint FSD Africa- ODI research program for financial sector development in Africa

FSD Africa is a specialist development agency working to build and strengthen financial markets across sub-Saharan Africa. Its mission is to reduce poverty through a 'market systems development' approach addressing the structural, underlying causes of poverty by improving how financial market systems function.

As part of their work, FSD Africa's invest in breakthrough research, analysis and intelligence-gathering projects to provide policy makers, regulators, development actors, investors and financial service providers with vital market insights and information and that contributes to long-term change.

As part of this research, FSD Africa have partnered with the ODI, the independent global development think-tank, to address policy issues in financial sector development in Africa. This includes a series of working papers by and for leading academics and an accompanying series of briefing papers focused on the policy implications of research targeted at policy makers, regulators and the broader stakeholder community.

The research program is being accompanied by joint FSD Africa and ODI dissemination events in the region and internationally to present and debate the policy implications of the research findings.

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Contents

Acknowledgements2

Acronyms4

1 Introduction5

2 Building green bond markets.....7

 2.1 Central banks and regulators7

 2.2 Public issuances7

 2.3 Private (corporate) bond issuers9

 2.4 The investor base9

3 Concluding remarks11

References12

 FSD Africa- ODI research program - Briefing papers.....12

 FSD Africa- ODI research program - Working papers.....12

 Key further reading13

Acronyms

AFDB	African Development Bank
FSD Africa	Financial Sector Deepening Africa
FCDO	Foreign, Commonwealth and Development Office
GDP	Gross national product
IFC	International Financial Corporation
IFI	International Financial Institution
SRI	Socially responsible investor
USD	United States Dollar

1 Introduction

Africa is the world's most vulnerable region to climate change. Rising temperatures, rising sea levels, and worsening erratic rainfall are increasing the frequency and intensity of natural disasters and disrupting agricultural production, damaging infrastructure and threatening the sustainability of urban areas. In addition, there is a need for continued economic development that is compatible with climate goals.

According to UNECA and the IMF, up to \$50 billion a year is needed with the current lack of finance being a key barrier (IPCC, 2018). The expected public financing available from national governments and international donors is unlikely to be able to meet these needs. That means that private finance needs to be mobilised.

One potential source of such private finance is the green bond market. Globally, there have been a huge growth in the last decade with the market now reaching \$2 trillion and 40 countries participating. This has been driven by complementary growth in the supply of green assets – most notably green infrastructure - and green investors who have emerged as a new and rapidly expanding investor class.

However, sub-Saharan Africa is not participated in these trends. To date, there have been only been 16 bond issuances, representing only 1.5% of total global bonds by number and less than 0.3% by value. To date, there have been 16 bonds issued in the region's capital markets. Governments (sovereign and municipals) and financial institutions dominate with most proceeds being directed into infrastructure (including energy, water and transport). Investors are largely domestic investors with investments being made through private placements or public offerings on national stock exchanges. (Table 1)

Table 1: Sub-Saharan Green Bonds Issues (2014-2020)

Issuer	Value (Issue CCY)	Issuing Currency	USD value (M)	Issuer	Country	Year	Use of Proceeds
Standard Bank Group	200	USD	200	Financial Institution	South Africa	2020	Water, Energy, Buildings
Acorn Project Limited	4300	KES	40.9	Corporate	Kenya	2019	Buildings
Federal Government of Nigeria	15000	NGN	41.4	Sovereign	Nigeria	2019	Conservation, Energy, Transportation

