Green Securitisation Roundtable:
A public sector agenda for green securitisation market development in Europe

8 June 2015 | Discussion primer

Project aim

Green securitisation can address the low-carbon financing gap by allowing smaller scale assets to be aggregated to access the bond markets. This can provide access to capital at scale, and lower the cost of capital. To tap into the potential of green securitisation, policymakers and the public sector can play a role by working with the private sector to address barriers that currently exist in the market.

The Green Securitisation Roundtable will feed into a policy brief for European policymakers and public sector entities that is being developed by the Climate Bonds Initiative and the Grantham Institute for Climate Change at the London School of Economics. The policy brief will be published in autumn 2015. The work will also be included into the final report from the UNEP Inquiry into a Sustainable Financial System, as well as an upcoming green bond report from the OECD.

Green securitisation can scale investment in low-carbon assets, but barriers remain

There is a strong rationale for green securitisation as a viable financing mechanism. The assets with a significant potential for green securitisation include mortgages to green buildings; cash flows from operating solar and wind assets or loans to these projects; energy efficiency project loans; loans to green SMEs and car loans to electric vehicles and hybrids. The potential benefits of securitisation of these small-scale low-carbon assets are well known, and include improved access to capital, and access to capital at lower cost. However, barriers currently remain that prevent private market actors to rapidly grow a green securitisation market in Europe:

Barrier	Description
Supply side	
Lack of green loans to bundle	To successfully tap debt capital markets using securitization, banks need a pipeline of loans big enough to ensure bulk and liquidity in a market.
Lack of standardised green loan contracts	Standardisation reduces the due diligence of bundling many loans together and evaluating their risks.
Lack of pool of green loans at individual loan provider level to securitise	There are very few banks with adequate loan books for renewable energy, energy efficiency projects, green mortgages or loans to electric and hybrid vehicles in their own right.
Credit risk profile can be too high at the early stage of a green securitisation market	Institutional investors have restrictions from asset owners in how large risks they can take in their investments. This means they will not be able to invest in low-carbon asset-backed securities if these are too high risk for their investment rules.
Demand side	
Uncertain investor demand	Institutional investor demand for asset-backed securities generally remains low in Europe post financial crisis. Institutional investors' demand for financially competitive green investments is however increasing, evidenced in particular by the rapid growth of the green bond market, but it is not clear if this evidence of demand extends to green asset-backed securities. Experience from trying to gauge the investor demand for green ABS suggests investors are reluctant to engage.

Q: Are these identified barriers applicable in the European market? Are there additional barriers to consider? Can some of them be overcome easily without support from public entities?

The public sector can play an important market development role by taking concrete actions to work with the private sector to speed up the process of breaking down the barriers that are currently preventing the market forces on their own from taking advantage of the green securitisation opportunity. Policymakers and public sector entities have stepped in to work with the private sector to successfully facilitate the development of securitisation markets in other policy priority areas. This includes in particular securitisation of mortgages, student loans and loans to small-medium enterprises. Lessons can also be drawn from how green securitisation is currently being facilitated in countries outside Europe, especially the US, where there are several examples of green securitisation deals and public market development initiatives.

Preliminary recommendations for the public sector

The opportunities of green securitisation are intertwined with the overall securitisation market in Europe. Therefore, a preliminary recommendation is for EU policymakers to reiterate their policy support to revive a high-quality securitisation market in Europe, and continue to educate the market on the potential benefits and risks of securitisation and how policymakers have learnt from the financial crisis in this respect. Recommendations for policymakers and public entities are mainly on the supply side, to facilitate that the market can offer investors green asset-backed securities that have attractive risk-adjusted returns. The public sector can facilitate green securitisation market developments through the following action areas:

1. Encouraging deal flow of green loans

Public institutions can offer preferential lending rates to green projects to encourage building a deal flow of loans large enough for securitisation in the bond markets. For example, Kommunalbanken Norge, the municipal bank of Norway, has offered 10 basis points preferential interest rates on loans financing green projects since 2010. In 2015, the public US mortgage loan provider Fannie Mae, started offering preferential lending rates and additional loan proceeds to green as well. At the EU level, relevant entities for direct preferential lending include the European Investment Bank and national development banks, such as KfW, the German development bank.

Policymakers can provide tax incentives for green loans. While the European Commission do not have taxation powers, the Commission can use their convening power to harmonise tax incentives for green loans across EU member states.

