

Green Securitisation: unlocking finance for small-scale low carbon projects

GREEN SECURITISATION can help unlock finance in debt capital markets for smaller scale low carbon and climate-resilient assets. The public sector has a key role to play to scale up securitisation markets for green assets.

Maturing green bond markets are seeing increased issuance of green Asset-Backed Securities (ABS)

About USD 5bn (6% of market share) of green securities issued in 2016 were asset-backed securities (ABS), up from USD 1.9 bn in 2014.

Leading examples from the US market include solar developer SolarCity, energy efficiency lender Renovate America and sustainable infrastructure company Hannon Armstrong. Other markets are growing as well as shown by the Canadian North Power and the two Australian climate bond certified FlexiGroup ABS issuances.

Europe also saw its first green ABS issuance in 2016 by Obvion, a Dutch mortgage provider (see box).

Annual green ABS to reach at least USD 280-380bn by 2035

Despite recent growth, the potential for issuance given investment needs is far greater.

The OECD estimates that annual issuance of green ABS could reach between USD 280-380 billion by 2035 for renewable energy, energy efficiency and low-emission vehicles (LEVs). Investments for low carbon public transport, adaptation, land-use and waste would add to the figure.

A securitization can be defined as 'green' when cash flows backing the securitization come from low carbon assets

Green securitization can also refer to any asset-backed security with proceeds raised to finance loans for green infrastructure. An example is the Toyota ABS securitising loans for electric and hybrid vehicles.

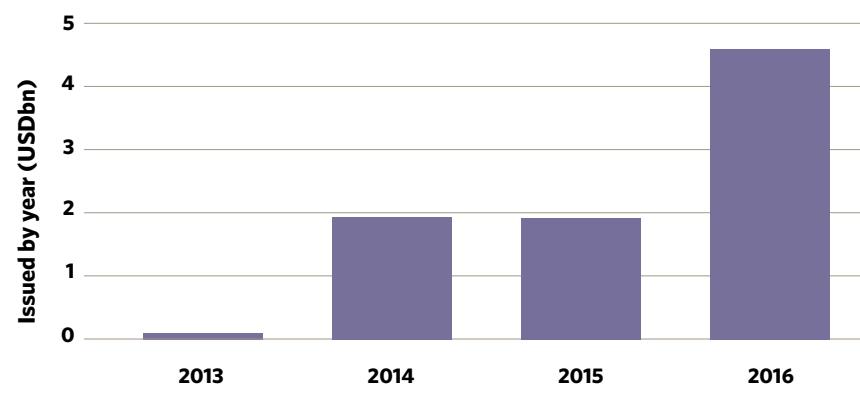
Securitisation refers to the process of transforming a pool of illiquid assets (normally many thousands of separate assets) into tradable financial instruments (securities). The investors' returns on the securities are drawn from the cash flows of the underlying assets, such as loans, leases or receivables against other assets. The vast majority of securitisation is used to refinance loans to existing assets, and banks are the main issuers of asset-backed securities.

Obvion's green RMBS

Dutch-based Obvion issued the world's first green Residential Mortgage-Backed Security (RMBS) in June 2016, a EUR 500m (USD 557m) deal certified under the Climate Bonds Standard.

Green RMBS are an ideal asset class to spur market development given the size of the mortgage market.

Growth of green labelled ABS issuance



Asset classes suitable for green securitisation

Within asset classes that are already being securitised	New asset classes
Mortgages to green buildings	Leases from solar and wind assets
Car loans to electric vehicles and hybrids	Loans for energy efficiency upgrades
Loans to green small-to-medium enterprises (SMEs)	Loans to battery and storage projects

Green securitisation improves access to capital and lowers cost of capital

Access to capital:

- Loans to small-scale projects can be aggregated and then securitised to reach an adequate deal size for bond markets
- Capital raised through the sale of asset-backed securities by the loan originators can be used to create a fresh portfolio of loans
- Tagging the securitisation as 'green' enables issuers to tap into the increasing demand for securities with environmental benefits

Lower cost of capital:

- In high interest environments, asset-backed securities issued in bond markets can offer lower cost of capital compared to bank financing
- This is important for low carbon projects that typically have high capital expenditure

Regulators are addressing many of the securitisation risks

Following the 2008 financial crisis, where the US market for sub-prime mortgage-backed securities played a catalysing role, securitisation markets have shrunk globally.

Efforts have been carried out to mitigate risks associated with the crisis, including moving away from re-securitisation, imposing higher risk retention requirements and improving the transparency of risk evaluations.

The public sector has an important role to play to scale up green securitisation markets

Historically, public sector entities have been involved to facilitate securitisation in policy priority areas since the market commenced with the securitisation of mortgages in the US in the 1970s. Securitisation markets in other asset classes such as auto loans, functioned well throughout the crisis.

Similar initiatives as those taken for securitisation of student loans or of loans to small and medium sized enterprises can be replicated for green assets (see table for policy recommendations).

To be effective, public support for green securitisation must rest on a broader favourable policy environment that generally supports investments in low carbon projects. This builds an important foundation for green securitisation by providing stable cash flows from low carbon projects and driving demand.

FlexiGroup certified solar securitisation

In 2016, FlexiGroup issued the first Climate Bonds certified green securitisation for AUD 50m (USD 39m) - a 'green' tranche of a AUD 265m (USD 204m) issue of securitised notes backed by loans for residential rooftop solar power systems. A second certified solar securitisation followed in February 2017. Both issuances received a AUD 20m cornerstone investment from the Clean Energy Finance Corp and saw tighter pricing, suggesting investors are willing to pay a premium for eco-friendly assets.

Policy actions to scale up green securitisation markets

Challenge	Recommendation
No clear and harmonic standards to define 'green' assets	Work with market players to develop clear and consistent definitions of what qualifies as green
Difficulty in identifying green assets in existing loans	Provide financial support for data collection on green assets at the initial stages of the markets
Limited standardisation for loan contracts for relevant low carbon asset types	Establish or offer financial support to existing public-private initiatives and groups working on standardisation of green loan contracts
Low credit ratings for green ABS	Offer guarantees for the junior and mezzanine tranches to make senior tranches attractive to institutional investors
Lack of sufficient volume of green loans within one lender	Support financial warehousing of standardised loans. A green warehouse entity can be set up as a public-private partnership or can be hosted by a local development bank
Uncertain investor demand for green ABS	Invest in green ABS and consider incorporating environmental factors into capital weights, favouring climate-friendly investments

2016 Green ABS issuance

Issuer	Amount (USD)
Toyota	1.6bn
Renovate America/Hero	1 bn
Obvion	595m
Wuxi Communication	296.8m
Suzano Papel	295.3m
AP Renewables	226m
Flexitrust	218m
Xinjiang Goldwind	192.2m
Ygrene Energy Fund	117.6m
Renew Financial	10.8m



www.climatebonds.net

Want to know more? Please contact
diletta.giuliani@climatebonds.net



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