Back to List | Print This Page

Cover Story

18-Mar-2015
Volume12.Issue11

The grass is always greener? Environmental Sukuk take the stage

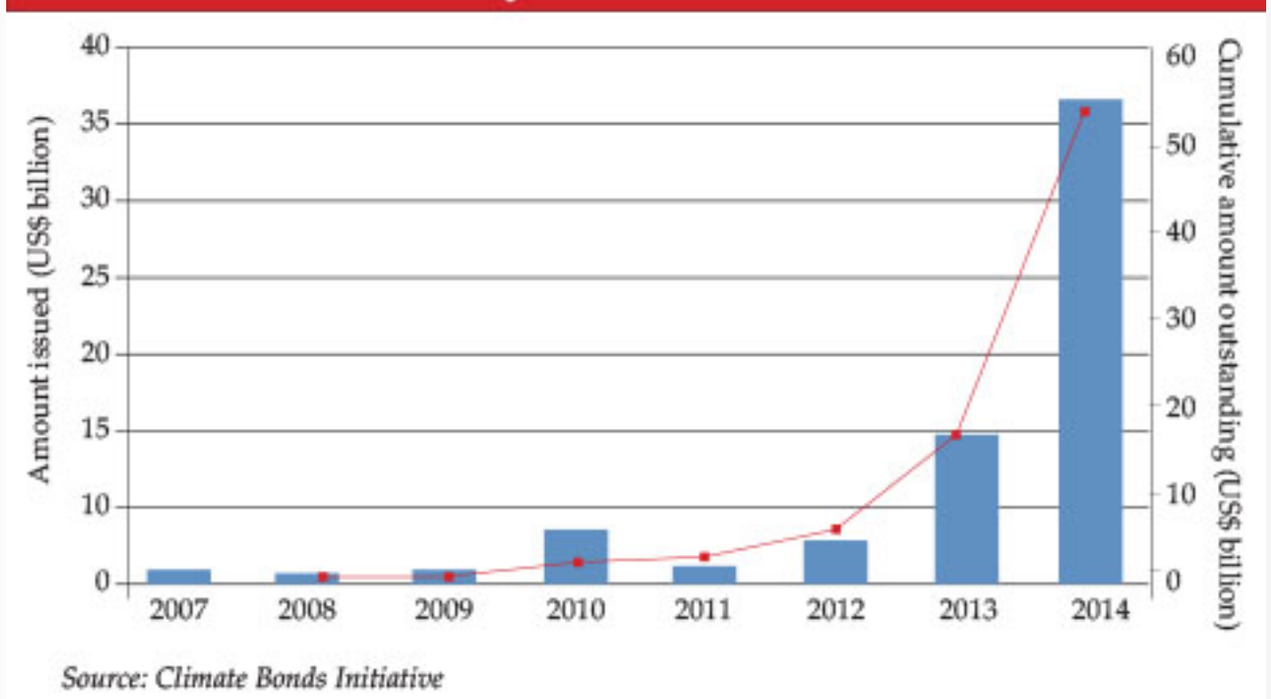
Islamic Finance news

The UAE could issue the world's first 'green Sukuk' as early as next month, as the Gulf takes the lead in the renewable energy race with two potential issuances this quarter. Drawing on the confluence of socially responsible investing (SRI) and Shariah principles, the move represents yet another step towards mainstream market influence for Islamic finance. LAUREN MCAUGHTRY looks at what we can expect from this new facet of the SRI trend.

Promoted by the Clean Energy Business Council, the Dubai Supreme Council of Energy, the Gulf Bond & Sukuk Association and the Climate Bonds Initiative (an international investor-focused NGO focused on mobilizing the US$100 trillion global bond market for climate change solutions), with National Bank of Abu Dhabi and Latham & Watkins also on board, the upcoming green deal is expected to be benchmark-sized and could kickstart a whole new market that has the potential to reach into trillions of dollars.