Q: What is the role for public entities to facilitate an increased deal flow of green assets suitable for securitisation? Are preferential lending rates and tax incentives suitable mechanisms to achieve this aim? What other tools are available?

2. Supporting the development of standardised contracts for low-carbon assets

Public institutions can offer direct financial support to existing market efforts on standardisation of green loan contracts, and establish public-private initiatives and working groups. In the US, the National Renewable Energy Laboratory (NREL) of the Department of Energy set up a 3-year project in 2013 to support the securitisation of contracts for solar assets in particular.

Policymakers can also support standard contracts by making public warehouse purchasing of loans conditional on the loans adhering to standard contracts, and ensuring publically supported green lending adhere to standardised loan contracts. The New York Green Bank is an example of this.

EU policymakers can use convening power to encourage harmonization of standards throughout Europe. There is an opportunity to utilise the momentum of the Capital Markets Union where it is already proposed to work to harmonise high-quality securitisation.

Q: What is the role for public entities to facilitate the development of standardised loan contracts for low-carbon assets? Are the identified mechanisms suitable to achieve this aim? What other tools are available?

3. Supporting the establishment of financial warehousing facilities for aggregation

Public institutions can set up a specialised green warehouse entity in public-private partnership. There are several examples from the US market. For example, in Pennsylvania, the Warehouse for Energy Efficiency Loans (WHEEL) was established as a public-private partnership in 2014. The UK's Green Deal Financing Company is an example of warehouse for energy efficiency loans in Europe.

Already established public green banks can host a green warehouse. In 2014, Connecticut's green bank, the Clean Energy and Finance Authority (CEFIA), issued their first round of ABS backed by loans funding energy efficiency upgrades in commercial buildings. The green bank had grown their loan book over time, holding onto loans in a $40m financial warehouse.

Similarly, a green warehouse can also be hosted or supported by a development bank. In emerging markets, in 2014, the Inter-American Development Bank initiated a project for securitisation of energy efficiency projects in Mexico.

Q: What is the role for public entities to support financial warehousing facilities for low-carbon assets? Which of the identified mechanisms (public-private partnership, green bank or development bank) are preferable? What other tools are available?

4. Reduce risks to investors in a transition phase

The public sector can supporting an initiative to build a publically available database on credit and operational performance of various green assets in Europe Providing market actors with improved access to data will improve their ability to model and evaluate risks of green assets. The US NREL Initiative has successfully built a database for solar assets that now includes 3800 installed systems.

Public credit enhancement facilities should be established for the green securities in a transitional phase. Abnormally high levels of overcollateralisation have been used as a market-led credit enhancement to gain investment ratings on green ABS deals in the US market. Public credit enhancement would reduce the level of overcollateralisation required, making issuance more attractive. Public entities can apply credit enhancement tools used in other investment areas, in particular subordinated debt, partial guarantees and monoline insurance.

At the early stage of the market, credit enhancement support can be combined with public-private warehousing solutions. For example, European public entities can replicate the model of the joint EIB/EC SME Initiative that facilitates securitisation of loans to small-to-medium enterprises (SMEs). The European Investment Bank is also recommended to continue developing the proposed EU Renewable Energy Platform for Institutional Investors (REPIN), a specific green securitisation initiative that would combine warehousing and credit enhancement.

The public sector can support an initiative to work with credit agencies to facilitate that the capabilities to rate green securities are strengthened. A mock filing to rating agencies of a green securitisation deal by a public-private working group is a tool that was used by the US NREL Initiative.

Q: What is the role for public entities to reduce the risk to investors of green ABS in a transitional phase? Which of the identified mechanisms of supporting a public database on asset performance, providing various types of credit enhancement and working with rating agencies is preferable? What other tools are available?

5. Investor demand

Public sector actors can engage with institutional investors, for example through organising investor roundtables and issuing subsequent investor statements. This would be valuable to establish the investor interest in green securitisation in Europe for different green asset classes.

Public entities can also engage more directly on the demand side. The European Investment Bank, the European Bank for Reconstruction and Development and national development banks, can take a cornerstone investment role in initial green ABS deals and make their commitment to do this clear to market actors. Once initial deal flow of green ABS is established, European Central Bank could prioritise green securities in their asset-purchasing program.

Q: What is the role for public entities to engage with institutional investors to encourage demand for green ABS? Is there also a role for more direct demand from public entities? Which of the identified mechanisms of supporting demand, both indirectly through investor engagement and directly through investment, are preferable? What other tools are available?