<i>Nedbank</i>	1662	ZAR	116.7	Financial Institution	South Africa	2019	Energy
<i>North South Power</i>	8500	NGN	23.5	Corporate	Nigeria	2019	-
<i>Access Bank</i>	15000	NGN	41.5	Financial Institution	Nigeria	2019	-
<i>Bank of Windhoek</i>	66	NAD	4.6	Financial Institution	Namibia	2018	Energy, Transportation
<i>Republic of Seychelles</i>	15	USD	15	Sovereign	Seychelles	2018	Conservation
<i>Growthpoint</i>	1100	ZAR	97.3	Corporate	South Africa	2018	-
<i>Federal Government of Nigeria</i>	10690	NGN	29.7	Sovereign	Nigeria	2017	Energy
<i>City of Cape Town</i>	1000	ZAR	73.8	Municipal	South Africa	2017	Conservation Urban infrastructure
<i>City of Johannesburg</i>	1460	ZAR	137.8	Municipal	South Africa	2014	Energy, Transportation

Source: CBI

There have been initiatives in the region to develop green bond markets to address this. But significant barriers remain.

There is muted international investor appetite for the region because of perceived high risks relative to other emerging economies. Domestically, investor demand is concentrated in governments and a few limited private sectors such as telecoms and financial services.

More finance needs to be directed to diversify and increase power sources including towards solar, wind and geothermal power and further finance is needed. Urban areas need improved water management systems and low carbon transport to reduce susceptibility to extreme weather events and rising sea levels but financing of this is below that needed.

Similarly, there is a need to raise much greater financing for the agricultural sector. The economy of the region remains heavily concentrated in agriculture and it is an area of considerable climate risk because it is predominantly rainfed, monoculture and uses techniques which damage the environment. Finance is needed to provide irrigation and climate friendly inputs (such as drought resistant crops) and reverse environmental degradation including soil erosion and deforestation. However, currently in African capital markets, there is almost no finance for agriculture.

This paper focuses on the domestic green bond market in Africa and what can be done to tackle these barriers.

2 Building green bond markets

As highlighted in briefing paper 2 of this series, critical aspects of capital market development include establishing a sound legislative and regulatory framework and then seeking to build critical mass in issuers and investors in primary and secondary markets.

Green bond markets would be expected to follow a similar process. In this section, we review what can be done to support this.

2.1 Central banks and regulators

Central banks and regulators in the region have been active in developing green bond markets.

There has been strengthening of the legal and regulatory framework through national green bond programmes including in South Africa, Nigeria and Kenya. These have introduced clear green bond guidelines and governance including independent verification and monitoring of proceeds, issuing benchmark sovereign green bonds and developing securitization vehicles.

These are all welcome and important initiatives as they lay the essential groundwork for the development of green bond markets.

However, this could be taken to the next stage. Central banks and other financial regulators can encourage investments in green bonds by allowing reductions in risk-weighted capital for green bonds or allowing them to be offset against capital for stranded assets. This could be particularly important for oil-dependent economies.

Developing green bond indices and a taxonomy for the region would be helpful. These could include aspects tailored to region's specific goals such as biodiversity and agriculture.

Stock exchanges in the region can also promote green bonds through dedicated green bond sections (only South Africa has one today) and promoting green bonds as a new investment product including providing market education and publicising forthcoming issuances.

2.2 Public issuances

Public bond markets dominate sub-Saharan bond markets and are an important part of laying the foundations for capital market

development because they enable liquidity to be built in both primary and secondary markets.

To date, in the region, there only two sovereigns have issued green bonds (The Federal Government of Nigeria and the Seychelles¹). In addition, there have been two municipal bond issuances in South Africa. (See Table 1)

One option to build the green bond market would be to focus on increasing public bond issuances. To date, several such bodies have issued green bonds. Indeed, sub-Saharan African issuances currently represent 3.9% of all supranational issues globally. However, these have been in international markets and almost exclusively in ‘hard’ currencies. (Table 2)

Table 2: Sub-Saharan Sovereign and Supranational Green Bonds Issues (2014-2020)

<i>Issuer</i>	USD value (M)
<i>Federal Government of Nigeria</i>	30
<i>Africa Finance Corporation</i>	178
<i>African Development Bank</i>	9,480
<i>IFC (All regions)</i>	12,140
<i>West African Development Bank</i>	909
<i>Percent of all sovereign issues</i>	>0.1%
<i>Percent of all supranational issues (Est for IFC to SSA of 10%)</i>	3.9%

Source: CBI

Issuers could include sovereign governments, municipal authorities and development finance institutions. This would mobilise finance directly for green projects including large-scale public infrastructure projects. However, it would also encourage the establishment of green bonds as an asset class for investors including familiarising them with green bond standardisation, risk management and investment decisions. This will potentially lay the groundwork for the expansion of green bonds into non-public issuers including financial institutions and corporates.