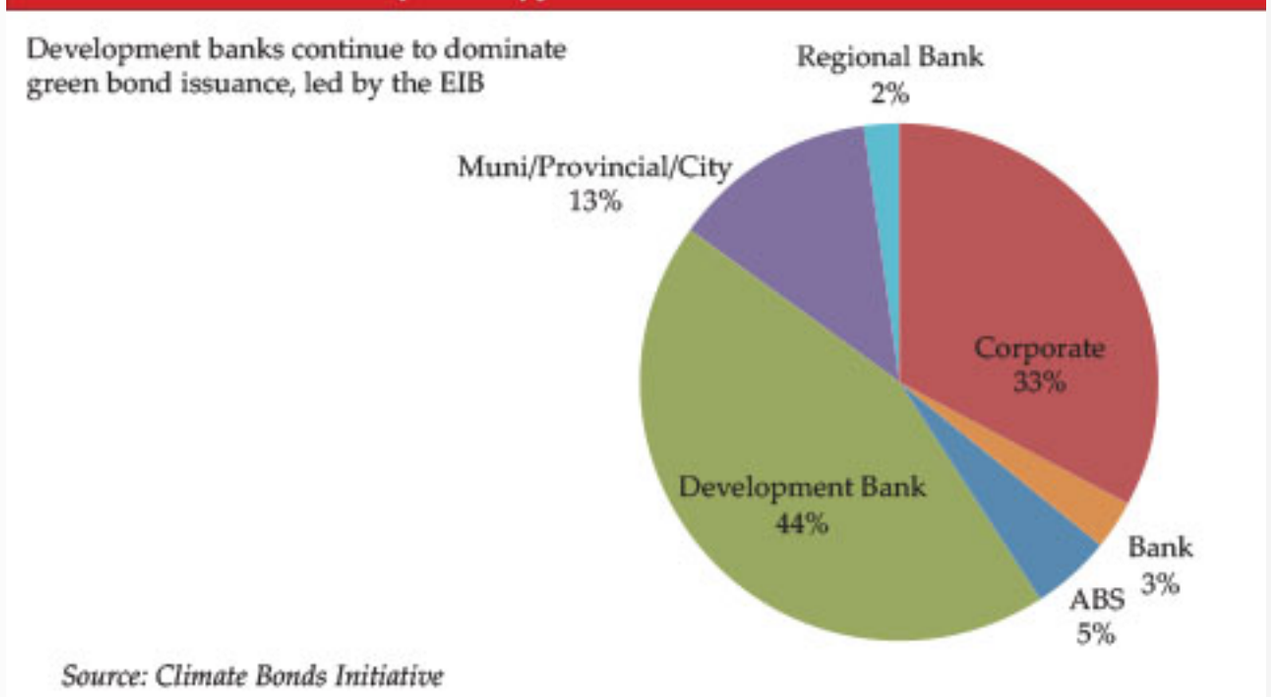
Last year was the biggest on record for the green bond market, with US$36.6 billion issued — triple that of 2013, with growth driven by corporate and municipal bonds (see Chart 1). As of July 2014, climate-themed bonds were estimated to total approximately US$502.6 billion globally — a significant jump from US$174 billion in 2012. In its report, 'Sizing the climate economy', HSBC estimated that nearly US$10 trillion in cumulative capital investments could be moved towards low-carbon energy between 2010-20; while the UN Principles for Responsible Investment already hold over 1,300 signatories representing over US$45 trillion in assets under management (up from just US$4 trillion in 2006). The World Bank, which last year issued its first socially responsible Sukuk with a US$500 million deal for the International Finance Facility for Immunization, has already issued almost US$7 billion in 67 green bond transactions across 17 currencies.

Chart 1: Green bond issuance has exploded



Source: Climate Bonds Initiative

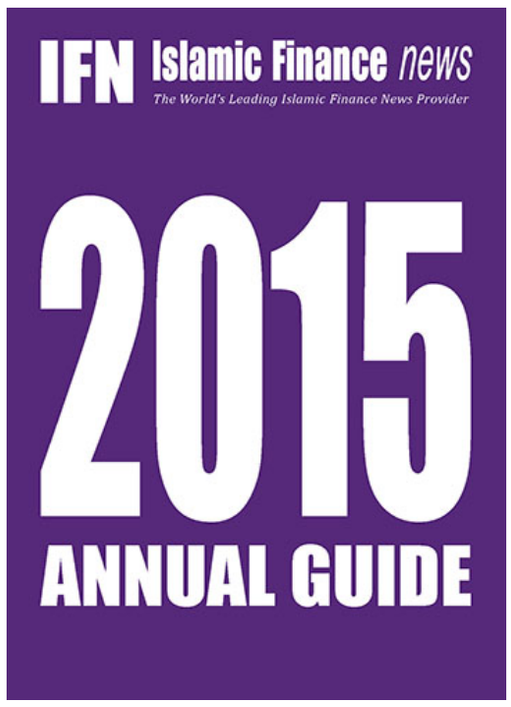
Chart 2: 2014 Green bonds by issuer type



Source: Climate Bonds Initiative

Chart 3: Top 10 green bond issuers	
EIB	US$5.6 billion

Latest Supplement



Supplements

Full Catalogue

Upcoming Training

Islamic Finance Qualification
Date: 9th - 11th March 2015
Venue: Kuala Lumpur

The preparation course shall be delivered through lectures, examples, exercises and discussions. In addition to the IFQ workbook, candidates attending the course shall also receive supplementary course materials developed by REDmoney. It is estimated that in addition to attending the course, between 80 and 100 hours of self study shall be required in order to pass the assessment...more

