

## States and Localities Are Finding a Huge Potential in Green Bonds

In just a few years, states and localities have vastly increased their issuance of green bonds to finance environmentally beneficial projects. The hike — from \$500 million in 2010 to \$3.8 billion in 2015, according to *Bloomberg New Energy Finance* — reflects a worldwide trend. Moody's Investor Services estimates that global issuance of green bonds this year will top last year's \$42.4 billion mark. The numbers are particularly impressive given that the first state green bond issuance occurred only a few years ago.

Development banks and corporations are the largest issuers of green bonds, but state and local governments are expected to increase their use of the financing tool. Last year, the New York state comptroller's office researched the potential market and concluded that it would "press for" the creation of a green bond program because "the environment and the market demand it." Similarly, California State Treasurer John Chiang wants to "unlock the potential of the green bond market."

Green bonds provide a financing tool for states and localities to address the country's aging infrastructure, as well as implement climate mitigation and adaptation projects, according to the U.S. Green City Bonds Coalition, a group of nongovernmental organizations. The increasing demand for sustainable investment vehicles makes green bonds a particularly attractive financing approach.

Green bonds are structured in the same way as other bonds, but the issuer self declares that the proceeds will be used to fund environmentally beneficial projects. The coalition explains that green bonds, similar to other bonds, come in a variety of types: general obligation bonds (backed by the issuer's "entire balance sheet"), revenue

bonds (backed by specific revenue streams such as water fees) and securitized bonds (backed by a pool of projects).

Massachusetts was the first state to proffer a green bond, a \$100 million general obligation issuance in 2013. The state dedicated the proceeds and those of a subsequent issue to environmental projects that fall into specified categories, such as land acquisition, habitat preservation, and energy efficiency.

Several other states have followed suit. For example, by 2015, California had issued \$300 million in green bonds, the proceeds of which it slated for a range of projects including transit and forest conservation. Hawaii's \$150 million issuance in 2014 is used to finance loans for private energy efficiency and renewables projects. And last year, Iowa issued over \$320 million in green bonds to support the State Revolving Fund's loans to municipalities for wastewater and drinking water infrastructure upgrades.

Localities also are using green bonds to fund a variety of projects, including wastewater infrastructure upgrades (District of Columbia, Los Angeles, Cleveland) and transit system improvements (Seattle, New York City).

A Brookings study points out that while the focus on financing green projects is relatively new, the basic approach is tried and true. The study notes that the \$3 trillion tax-exempt municipal bond market has financed three quarters of the country's infrastructure. According to the study, green bonds are a particularly important tool for financing clean energy projects when federal support is tepid or fluctuates.

Despite widespread agreement that green bonds have tremendous

**Despite agreement about their potential, issuances may need clearer standards**



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potential, the rapid pace of issuances sans clear standards raises concerns. KPMG's Wim Bartels asserts that "standardized criteria for what makes a bond 'green' are critical for the future credibility of the market."

To date, the voluntary standards that have been developed are not comprehensive. The International Capital Markets Association developed "Green Bond Principles" that emphasize the importance of transparency and address best practices for the use of proceeds, the process for project evaluation and selection, management of the proceeds, and reporting. The principles, however, do not specify in any detail what constitutes a "green" project.

A nongovernmental organization is developing more detailed, voluntary "Climate Bond Standards," for certain types of projects, but KPMG's Bill Murphy still likens the situation to the "wild West," due to "aggressive marketing" and "few established rules." In addition to obtaining private certification that a bond meets a set of voluntary standards, some issuers are securing "second opinions" from third parties that their proposed projects are indeed green and will produce anticipated results.

While it is essential to ensure that green bond proceeds are dedicated to appropriate projects, there will undoubtedly be growing pains in a rapidly accelerating market that holds promise for financing much-needed infrastructure projects and climate change initiatives.