A push should be given to switching a portion of these into national capital markets in the region and to issues in local currency and accompany them with measures to promote market development as well as raise finance. For example, the African Development Bank (AFDB) has the capacity and the demand from its extensive programme of green infrastructure development to lead this strategy.

¹ Technically a ‘blue’ bond which is a subset of green bonds.

However, it would be helpful for the AFDB to use international certification rather than self-labelling and issue in local currencies.

International financial institutions (such as the International Finance Corporation and the African Development Bank) also have significant levels of 'market ready' green assets on their balance sheets including infrastructure assets. Such IFIs could use such assets as the underlying for green bonds or for green securitizations in domestic markets.

2.3 Private (corporate) bond issuers

To date, private issuers of green bonds in the region have been limited with only a few issuances by financial institutions and green power companies (Table 1).

Given the significant number of private companies active in green infrastructure in the region – and especially in small and medium scale projects in, for example, solar energy or urban infrastructure which are 'below the radar' of IFIs - such issuances can be expanded to provide capital for scaling of successful private innovations in green technology.

This could be accelerated by assistance to support private issuers to come to the market. There are several ways to do this. Firstly, technical assistance is needed to meet requirements such as determining green bond frameworks, conducting portfolio reviews to identify eligible projects and assets, conducting external review and meeting green bond certification standards (as well as more basic listing requirements).

More substantially, there is also a need to provide capital to provide 'anchor' investment in new issuances. This could include using capital to underwrite bonds, provide partial guarantees or finance first loss tranches as well as *pari passu* investment.

2.4 The investor base

More needs to be done to deepen the investor base for sub-Saharan African green bonds.

Encouraging domestic institutional investors to invest in green bonds is critical in this regard. The noted improvements in national regulation and market frameworks are attracting investors as they ensure national green bonds meet international certification and governance standards. Developing investment know-how for green assets pension and life- insurance funds would be helpful (in addition to regulatory incentives noted).

The demand for green bonds has also grown exponentially amongst international investors including those with specialist interests in the region such as socially responsible investors. Attracting such capital into green bonds in the region would provide a significant boost to its

development (although care should also be taken to assess the risks of cross border capital flows).

This could be done simply by promoting African green bonds amongst international investors including, potentially, cross listing on international stock exchanges for larger issuances such as sovereigns.

It would also be possible to design products that are specifically target such investors including tiered structures which allowed them to manage their risk profiles appropriately and products which can be shown to have specialist 'bottom double lines' such as conservation bonds which have already proved popular with specialist international investors.

3 Concluding remarks

This paper has discussed the imperative of mobilising climate finance for sub-Saharan Africa. Green bonds can make a significant contribution to this especially given the huge growth in green finance globally. Section 2 has highlighted some key initiatives that could help progress this.

A further key aspect to highlight in conclusion is that public actors need to take the lead.

As discussed, green markets in the region are nascent and there needs to be a sequential approach to building them.

That needs to start with the regulatory and certification frameworks and then be developed further into pro-active developments such as climate-adapted capital and liquidity for financial institutions and dedicated segments within mainstream exchanges.

Moreover, and equally importantly, new issuances from national governments and supranational bodies can not only raise finance directly for climate action but also have indirect impact on market development by increasing the number and scale of bonds in primary markets and encouraging secondary market liquidity.

Consequently, whilst, in the medium term, the aspiration should be for private issuers to take the lead, the immediate focus should be on national governments and regulators and their development partners to achieve these goals in order to deliver the most rapid path to green bond market development for the region.

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