KfW	US$3.5 billion
GDF Suez	US$3.4 billion
World Bank	US$3.1 billion
Toyota	US$1.75 billion
AfD	US$1.3 billion
Iberdrola	US$1 billion
Unibail-Rodamco	US$1 billion
Ile de France	US$829 million
Hera SPA	US$680 million
Source: Climate Bonds Initiative	

Gaining traction
The potential for a green Sukuk has long been discussed and in recent months has gained serious traction, with a Green Sukuk Working Group set up in the UAE to design a transaction in compliance with the Climate Bond Standards created by the Climate Bonds Initiative. In January last year, 13 financial institutions also united to launch the Green Bond Principles, a voluntary set of guidelines for 'green' projects including standards for the use of proceeds, evaluation, management and reporting performance indicators. With increasing numbers of asset managers (such as Arabesque, SEDCO Capital and Saturna) looking towards socially responsible investing as a key investment differentiator generating positive returns, the demand is clearly there while the supply has so far lagged. But with the advent of the expected green Sukuk from the UAE, all this could change. So what is the real potential for the sector, and what could it achieve going forward?

Attracting interest
"The tempo has certainly increased. It takes a while for people to get used to the idea and its benefits. But the growth of the global green bonds market, which has tripled in the last two years, has got everyone thinking," explained Sean Kidney, CEO of the Climate Bonds Initiative, to IFN. "We have interest around the world in green products that are investment grade and financially competitive — not just in Europe or the US." India has already seen one green bond with three more in the works, while South Africa, the Gulf and Indonesia are also all expecting to enter the market this year — with interest from Indonesia especially ramping up as it works to develop its Islamic finance, and activity expected before the end of the year.

"And the idea of the Islamic bond market itself has grown in the last few years," pointed out Kidney. "This is just a new differentiator addressing new issues and giving it a new flavor with new credentials."

A whole new race
Although Malaysia was an early leader in the socially responsible Sukuk surge, with guidelines for sustainable and socially responsible investment Sukuk published by the Securities Commission Malaysia in August 2014 and an announcement in November of an expected SRI Sukuk issuance from sovereign wealth fund Khazanah in 2015, little has so far emerged. "This discussion started in Malaysia, but we haven't seen an issuance. It's only a matter of time but doesn't look like it will happen imminently, which is surprising," said Kidney. "It looks like Dubai might pip them to the post — although I would expect a Malaysian green Sukuk out by the end of the year."

In contrast the Gulf and especially the UAE have been working hard towards positive results. The Dubai government has stated its goal of financing clean energy and efficiency goals through Sukuk, giving it a policy imperative and incentive to issue, while further afield firms such as Saudi's ACWA Power have also stated their intentions to finance renewable energy projects through Sukuk. An issuance — whether corporate or sovereign — would have a considerable impact in kickstarting the sector and encouraging others to follow. "I have reason to believe it will be a fairly substantial size — enough to get the market moving," Kidney informed IFN. "And it will be a high grade issuer, which is what you need to kick off the market and get it noticed. It looks like we are going to get that — the proof is in the pudding, but I am very hopeful at the moment."

Once the first issuance is launched, we can expect to see a flurry of activity come to market. "A number of entities with capital market experience are seriously considering, or even planning to launch," confirmed Michael Grifferty, CEO of the Gulf Bond and Sukuk Association, to IFN. "The first will be a great accomplishment, but remember that each of the early issues will be unique and so there will be room for a number of 'firsts'."

Scale and purpose
In terms of the style of financial products there is also enormous potential, especially as this type of renewability asset becomes more popular. These assets are very safe, over long periods of up to 30-40 years — and therefore ideal for low-risk Sukuk instruments; therefore this kind of structure is likely to become much more pervasive as a way of refinancing assets and allowing developers to recycle their capital into new projects, especially as renewable energy products gain scale and traction over the coming years. This is likely to stimulate issuance by corporate issuers, while institutional investors are also likely to be keen on these as low-risk products, resulting in a huge appetite overall.

Growth in the green bond market last year was driven by corporates, and this could also hold true for the green Sukuk trend. "In corporate terms, the desire to do good while doing well and do well while doing good is becoming increasingly pervasive," confirmed Kidney. "Can you contribute to society whilst also getting a competitive return and meeting your fiduciary obligations? If the answer is yes, then pension funds and insurance funds and even retail investors will see this as a very exciting prospect; and I think we will see a lot more purpose-related capital."

On top of that, as you get liquidity in the market, this opens up enormous opportunities for innovation. This is likely to drive private sector firms towards raising money on the bond market in order to make a social contribution to justify their existence beyond just paying a standard coupon. "We see some firms, some banks now that do this specifically for staff retention," said Kidney. "We will start seeing this across the financial markets, and this will attract both socially responsible investors and people who are seeking good returns and diversification. Purpose is a key differentiating theme here."

Sovereign support
Last year, private firms issued around a third of all green bonds — including the largest ever green bond in the world from GDF Suez, a US$3.5 billion issuance in May 2014 linked to renewable energy and energy efficiency projects. However, until the sector gains scale and traction their role will necessarily be limited, compared to the potential influence that sovereigns could have in developing the market.

"It would be difficult to hazard a guess based on a small number of deals in the pipeline. Finding qualifying projects with suitable cash flows that also achieve sufficient scale for a capital market issue can be challenging, although not impossible. You can imagine dedicated green project deals that could come in at US$100 million or even less," warned Grifferty. In comparison if a sovereign identified some major components of its capital improvement program that qualify under the green criteria, it could fund them based on its sovereign credit, which could be an easier path. "Sovereign support for this segment… would be incredibly important. There is no substitute for the sovereign role in establishing scale for a new market," he emphasized. However, in the GCC, this role is often delegated to a quasi-

Upcoming Conferences

IFN Investor Forum 2015
1st April 2015
Dubai

IFN Indonesia Forum 2015
22nd April 2015
Jakarta

Events Diary

Partners

dealogic IdealRatings® EUREKAHEDGE

sovereign or a GRE — could this be the case for green Sukuk as well? "When you look at the types of investments that are needed in both the hydrocarbon importers and exporters, there is an uncanny confluence of interests between the investments sorely needed in the MENA region and the kinds of projects suitable for green Sukuk," he suggested.

Supply and demand
There is no question that demand for these types of products is growing exponentially. Investors representing over US$2 trillion in assets under management (including Zurich Insurance Group, Barclays and Aviva) last September issued an investor statement on green bonds which committed to growing the global market in the financing of climate change solutions. Barclays also recently confirmed plans to invest GBP1 billion (US$1.48 billion) in green bonds by 2016; while Zurich Insurance Group intends to invest US$2 billion in green bonds. Two insurance industry associations, the International Cooperative and Mutual Insurance Federation and the International Insurance Society (according to Latham & Watkins) have also stated that their members will double climate investments to US$84 billion by the end of 2015 and multiply their green investment ten-fold by 2020.

And the conditions are combining to create the correct conditions for issuance. "The GCC sovereigns and their key companies enjoy access to the international capital markets, both conventional and Islamic. They have substantial capital investment programs and intentions to redraw their energy mix and reduce the carbon footprint. Add on that several are aiming for leadership as financial centers, prominently including Islamic finance," agreed Grifferty. "Hence, the conditions are right, and there is every reason to believe a well structured green Sukuk with good cash flows and a good sponsor will be well received by the range of Sukuk investors in the region and out — provided too that its properly priced."

It must be remembered that while the potential is strong, there is not yet a dedicated SRI investor base for Sukuk and its history and track record are still relatively short so while the potential is there, the performance has not yet been proven. A dedicated investor community can develop only once there is a product to develop around — so issuance is crucial. However, as Grifferty remarked: "There is a lot of potential for green Sukuk as a kind of wedge for Islamic finance to help it get a full viewing from the very large and active global ethical investment community."

And it looks as if supply is finally moving to meet this demand. "Our ambition by 2050 is that the whole US$100 trillion bond market is green," said Kidney. "But at this stage we are looking at a US$1 trillion green bond market by 2020. That is spectacular growth, and I think there is a very good chance we could see a green Sukuk market of between US$10-20 billion by 2018 — just under 10% of the total expected US$300 billion green issuance."

Huge potential
Looked at objectively, the potential for issuance across both the Gulf and Asia is vast and almost unlimited. Anyone doing renewable energy investments, light transport, green buildings and more could theoretically issue. And there are a lot of high-rated corporates, sovereigns and GREs doing just that.

Abu Dhabi has announced a target of 7% of its energy capacity obtained from renewable sources by 2020. In January 2015, the Masdar Institute of Science and Technology released a UAE Wind Atlas, similar to its previous Solar Atlas, to support investment in renewable projects. The King Abdullah City for Atomic and Renewable Energy in Saudi intends to generate 54,000 megawatts from renewable energy projects by 2032. The Dubai Integrated Energy 2030 Strategy expects solar energy to account for 5% of the emirate's total energy usage by 2030. With massive announcements in renewable energy coming from all quarters — Saudi Arabia, Qatar, Jordan and the UAE to name just a few — and all of these projects theoretically eligible for financing through green Sukuk, the possibilities seem endless.

"It would seem to be a simple marketing ploy to consider financing those in the green market, and to be frank I think they will. That should be a reminder to people that there is a huge demand out there and a real shortage of issuance in the green bond market," asserted Kidney. "I am very hopeful that we will see this in the green Sukuk market as well. Opportunity, opportunity, opportunity!"

Print This Page

Go top